

Must a Lender Discharge a Future Advance Mortgage Following a Payoff of the Mortgage, Even if the Underlying Line of Credit is Not Closed?

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The field of title litigation has seen its share of appellate activity over the past few years. The doctrine of equitable subrogation was aggressively litigated between 2005 and 2007, culminating in the convening of a Court of Appeals conflict panel that rendered a decision in *Ameriquest Mortgage Co v Alton*.¹ In *Ameriquest*, the Court of Appeals rejected the use of equitable subrogation by "sophisticated financial institutions," because they are held to be "mere volunteers" to financing transactions.²

Another legal issue that is significant to the title industry, but has received less attention, involves the unique situation of the discharge of a future advance mortgage securing a line of credit.³ The issue is: must a lender discharge a future advance mortgage following a payoff of the mortgage, even if the underlying line of credit is not closed? This particular question (along with the equitable subrogation issue) was addressed by the Michigan Court of Appeals in *Deutsche Bank Trust Co Americas v. Spot Realty, Inc.*⁴

In *Spot Realty*, two homeowners borrowed \$284,000 from an investment company, secured by a senior mort-

gage on their home (Mortgage A). The homeowners then opened a revolving line of credit with another lender in the amount of \$40,000, which permitted the homeowners to draw amounts up to the credit limit throughout the term of the loan. This revolving line of credit was secured by a future advance mortgage on their home (Mortgage B), which was a second lien subordinate to Mortgage A.

A few years later, the homeowners refinanced their home with a third lender (Mortgage C). The proceeds secured by Mortgage C were intended to pay off and discharge both Mortgage A and Mortgage B, thereby making Mortgage C the first and only mortgage on the property. Mortgage A was paid and discharged as planned. Mortgage B, however, was not discharged. Although the Mortgage C lender paid the balance remaining on the line of credit secured by Mortgage B, the Mortgage B lender did not discharge the future advance mortgage securing the line of credit or close the line of credit, because it required the homeowners' written authorization to close the account. Subsequently, the homeowners re-drew on the line of credit, which was still

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secured by the future advance mortgage (Mortgage B). As a result, Mortgage B remained a lien on the property in a first-lien position, ahead of Mortgage C.

The homeowners then defaulted on Mortgage B with an outstanding balance of \$39,050, and the Mortgage B lender foreclosed on the home. Since Mortgage B was never discharged, the Mortgage B lender was entitled to take ownership of the property by foreclosure sale, wiping out the later-recorded Mortgage C.

When considering these facts, the question arises: why would the Mortgage C lender pay off the balance on the line of credit without ensuring that it obtained a discharge of Mortgage B? The answer is simple: it was relying on Michigan law.

MCL 565.41(a) governs the discharge of mortgages, and provides that "after a mortgage has been paid or otherwise satisfied," the mortgagee or assignee "shall" prepare and record a discharge of the mortgage with the register of deeds. In *Spot Realty*, the Mortgage C lender, having paid off Mortgage B, believed that the Mortgage B lender was required by this statute to discharge Mortgage B. The Mortgage B lender, however, did not discharge the mortgage securing the line of credit, relying on a provision requiring the written authorization of the homeowner before canceling the underlying line of credit:

You may cancel your Line at any time by giving [Mortgage B lender] *written* notice of cancellation. ... This agreement will remain in full force and effect if the Line is cancelled, except [Mortgage B lender] will have no obligation to extend credit, and you agree to pay [Mortgage B lender] the Obligations when due. ...⁵

Relying upon this provision, although it received payment of its mortgage in full, the Mortgage B lender refused to discharge its future advance mortgage because the homeowners never submitted a written notice of cancellation and, therefore, the underlying revolving line of credit was never closed. The Mortgage B lender also may have been reluctant to close out the line of credit due to the effect of the Federal Truth in Lending Law, which precludes lenders from unilaterally terminating a credit line except under certain circumstances.⁶

The Mortgage C lender filed suit to quiet title to the property following foreclosure, relying on the mortgage discharge requirement of MCL 565.41(a) (as well as the alternative theory of equitable subrogation). The trial court found in favor of Mortgage B, in part based upon its conclusion that MCL 565.41(a) does not apply to future advance mortgages. (continued)

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On appeal, the Michigan Court of Appeals affirmed the decision, but for a different reason. The *Spot Realty* Court determined that MCL 565.41(a) does apply to future advance mortgages, but that the statute requires something more than simply paying the mortgage off before the lender is required to discharge such a mortgage.

The *Spot Realty* Court rejected the argument that MCL 565.41(a) required the Mortgage B lender to discharge the future advance mortgage merely upon payment of the mortgage, stating:

The statute provided that “[a] mortgagee ... within 90 days after a mortgage *has been paid or otherwise satisfied* and discharged, shall prepare and file a discharge thereof ...” A future advance mortgage is not “paid or otherwise satisfied” unless the debt is paid off and future advances are terminated. (emphasis in original)⁷

The Court held that, because the Mortgage C lender failed to “otherwise satisfy” Mortgage B, the Mortgage B lender “was under no statutory duty to discharge its interest.”⁸ In addition to concluding that the requirements for discharge under §541(a) had not been met by a mere payoff of the mortgage, the Court in *Spot Realty* also relied upon the facts that the Mortgage C lender’s predecessor had failed to ensure that the Mortgage B lender’s requirements for closing the credit line (written authorization of the homeowners) had been met, and also failed to follow up on the requested discharge documents when it did not receive them.⁹

It is not completely clear whether the *Spot Realty* Court was holding that the duty to discharge a future advance mortgage is dependent on the mortgage being both “paid” and “otherwise satisfied,” or whether the Court’s holding was that a future advance mortgage is not to be considered either “paid” or “satisfied” until the requirements for closing the underlying line of credit have been met. To the extent that it was the former, this is arguably inconsistent with the plain language of §541(a), requiring discharge if the mortgage is “paid or otherwise satisfied...” To the extent that it was the latter, this could be said to be inconsistent with the Court’s recognition that §541(a) applies equally to future advance mortgages as it does to other mortgages, and with the lack of any specific additional statutory requirement that would distinguish the discharge of such mortgages.

The somewhat curious conclusion of *Spot Realty* – which resulted in the Mortgage C Lender losing its \$400,000-plus interest in the property in favor of the Mortgage B lender’s \$39,000 interest (which was accrued because the Mortgage B lender continued to lend money on the credit line after the Mortgage C lender had paid off the balance) – perhaps can be explained by what the Court of Appeals apparently viewed as a lack of diligence on the part of the Mortgage C lender in ensuring that Mortgage B was properly discharged. While this may have played a part in the decision, it is equally likely that the Court was

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concerned that requiring a lender to discharge a future advance mortgage, even when the requirements for closing the underlying line of credit have not been met, would result in a windfall for the homeowner/borrower, who could pay down a line of credit without terminating it, and yet obtain a discharge of the bank's mortgage – thereby creating an unsecured line of credit.

Although this issue has arisen in more than one case (and been resolved in favor of the future advance mortgage lender), the Supreme Court has unanimously denied leave to appeal in at least one recent case presenting this issue.¹⁰ It thus does not appear likely that the Supreme Court will address this issue in the near future.

Ultimately, by interpreting MCL 565.41(a) to require more than payoff of the future advance mortgage before the mortgage must be discharged, the Court of Appeals put the burden on title agents to ensure that the requirements for terminating the underlying line of credit, as well as those for discharging the future advance mortgage itself, have been met at the time of closing. As a result, title agents throughout Michigan must be diligent in requiring borrowers to meet the requirements for termination of lines of credit at or subsequent to closing. Otherwise, they may face the unintended consequence of leaving an otherwise paid-off future advance mortgage not discharged, without any recourse under Michigan law.

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Footnotes

- 1 273 Mich App 84; 731 NW2d 99 (2006).
- 2 *Id.* at 97-98.
- 3 "Future advance" is defined as "an indebtedness or other obligation that is secured by a mortgage and arises or is incurred after the mortgage has been recorded, whether or not the future advance was obligatory or optional on the part of the mortgagee." MCL 565.901(a). "Future advance mortgage" is defined as "a mortgage that secures a future advance and is recorded either prior to or after the effective date of this act. If a recorded mortgage is amended to secure, expressly and not by implication, a future advance arising after the amendment, the mortgage becomes a future advance mortgage at the time the amendment is recorded." MCL 565.901(b).
- 4 269 Mich App 607; 714 NW2d 409 (2005).
- 5 *Spot Realty* at 610.
- 6 See 15 USC 1647(b). The effect of the Federal Truth in Lending Law is discussed in *Flagstar Bank v Charter One Bank*, unpublished opinion per curiam of the Court of Appeals, issued August 25, 2005 (Docket No. 253992) *to den* 474 Mich 1069; 711 NW2d 313 (2006).
- 7 *Spot Realty* at 614.
- 8 *Id.* at 614.
- 9 *Id.* at 614.
- 10 See *Flagstar Bank v Charter One Bank*, unpublished opinion per curiam of the Court of Appeals, decided August 25, 2005 (Docket No. 253992) *to den* 474 Mich 1069; 711 NW2d 313 (2006).

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