NINETEENTH JUDICIAL CIRCUIT OF VIRGINIA

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February 27, 2018

LETTER OPINION

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OPINION LETTER

Mr. Milton H. Cortez
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Pro se Defendant

RE: *Atlantic Trustee Services, L.L.C. vs. Milton H. Cortez, et al.*
CL-2017-8414

Dear Counsel and Mr. Cortez:

This cause came before the Court on Cross-Claim Defendant Wells Fargo Bank, N.A.'s ("Wells Fargo") Motion to Dismiss the cross-claim of Defendant Futuri Real Estate, Inc. ("Futuri"), seeking a declaration that at the time of the foreclosure sale a deed of trust recorded by SunTrust Bank ("SunTrust") on the subject property was superior to two deeds of trust recorded by Wells Fargo. This Letter Opinion is issued as a replacement for the Court's previous opinion dated January 10, 2018.[1] This case presents an issue of seeming first impression in Virginia, namely whether a lien holder, in this case Wells Fargo, can subordinate its first-in-priority lien to one of its subsequent liens without waiving such priority with respect to any other liens or as to any third party claims. For the reasons as more fully stated herein, this Court holds that such partial subordination clauses are permitted and enforceable in Virginia without having the unintended effect of waiver of priority or security with respect to other liens or the

[1] The parties appeared before this Court on February 23, 2018, on Futuri's Motion to Reconsider this Court's rulings in its prior Letter Opinion dated January 10, 2018, which are largely identical in substance to the holdings in this opinion. Among the facts alleged by Futuri, was that the loan amount subject to the subordination of Wells Fargo's first loan, was not the entirety of the $252,007.33 of Wells Fargo's second loan, but rather only $250,000.00 as contained in the recorded subordination agreement. While this Court is not persuaded that this true fact or the other averments made in support of Futuri's Motion to Reconsider alter the soundness of the Court's main legal conclusions, such fact does change the determination of the amounts of Wells Fargo's two loans that remain secured by the subject property, requiring issuance of this Opinion in replacement of that issued January 10, 2018.

interests of third parties. Accordingly, Defendant Futuri's cross-claim against Wells Fargo shall be dismissed with prejudice.

BACKGROUND

This suit comprehends an interpleader action brought by Plaintiff, Atlantic Trustee Services, L.L.C. ("Atlantic"), arising after Defendant Mr. Milton H. Cortez and Ms. Armida Cortez ("Borrowers") defaulted on a note made payable to Defendant SunTrust. On August 5, 2005, Borrowers executed an Access 3 Equity Line Account Agreement and Disclosure Statement ("Note") in the principal amount of $220,000.00. The Note was secured by a deed of trust granting SunTrust a secured interest in real property owned by Borrowers.

After Borrowers defaulted on their payments, the property was sold at a public auction by Plaintiff Atlantic. Plaintiff was appointed by Defendant SunTrust as substitute trustee under the deed of trust. Futuri purchased the property for $468,000.00 at the foreclosure sale. The sum of $201,647.94 remains for distribution, the debt owed SunTrust having been satisfied. At the time of the sale, there were two additional liens against the property. Both liens were for loans Borrowers obtained from Wachovia Bank. The first loan in the amount of $415,000.00 was entered into before the SunTrust loan, and the second loan in the amount of $252,007.33 was entered into thereafter. At issue is a subordination agreement ("Agreement") Wachovia Bank executed subordinating its first loan to its second loan. Wells Fargo is successor-in-interest to Wachovia Bank.

ARGUMENTS OF THE PARTIES

A. Defendant Wells Fargo's Argument

1. Facts averred:

Futuri filed a cross-claim against Wells Fargo, as successor-in-interest to Wachovia Bank (hereinafter thus referred to interchangeably as "Wells Fargo"), seeking a declaration that at the time of the foreclosure sale a deed of trust recorded by SunTrust on the property was superior to the two deeds of trust recorded by Wells Fargo. When Borrowers purchased the home, they obtained two loans. The first loan was with Wells Fargo for $415,000.00, the borrowers executing a deed of trust on August 23, 2005, and recording it on September 23, 2005. Borrowers also obtained a loan from SunTrust for $220,000.00, on August 5, 2005. This deed was recorded on September 30, 2005.

Borrowers obtained a second loan from Wells Fargo for $252,007.33, recorded on October 25, 2006. Wells Fargo simultaneously executed a Subordination Agreement, which was recorded on October 26, 2006. The Agreement provided that this second lien would have a prior and superior right to the first Wells Fargo lien, to the extent of $250,000.00. Borrowers defaulted on the SunTrust loan, and SunTrust appointed Atlantic as a substitute trustee. Atlantic held a foreclosure sale on January 19, 2017, where the property was sold to Futuri for $468,000.00.

2. Legal Argument – Wells Fargo was first in lien priority at time of foreclosure:

Virginia's recordation statute provides for first in time, first in right lien priority. Va. Code Ann. § 55-96. Wells Fargo argues its first lien was recorded before the SunTrust

deed of trust, and that a trustee sells subject to prior liens. Futuri acquired the Property subject to any liens superior to those of SunTrust. Furthermore, Wells Fargo claims whether it had notice of SunTrust's unrecorded deed is irrelevant, because a lien creditor's rights are only protected upon recordation. Va. Code Ann. § 55-96. This is "irrespective of the lien creditor's actual or constructive knowledge." *Ameribanc Savings Banks, FSB v. Resolution Trust Corp.*, 858 F. Supp. 576 (E.D. Va. 1994).

3. Legal Argument – the Subordination Agreement did not impact Wells Fargo's priority:

Wells Fargo avers Futuri is incorrect in its argument that the Subordination Agreement ousted Wells Fargo from its first priority position. The Agreement makes it clear that it is an agreement between and for the benefit of Wells Fargo. Wells Fargo emphasizes that the Agreement must be ascertained as a whole. The Agreement does not provide a basis to argue Wells Fargo intended to subordinate its interest in the Property to SunTrust. SunTrust can also not argue it was a third-party beneficiary to the Agreement.

B. Futuri Real Estate's Opposition

Futuri argues there is no case law in Virginia which directly addresses the impact of the Subordination Agreement on the Wells Fargo loans. Additionally, case law across the nation is inconsistent. The cases cited by Wells Fargo adhere to a partial subordination application and is the holding of a majority of states. Other jurisdictions, however, adopt the complete subordination approach Futuri advances. Futuri contends the Court must interpret the intent of the parties to the Agreement, which is a question of fact for trial and not appropriate for a motion to dismiss.

ANALYSIS

I. Standard for Consideration of the Motion to Dismiss

Wells Fargo filed a Motion to Dismiss. In Virginia jurisprudence a motion to dismiss does not lie absent narrow and proper legal grounds. Though not directly applicable in state courts, Federal Rule of Civil Procedure 12(b) succinctly illustrates the reasons for which a litigant may file a motion to dismiss. These reasons include: 1) lack of subject-matter jurisdiction; 2) lack of personal jurisdiction; 3) improper venue; 4) insufficient process; 5) insufficient service of process; 6) failure to state a claim upon which relief can be granted; and 7) failure to join a party under Rule 19. FED. R. CIV. P. 12 (b). The Supreme Court of Virginia Rules of Civil Procedure also allow for motions to dismiss to be adjudicated. Virginia Rule 3:8 specifically classifies a motion to dismiss as a pleading. VA. SUP. CT. R. 3:8 ("A demurrer, plea, motion to dismiss, and motion for a bill of particulars shall each be deemed a pleading in response for the count or counts addressed therein.").

There is no Supreme Court of Virginia Rule, however, comparable to Federal Rule 12; that is, there is no rule which sets forth all the grounds for which a motion to dismiss may be brought. Virginia Code Section 8.01-277 allows for a motion to dismiss based on untimely service. Va. Code. Ann. § 8.01-227 (B) ("A person, upon whom process has not been served within one year of commencement of the action against him, may make a special appearance, which does not constitute a general appearance, to file a motion to dismiss."). Virginia Code Section 8.01-273 sets forth the grounds for a demurrer. Va. Code Ann. § 8.01-273 ("[T]he contention that a pleading does not state a cause of action or that such pleading fails to state facts upon which the relief demanded

can be granted may be made by demurrer."). A demurrer is equivalent to a motion to dismiss for failure to state a claim for relief in Federal Court. Motions to dismiss based on other legal defenses are brought before the Court with great frequency. Nevertheless, the standard the Court is to follow when determining whether to sustain or deny such motions is somewhat unclear.

A motion to dismiss is similar to a motion for summary judgment in the sense that both avenues shorten a case or claim's lifespan. Summary judgment is intended to allow courts to "bring litigation to an end at an early stage, when it clearly appears that one of the parties is entitled to judgment within the framework of the case." *Carwile v. Richmond Newspapers, Inc.*, 196 Va. 1, 5 (1954). Nonetheless, the Supreme Court of Virginia has indicated repeatedly that summary judgment is considered a drastic remedy and is strongly disfavored. *Smith v. Smith*, 254 Va. 99, 103 (1997). Similarly, the Court should consider a motion to dismiss to be a drastic remedy when the motion seeks to dismiss an entire claim based on a legal defense that is not primarily procedural, such as lack of subject-matter jurisdiction, lack of personal jurisdiction, improper venue, insufficient process, insufficient service of process, and failure to join an indispensable party.

Thus, in considering whether the instant cross-claim of Futuri ought to be dismissed, the Court must entertain three considerations. First, the Court must determine whether there are *issues of fact* not yet adduced before the Court which remain genuinely in dispute. *Winslow, Inc. v. Scaife*, 224 Va. 647, 652 (1983). In that regard, the litigating parties have both pointed the Court to the governing deeds of trust and the Subordination Agreement contained in the Court's file, to be considered as

evidence in deciding the merits of the Motion to Dismiss. The factual evidence is thus not in dispute; the legal interpretation the Court is to derive therefrom, however, is contested. Second, the Court must determine whether the intention of the parties entering into the Subordination Agreement was such that "reasonable persons could not differ" in concluding such subordination was meant only to be partial and exclusively to Wells Fargo's secondary lien. *Atkinson v. Sheer*, 256 Va. 448, 453-54 (1998) (internal citation omitted). Third, even in the face of the intention of the contracting parties to the contrary, the Court must also determine whether such lien subordination nevertheless operated as a waiver of lien priority with respect to third party liens.

II. Whether Wells Fargo's intent is clear on the face of the Subordination Agreement

Virginia Code Section 55-96 reads in part:

> Every (i) such contract in writing, (ii) deed conveying any such estate or term, (iii) deed of gift, or deed of trust, or mortgage conveying real estate or goods and chattels and (iv) such bill of sale, or contract for the sale of goods and chattels, when the possession is allowed to remain with the grantor, shall be void as to all purchasers for valuable consideration without notice not parties thereto and lien creditors, until and except from the time it is duly admitted to record in the county or city wherein the property embraced in such contract, deed or bill of sale may be.

Va. Code Ann. § 55-96 (A) (1). Virginia is a "race-notice" lien jurisdiction. *Cruickshanks v. Pemberton Oaks Townhouse Ass'n*, 512 B.R. 814, 818-19 (Bankr. E.D. Va. 2014). "As such, it adheres to a first in time, first in right priority scheme. The first to properly record a lien against real property with the Clerk's Office of the applicable jurisdiction has priority over subsequently recorded liens." *Id.* A first-in-priority lien thus statutorily

survives foreclosure by an inferior lienholder to whom it is not subordinated. The foreclosure only dislodges inferior liens from their secured position.

A subordination clause or agreement may change the order of priority. A "subordination clause should be interpreted by an examination of the face of the . . . instrument . . . ." *First Funding Corp. v. Birge*, 220 Va. 326, 333 (1979). The Court is to apply the plain meaning rule, absent any ambiguity in the language. *Seldon v. Klaput*, 46 Va. Cir. 104, 107 (1998). The Court is to look to the parties' intentions to establish the order of priority. *Id.* Further, "it is inappropriate for a court to follow the order of recording if the parties' contract or other evidence shows that it contradicts the parties' intentions as to priority, or that the recording order was inadvertent, was contrary to the parties' instructions, or was regarded by them as insignificant." *Id.* (internal citation omitted).

In this case, the Subordination Agreement is a short document consisting of six paragraphs. Paragraph one details the first transaction between Borrowers and Wells Fargo ("Lender"). Borrowers executed a security instrument to secure payment for $415,000.00. The Agreement identifies this transaction as "the 'Original Security Instrument'". Paragraph two describes the subject property. Paragraph three describes a second transaction between Borrowers and Lender. In this second transaction, Borrowers executed a security instrument to secure payment for $250,000.00. The Agreement identifies this second transaction as "the 'Subsequent Security Instrument'". (Compl., Ex. H).

The fourth paragraph reads, "WHEREAS, Lender has been requested to and has agreed to subordinate the lien of the Original Security Instrument to the lien of the Subsequent Security Instrument. [sic]" (Compl., Ex. H). The paragraph identifies both of

the transactions involving Borrowers and Lender. It specifies Lender agreed to subordinate the first lien to the second lien. It explicitly identifies each lien without making reference to any other liens.

The language in the fifth paragraph provides

> NOW, THEREFORE, for a good and valuable consideration, the receipt of which is hereby acknowledged, Lender hereby agrees that the lien of the Original Security Instrument is subordinate and junior to the lien of the Subsequent Security Instrument and that the lien of the Subsequent Security Instrument shall also have a prior and superior right over the lien of the Original Security Instrument.

(Compl., Ex. H). The language in this paragraph is careful to specify in detail the relationship between the two liens. The document fails to mention any other liens. The last paragraph states the officers of Lender entered into the agreement on September 23, 2006.

A subordination agreement is a contract, and the Court

> "cannot read into [the contract] language which will add to or take away from the meaning of the words already contained therein." *Wilson v. Holyfield*, 227 Va. 184, 187, 313 S.E.2d 396, 398 (1984). The Supreme Court has held that when interpreting the plain meaning of a contract's terms, the court assigns reasonable meaning to the words and clauses in the contract and assumes that no word or clause is without purpose. *PMA Capital Ins. Co. v. U.S. Airways, Inc.*, 271 Va. 352, 358, 626 S.E.2d 369, 372-73 (2006).
>
> It is the function of [this Court] to construe the contract made by the parties, not to make a contract for them. The question for [this Court] is what did the parties agree to as evidenced by their contract. The guiding light in the construction of a contract is the intention of the parties as expressed by them in the words they have used, and courts are bound to say that the parties intended what the written instrument plainly declares. *Wilson*, 227 Va. at 187, 313 S.E.2d at 398 (quoting *Meade v. Wallen*, 226 Va. 465, 467, 311 S.E.2d 103, 104 (1984)).

> "In determining the intent of the parties, courts will generally not infer covenants and promises which are not contained in the written provisions." *Pellegrin v. Pellegrin*, 31 Va. App. 753, 759, 525 S.E.2d 611, 614 (2000). "When the terms of a disputed provision are clear and definite, it is axiomatic that they are to be applied according to their ordinary meaning." *Smith*, 3 Va. App. at 514, 351 S.E.2d at 595.

Allen v. Allen, 66 Va. App. 586, 596-97 (2016).

The intent of the parties in the Subordination Agreement is clear. Wells Fargo was asked to and agreed to subordinate its original lien to its subsequent lien, and Wells Fargo did not agree to anything else. The Agreement focuses solely on the relationship between the two Wells Fargo liens. The language in paragraph five is very deliberate. It describes the impact of the Agreement on both liens in relation to one another.

There would additionally be no logically inferable purpose for the parties to agree to subordinate the first Wells Fargo lien to the subsequent SunTrust lien. The apparent purpose of Wells Fargo subordinating its first-in-priority to its third-in-priority lien is to enhance the collectability of its loans by ensuring that, in the event of a foreclosure of the SunTrust loan, both Wells Fargo loans would remain secured by the subject property. If the Agreement had not been entered into, the order of priority dictated by Virginia Code Section 55-96, would have been as follows:

Priority	**Lienholder**	**Loan Amount**
First	Wells Fargo (first lien)	$415,000.00
Second	SunTrust	$220,000.00
Third	Wells Fargo (second lien)	$252,007.33

When a foreclosure occurs, the sale proceeds are used to pay off lien holders in the downstream order of their priority, with the upstream lienholder remaining unaffected. Va. Code Ann. § 55-59.4. Each superior lienholder starting with the one foreclosing pursuant to the deed of trust, is entitled to full satisfaction before a junior lienholder may receive payment. In this case, Wells Fargo did not foreclose on its first loan, so thus its lien above that of SunTrust would retain its priority and would not be extinguished by the foreclosure. If the funds are insufficient to satisfy the junior lienholder's lien, such lienholder can normally no longer look to the property for satisfaction, but may only seek payment from the debtors. Assuming SunTrust foreclosed, Wells Fargo chose not to do so, and the property sold for $468,000.00, there are insufficient funds to satisfy fully Wells Fargo's second lien. The result of such scenario without subordination, would be as follows:

Priority	**Lienholder**	**Loan Amount Balance After Sale**
First	Wells Fargo (first lien)	**$415,000.00** (secured by the property)
Second	SunTrust	$220,000.00 + $46,352.06 (applicable fees) - $266,352.06 (partial foreclosure sale proceeds) = **0**
Third	Wells Fargo (second lien)	$252,007.33 - $201,647.94 (remaining foreclosure sale proceeds) = **$50,359.39** (unsecured deficiency)

Since Wells Fargo's first lien would remain in priority to the SunTrust lien and not be extinguished by the foreclosure, the proceeds would go first to satisfy the SunTrust debt, then to pay part of the second Wells Fargo lien. Any purchaser would continue to be subject to the first Wells Fargo lien to the extent of $415,000.00. Wells Fargo's sole

remedy to collect the remaining $50,359.39 on its second loan, made unsecured, would be to collect from the debtors.

The Subordination Agreement changes the above scenario significantly. It prevents the deficiency of Wells Fargo's second loan from becoming unsecured, while maintaining full recourse against the property for the entire amount of both outstanding unsatisfied loans, with the exception of $2,007.33 not sheltered by subordination.

Subordination results in a circuity of liens where the security of the third loan becomes immune from being extinguished by foreclosure of the SunTrust loan. Wells Fargo can only subordinate its first loan to its second loan to the extent of the lesser of the two loans, in this case $252,007.33. Wells Fargo, however, subordinated only $250,000.00 of its first loan of $415,000.00 to its second loan. In the case at bar, $250,000.00 of the second Wells Fargo loan amount thus gains first priority position. The remaining amount of the first loan not subordinated is $165,000.00, and remains in first priority position. The subordinated amount of the first loan, namely $250,000.00, drops to a third priority position. This circumstance is somewhat labyrinthine and best illustrated visually:

Priority	**Before the Subordination**	**After the Subordination**
First	Wells Fargo 1 = $415,000.00	Wells Fargo 1 = $165,000.00 Wells Fargo 2 = $250,000.00
Second	SunTrust = $220,000.00	SunTrust = $220,000.00
Third	Wells Fargo 2 = $252,007.33	Wells Fargo 1 = $250,000.00 Wells Fargo 2 = $2,007.33

The Subordination Agreement does not bind or affect SunTrust's interest, but it does affect which lien the trustee satisfies after the payout to SunTrust. The effect is that the remaining proceeds of $201,647.94 are to be paid on the *subordinated portion* of Wells Fargo's first loan, leaving a secured deficiency of $48,352.06 as such amount is not extinguished by the foreclosure. Although third in priority with respect to the second Wells Fargo loan, the original Wells Fargo lien is superior to the SunTrust lien, and therefore none of the security for such original Wells Fargo first lien can be eliminated by the foreclosure. The $2,007.33 portion of Wells Fargo's second loan which was not shielded by subordination of the first loan of Wells Fargo, is no longer secured by the subject property. The result is that $463,352.06 of the $465,359.39 balance owed Wells Fargo on both loans remains secured in the aftermath of the foreclosure process. To the extent they are unpaid, both Wells Fargo's liens against the subject property survive the foreclosure sale, except for the $2,007.33 which was not the object of subordination.

The resulting loan balance consequences of the Agreement after the foreclosure payouts are made in accordance with the order prescribed by Virginia Code Section 55-59.4, are as follows:

Priority	**Lienholder**	**Loan Amount Balance After Sale**
First	Wells Fargo (part of first lien, $165,000.00) Wells Fargo (part of second lien, $250,000.00)	Wells Fargo 1 = $165,000.00 Wells Fargo 2 = $250,000.00 Totaling **$415,000.00** (secured by property)
Second	SunTrust	$220,000.00 + $46,352.06 (applicable fees) - $266,352.06 (partial foreclosure sale proceeds) = **0**

Third	Wells Fargo (part of first lien, $250,000.00)	Wells Fargo 1 = $250,000.00 from first loan - $201,647.94 (remaining foreclosure sales proceeds) = **$48,352.06** (unsatisfied deficiency secured by property)
	Wells Fargo (part of second lien, $2,007.33)	**$2,007.33** (unsatisfied unsecured deficiency)

This Agreement also has the effect of protecting the Borrowers from being solely responsible for a deficiency produced by the failure of Wells Fargo to have recourse against the property under its superior lien. Futuri argues that Wells Fargo's second lien should be partially satisfied by the sales proceeds after payment of SunTrust's lien, leaving a deficiency of $50,359.39 on the second loan. Futuri further posits that the entirety of Wells Fargo's first loan along with the deficiency balance of the second loan should become unsecured resulting from the foreclosure. Under Futuri's view, it would be the third party beneficiary of a windfall of the discharge of the secured liens on the property amounting to $463,352.06, a circumstance for which there is no evidence the loan contracting parties intended. As the chart below demonstrates, under such situation, Wells Fargo's recourse against the property would be extinguished and Wells Fargo's sole method of collecting the $463,352.06 deficiency secured in part by subordination,[2] would be to proceed against the Borrowers:

Priority	**Lienholder**	**Loan Amount Balance After Sale**
First	SunTrust	$220,000.00 + $46,352.06 (applicable fees) - $266,352.06 (partial sale proceeds) = **0**

[2] Wells Fargo only subordinated $250,000.00 of its first loan of $415,000.00 to its second loan of $252,007.33, thereby leaving $2,007.33 unshielded by subordination, accounting for the difference between the secured deficiencies of the loans of $463,352.06 versus the total deficiency of $465,359.39.

Second	Wells Fargo (second lien)	$252,007.33 - $201,647.94 = **$50,359.39** (unsecured per Futuri's view)
	Wells Fargo (first lien)	**$415,000.00** (unsecured per Futuri's view)
		Totaling **$465,359.39** (deficiency)

A more careful drafting of the Agreement could have expressly stated that the first Wells Fargo lien would not be subordinate to the SunTrust or any other unspecified third party lien. The drafters of the Agreement opted not to include such language, although perhaps such clarifying prose would have further inoculated Wells Fargo against Futuri's claim. The Court will in any event not insert language into a contract favoring either party that is not already contained therein. Therefore, the Court "has no reason to overlook the obvious intent of the parties to the subordination agreement, even though the drafting of the agreement may be less than perfect." *Wells Fargo Bank v. Neilsen*, 178 Cal. App. 4th 602, 617 (2009).

Based on its language, the Court concludes the Agreement plainly declares it was meant to impact only the two liens it expressly references. If the Court were to infer the parties meant to subordinate both Wells Fargo liens to the SunTrust lien, the Court would be inferring a promise that is not supported by the language contained in the Agreement.

III. Whether Wells Fargo waived the priority of its original lien with respect to third party liens or claims by executing a subordination agreement

The parties cite several opinions from other jurisdictions, which they argue the Court should consider in determining whether the Subordination Agreement in this case

resulted in partial or complete subordination, maintaining this is a case of first impression in Virginia. The Court will review each opinion in turn.

In *AmSouth Bank v. J&D Financial Corp.*, 679 So. 2d 695 (Ala. 1996), the Supreme Court of Alabama determined the impact of a subordination agreement entered into between Presidential and J&D. The order of priority without the subordination agreement would have been as follows: 1) Presidential; 2) AmSouth; and 3) J&D. The Court held the subordination agreement changed the order of priority to: 1) AmSouth; 2) J&D and 3) Presidential. Thus, the subordination agreement had the effect of complete subordination. The Court based its determination on the following definition of "subordination agreement":

> [a]n agreement by which one holding an otherwise senior lien or other real estate interest *consents to* a reduction *in priority* vis-à-vis another person holding an interest in the same real estate. An agreement by which *the subordinating party agrees that its interest in real property should have a lower priority than the interest to which it is being subordinated.*

AmSouth Bank, 679 So. 2d at 698 (citing Black's Law Dictionary (6th ed. 1990)) (emphasis in original). The Court held, "[b]y definition, 'subordination' contemplates a reduction in priority. Nothing in the definition contemplates raising a lower priority lienholder up to the position of the subordinating party." *Id.* at 698. This complete subordination approach has been followed in a minority of other states. *See Blickenstaff v. Clegg*, 97 P.3d 439 (Idaho 2004); *Old Stone Mortg. & Realty Trust v. New Ga. Plumbing, Inc.*, 236 S.E.2d 592 (Ga. 1977).

The rule of partial subordination is followed in a majority of states. *Tomar Dev., Inc. v. Friend*, No. 14CA0519, 2015 Colo. App., LEXIS 842, at *1 (Colo. App. 2015); *VCS, Inc. v. Countrywide Home Loans, Inc.*, 349 P.3d 704, 706 (Utah 2015); *Alliance,*

LLP v. Monticello Farm Serv., 7 N.E.3d 355, 356 (Ind. Ct. App. 2014). In *Bratcher v. Buckner*, the Appeals Court of California illustrated application of such partial subordination rule in analyzing two subordination agreements entered into by Gant & Asaro and Bucker. But for the subordination agreements, the order of priority would have been: 1) Gant & Asaro, 2) Buckner, 3) Bratcher, and 4) the SBA. The agreements provided that the Gant & Asaro and Buckner deeds would be subordinated to the SBA lien. The agreements, however, made no mention of the Bratcher lien. The Court referred to this situation as a "circuity of liens." *Bratcher v. Buckner*, 90 Cal. App. 4th 1177, 1185 (Cal. Ct. App. 2001). Circuity of liens is

> [a] first rate legal puzzle [that] arises when, by agreement or otherwise, a superior mortgage is subordinated to another mortgage that is subject to intervening liens to which the subordinated superior lien is otherwise paramount. Circuity of lien results because the prior mortgage is displaced by the subordinating lien while apparently retaining its priority over the intervening liens. Thus, a situation is created in which each is simultaneously prior and subordinate to the other.

Id. Bratcher argued that the subordination agreements resulted in the Gant & Asaro and Buckner liens being subordinated to his lien. The Court, however, was not persuaded and stated that "to accept Bratcher's argument, we would effectively make him a third party beneficiary of the subordination agreements, which do not even mention him." *Bratcher*, 90 Cal App. at 1186. The Court also analyzed the *AmSouth* decision and stated,

> *AmSouth (AmSouth, supra*, 679 So.2d 695*)* based its decision that a beneficiary of a subordination agreement does not step into the shoes of the subordinating lienholder upon the definition of the term "subordination," stating that "nothing in the definition contemplates *raising* a lower priority lienholder up to the position of the subordinating party." (*Id.* at p. 698, original italics, fn. omitted.) However, the decision ignores the fact that the lower priority lienholder is only succeeding to the first priority

> lienholder's claim to the *extent of the amount of that claim*. Thus, for all practical purposes, the priorities remain unchanged as to the intervening lienholder: its position is neither benefited nor prejudiced. The court in *AmSouth* also ignores the uncontracted-for *windfall* that its decision gives to an intervening lienholder by placing it in a first priority position.

Id. at 1188 (emphasis in original).

In *In re Price Waterhouse, Ltd.*, the Supreme Court of Arizona answered the following certified question:

> Where real property is subject to a first priority deed of trust, a second priority mechanic's lien, and a third priority deed of trust, where the holder of the first priority deed of trust and the holder of the third priority deed of trust enter into a written subordination agreement pursuant to which the holder of the first priority deed of trust agrees that the third priority deed of trust shall constitute a lien or charge upon said land which is unconditionally prior to and superior to the lien or charge of the first priority deed of trust, and where the holder of the second priority mechanic's lien is not a party to the subordination agreement, what effect, if any, does the subordination agreement have on the relative priorities of the liens of the three parties based on the facts set forth below?

202 Ariz. 397, 409-10 (2002). The Court adopted the partial subordination analysis and summarized the approach as follows:

> Partial subordination means that this alteration of the priority of liens between the first and third lienholders has no effect on the second priority lienholder. The shift in priority relates only to the amount of the original third priority lien. If the third priority lien is larger than the original first priority lien, then the original first priority lien moves completely to the third position. The original third priority lien moves into first position *but only to the amount of the original first priority lien*. If the third priority lien is smaller than the original first priority lien, then the difference between the two amounts, *up to the total of the original first priority lien*, is still in a priority position relative to the second priority lienholder. The holder of the second priority lien is neither advantaged nor disadvantaged by the agreement. The second priority lienholder is not a party to the agreement and should not be affected by it. His status remains the same to the extent of any remaining assets available once the amount of the first priority lien has been satisfied. The consequence of a subordination agreement is that the amount of the first lien simply goes toward satisfying in whole or in part two liens as opposed to one.

Pricewaterhouse Coopers, Inc. v. Decca Design Build, Inc. (In re Price Waterhouse Ltd.), 202 Ariz. 397, 399-400 (2002) (emphasis in original).

In *ITT Diversified Credit Corporation v. First City Capital Corporation,* the Supreme Court of Texas held that "i[n] a non-real property situation, the third lienholder should be able to succeed to that part of the interest that was subordinated by the first lienholder, as long as the second lienholder is neither burdened nor benefitted by the subordination agreement." 737 S.W.2d 803, 803 (Tex. 1987). The Court then set out the following example in detail:

> For example, A, B and C have claims against the debtor which are entitled to priority in alphabetical order. "A" subordinates his claim to "C." After foreclosure of the secured interest, the resulting fund is insufficient to satisfy all three claims. The proper distribution of the fund is as follows.
>
> 1. Set aside from the fund the amount of "A"'s claim.
>
> 2. Out of the money set aside, pay "C" the amount of its claim, pay "A" to the extent of any balance remaining after "C"'s claim is satisfied.
>
> 3. Pay "B" the amount of the fund remaining after "A"'s claim has been set aside.
>
> 4. If any balance remains in the fund after "A"'s claim has been set aside and "B"'s claim has been satisfied, distribute the balance to "C" and "A".
>
> *See* Gilmore, *Security Interests in Personal Property* § 39.1 at 1021 (1965).
>
> Thus, "C", by virtue of the subordination agreement, is paid first, but only to the amount of "A"'s claim, to which "B" was in any event junior. "B" receives what it had expected to receive, the fund less "A"'s prior claim. If "A"'s claim is smaller than "C"'s, "C" will collect the balance of its claim, in its own right, only after "B" has been paid in full. "A", the subordinator, receives nothing until "B" and "C" have been paid except to the extent that its claim, entitled to first priority, exceeds the amount of "C"'s claim, which, under its agreement, is to be first paid.

Id. at 804.

Lastly, in *Wells Fargo Bank v. Neilsen*, the Court of Appeals of California relied heavily on the *Bratcher*, *ITT Diversified* and *In re Price Waterhouse* cases in adopting the partial subordination reasoning in its own decision. The Court stated,

> A court has no reason to overlook the obvious intent of the parties to the subordination agreement, even though the drafting of the agreement may be less than perfect.... Courts should reject the complete subordination approach and, in cases of circuity resulting from a subordination agreement, apply the partial subordination approach to break the circle. Shortly and simply stated, we agree with this analysis, and its application in *Bratcher*, *ITT* and *Price Waterhouse*.

Neilsen, 178 Cal. App. 4th at 617 (internal citations omitted).

The facts in the case before the Court differ from the cases analyzed insomuch as the moving party is not a lienholder. The moving party, Futuri, is the purchaser of the property which was the subject of foreclosure. The Court's determination will not impact whether SunTrust receives payment, as SunTrust has already been paid in full. The impact will be whether liens remain on the property Futuri purchased and on the order of distribution of the remaining $201,647.94, as previously detailed.

It is not the Court's province to interfere with the parties' lawful ability to contract and to impose that which was not intended.

> Generally speaking every adult person has a right to contract with respect to his property rights and when they have done so, courts are without authority to annul their obligations thus assumed unless they have been entered into under such circumstances as to indicate that their procurement had been brought about by fraud.

Moore v. Gregory, 146 Va. 504, 523 (1925). Wells Fargo subordinated one of its liens to another one of its liens. It is clear it had no intention to subordinate its first lien to any third party lien. The Court holds that Virginia law is in harmony with the majority view of other states. The Wells Fargo Subordination Agreement thus resulted in only a partial

subordination of its first-in-priority lien to its own inferior lien, did not result in subordination to any other lien, and did not waive the secured status of Wells Fargo's first lien by its subordination to its second lien. The Court will not overlook the obvious intent of the parties and impose an order of priority never intended. Doing so would give an unintended windfall to Futuri.

Consequently, there being no genuine issue of material fact in dispute regarding the Subordination Agreement not yet adduced, the intent of Wells Fargo and of the Borrowers being clear, there being no waiver of lien priority with respect to third party liens or claims, it is "conclusively apparent" that Defendant Futuri's cross-claim must be dismissed. *See Brown v. Koulizakis*, 229 Va. 524, 531 (1985) (citation omitted).

CONCLUSION

The Court has considered Cross-Claim Defendant Wells Fargo's Motion to Dismiss the cross-claim of Defendant Futuri Real Estate Inc., seeking a declaration that at the time of the foreclosure sale a deed of trust recorded by SunTrust on the subject property was superior to two deeds of trust recorded by Wells Fargo. This cause presents an issue of seeming first impression in Virginia, namely whether a lien holder, in this case Wells Fargo, can subordinate its first-in-priority lien to one of its subsequent liens without thereby waiving such priority with respect to any other liens or as to any third party claims. For the reasons more fully stated herein, this Court holds that such partial subordination clauses are permitted and enforceable in Virginia without having the unintended effect of waiver of priority or security with respect to other liens or the

interests of third parties. Accordingly, Defendant Futuri Real Estate Inc.'s cross-claim against Wells Fargo shall be dismissed with prejudice.

This Court shall issue a separate order incorporating the ruling in this Letter Opinion.

AND THIS CAUSE CONTINUES.

Sincerely,

[redacted]

David Bernhard
Judge, Fairfax Circuit Court

OPINION LETTER