



Partial Subordination: A Circuitous Route to a Fair Result

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In *Futuri Real Estate, Inc. v. Atlantic Trustee Servs., LLC*, borrowers Milton and Armida Cortez (the "Borrowers") obtained three loans secured by separate deeds of trust on their residence: (A) a \$415,000 deed of trust in favor of Wells Fargo Bank, N.A. (the "first Wells Fargo lien"); (B) a \$220,000 deed of trust in favor of SunTrust Bank (the "SunTrust lien"); and (C) a \$252,007.33 deed of trust in favor of Wells Fargo (the "second Wells Fargo lien"). After recording its second lien, Wells Fargo recorded a Subordination Agreement providing that the second Wells Fargo lien would have priority over the first Wells Fargo lien up to \$250,000.

The Borrowers defaulted on their SunTrust loan, and SunTrust appointed a substitute trustee to foreclose. Futuri Real Estate, Inc. ("Futuri") bought the property at foreclosure for \$468,000. A dispute then arose between Futuri and Wells Fargo over the disbursement of \$201,647.94 in sale proceeds remaining after payment of taxes, fees, and SunTrust's lien. The substitute trustee interpleaded those funds to the Fairfax County Circuit Court where Futuri argued that Wells Fargo's Subordination Agreement had completely subordinated the first Wells Fargo lien, causing the intervening SunTrust lien to move into first position. Thus, according to Futuri, SunTrust's foreclosure extinguished both the first and the second Wells Fargo liens.

Wells Fargo countered that the Subordination Agreement only partially subordinated the first Wells Fargo lien (up to \$250,000) such that the unsubordinated portion of the first Wells Fargo lien (\$165,000) survived the foreclosure, along with the second Wells Fargo lien up to \$250,000. The circuit court agreed with Wells Fargo.

On appeal, Futuri urged the Supreme Court of Virginia to adopt the complete subordination rule. Under the complete subordination rule, if A is the senior lienholder, B the second lienholder, and C the third, and A subordinates its lien to C, it would move B into the first place priority.^[1] By contrast, under the partial subordination rule, if A, B, and C occupy first, second, and third lien positions, respectively, and if A subordinates its lien to C, limited to the amount of A's lien, [then] C becomes senior to A but remains junior to B and A remains senior to B but becomes junior to C to the amount subordinated not

exceeding the amount of A's lien.^[2] The Supreme Court of Virginia agreed with Wells Fargo that this rule, though circuitous in application, produces a fairer result.

As applied in *Futuri*, the partial subordination rule avoided a windfall to Futuri, who would have purchased the property free of any Wells Fargo liens. It protected the Borrowers from being solely responsible for an unsecured deficiency balance on both Wells Fargo loans as that bank would no longer have recourse against the property. It also protected Wells Fargo: the second Wells Fargo lien up to \$250,000 remained secured in first position, along with that portion of the first Wells Fargo lien (\$165,000) not subject to the Subordination Agreement. The subordinated portion of the first Wells Fargo lien (occupying third position) received a disbursement of \$201,647.94 in foreclosure sale proceeds.

It should be noted that the Supreme Court of Virginia did not address the manner in which the circuit court directed disbursement of the foreclosure proceeds because Futuri assigned no error to the issue. At least some uncertainty exists. For example, the circuit court described the \$48,352.06 balance remaining after application of \$201,647.94 in sale proceeds to the subordinated portion of the first Wells Fargo lien as a "secured deficiency" not extinguished by the foreclosure.^[3] However, the phrase "secured deficiency" is an oxymoron. If that \$48,352.06 balance remains secured, that means the property entered a foreclosure on SunTrust's second lien encumbered by first liens totaling \$463,352.06 as opposed to the \$415,000 first lien behind which SunTrust agreed to accept a second lien position. Had the Supreme Court of Virginia addressed the issue, it may well have concluded that the \$48,352.06 balance remaining on the first Wells Fargo loan was unsecured.

[1] *Futuri*, 835 S.E.2d 75 (Va. 2019).

[2] *Id.*

[3] *Atl. Tr. Servs., L.L.C. v. Cortez*, 98 Va. Cir. 182 (2018).

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