STATE OF MICHIGAN

COURT OF APPEALS

AIDA MAHFOUZ,

Plaintiff-Appellant,

v

LEON LONDON, d/b/a WOLVERINE STATE INVESTMENT FUND,

Defendant-Appellee.

UNPUBLISHED
January 25, 2005

No. 237572
Wayne Circuit Court
LC No. 00-019720-CH

Before: Markey, P.J, and White and Zahra, JJ.

PER CURIAM.

Plaintiff appeals as of right the circuit court's order granting defendant's motion for summary disposition pursuant to MCR 2.116(C)(10), and its order fixing the amount of an equitable trust. We affirm in part and reverse in part.

I

Plaintiff Aida Mahfouz (Mahfouz) acquired the property at issue by warranty deed from Rabih and Kathy Jawad for the purchase price of $106,000 on December 31, 1998. The deed to plaintiff was recorded on March 5, 1999. Rabih Jawad acquired the property by warranty deed from Sam Aoun and his wife, Ghada Aoun, on July 11, 1997, for $76,750. Jawad took possession of the home and property immediately after the closing. The deed to Jawad was recorded on March 5, 1998. At the time of the purchase of the property by Jawad from the Aouns, Sam Aoun had three mortgages of record, each of which was paid off and discharged using a portion of the purchase price paid by Jawad. The total payoff amount for the three mortgages was $70,101.04. In addition, there was a fourth mortgage that, on April 30, 1997, Sam Aoun, as a single man, had given to G & S Development Ltd. (G & S) to secure a recited indebtedness in the principal amount of $19,800. This mortgage was not recorded until September 9, 1997, after Jawad had already purchased the property from Aoun and taken up occupancy and possession of the property without notice of the fourth mortgage, and while he was still living in the house

On September 22, 1999, a Sheriff's Deed on Mortgage Sale was acquired by defendant, Leon London, d/b/a Wolverine State Investment Fund (WSIF) for a purchase price of $34,051.60, following a foreclosure by advertisement of the G & S mortgage. The Sheriff's Deed was recorded on October 13, 1999. Plaintiff asserts that she failed to respond to the

foreclosure notices, and summons and complaint commenced by defendant for possession of the property, because the proceedings were commenced against Sam Aoun, and neither plaintiff nor her husband were named as a party in the complaint or summons filed by defendant. Plaintiff and her husband did not know Sam Aoun, had never met him, and were unaware of any mortgage he may have given to G & S until after plaintiff and her husband were notified by a court officer that they were being evicted from their home in June 2000. On June 19, 2000, plaintiff and her husband filed suit against defendant seeking to quiet title to the property and for other injunctive relief.

II

Plaintiff first argues that the circuit court erred in granting summary disposition in favor of defendant because actual, open possession of property is the equivalent of record notice, and therefore, because plaintiff's seller, Rabih Jawad, a good-faith purchaser without notice, purchased the home and took possession of it before the G & S mortgage was recorded, the G & S mortgage was extinguished. We disagree.

Michigan is a race-notice state. MCL 565.29 provides, in relevant part:

> Every conveyance of real estate within the state hereafter made, which shall not be recorded as provided in this chapter, shall be void as against any subsequent purchaser in good faith and for a valuable consideration, of the same real estate or any portion thereof, whose conveyance shall be first duly recorded.

Recorded liens, rights, and interests in property take priority over subsequent owners and encumbrances. MCL 565.25. A mortgage of lands is a conveyance within the meaning of the recording acts. MCL 565.35; *Stover v Bryant & Detwiler Improvement Corp of Detroit,* 329 Mich 482, 484; 45 NW2d 364 (1951). Where an individual fails to record an interest, that interest is void against any subsequent holder who purchased the interest in good faith for valuable consideration and who records first. MCL 565.29. A person who has notice of a possible defect in a vendor's title and fails to make further inquiry into the possible rights of a third-party is not a good-faith purchaser, and is chargeable with notice of what an inquiry would have disclosed. *Kastle v Clemons,* 330 Mich 28, 31; 46 NW2d 450 (1951); *Royce v Duthler,* 209 Mich App 682, 690; 531 NW2d 817 (1995). Notice need only be of the possibility of the rights of another, not positive knowledge of those rights. *Id.* Notice must be of such facts that would lead any honest person, using ordinary caution, to make further inquiries into the possible rights of another in the property. *Id.*

The circuit court incorrectly concluded that because the G & S mortgage was recorded before Jawad recorded his warranty deed, Jawad had notice that the property was subject to the mortgage, and was not a good-faith purchaser. The G & S mortgage was acquired on April 30, 1997, but was not recorded until September 9, 1997. Jawad purchased the property from Sam Aoun on June 11, 1997, for valuable consideration. Because the G & S mortgage was not recorded until almost three months after Jawad purchased the property, and Jawad had no other notice of the mortgage, Jawad was a good-faith purchaser under the statute. Further, plaintiff's constructive notice of the mortgage at the time of her purchase is irrelevant because a good-faith purchaser is able to transfer whatever interest he or she owns, regardless of subsequent notice to his or her grantee purchaser. *Fraser v Fleming,* 190 Mich 238, 244-245; 157 NW 269 (1916), 1

Cameron, Michigan Real Property Law, § 11.28, citing *Shotwell v Harrison*, 22 Mich 410 (1871), and *Godfrey v Disborow*, 1 Walk Ch 260 (1843).

However, in addition to requiring that a person be a good-faith purchaser for valuable consideration, MCL 565.29 also requires that his or her conveyance be first duly recorded. The record reveals that Jawad did not record his warranty deed until March 5, 1998, almost six months after the G & S mortgage was recorded. Thus, although a good-faith purchaser, Jawad was not the first to duly record his deed, and, therefore, the earlier mortgage was not void as to his interest under MCL 565.29.

Contrary to plaintiff's assertion, the fact that Jawad went into open and exclusive possession of the property before the G & S mortgage was recorded does not extinguish the mortgage. Although the Michigan Supreme Court has held that "[c]onstructive notice by possession is equal to constructive notice by record," *Fraser, supra* at 244, this observation pertains to the good-faith purchaser requirement, since in order to be a good faith purchaser, one cannot have notice of possible defects in the title. It does not apply here because Aoun was in possession when he gave the mortgage on the property, not Jawad. MCL 565.29 explicitly contains a separate recording requirement, and thus open possession does not obviate the need to record first in order to render the prior interest void.

III

Plaintiff next asserts that when Jawad purchased the property, and the money was used to pay off the three recorded mortgages before the G & S mortgage was recorded, Jawad acquired the rights of those mortgagees under the doctrine of equitable subrogation. Plaintiff further argues that as Jawad's purchaser, she acquired any rights Jawad had in the property, including those of subrogation.

Equitable subrogation is a legal fiction through which a person who pays a debt for which another is primarily responsible is substituted or subrogated to all the rights and remedies of the other. *Neal v Neal,* 219 Mich App 490, 495-496; 557 NW2d 133 (1996). In the mortgage context, the doctrine is applied where the grantee of the mortgagor pays off a prior mortgage in actual ignorance of a later encumbrance. Osborne, Handbook on the Law of Mortgages (2d ed 1970), p 574, or where one provides the money used to satisfy the mortgage debt. *Walker v Bates*, 244 Mich 582, 586-587; 222 NW 209 (1928); *Smith v Sprague*, 244 Mich 577; 222 NW 207 (1928); *Leser v Smith*, 219 Mich 509, 189 NW 38 (1922). The grantee then is subrogated to the rights of the prior mortgagee, and the later mortgage remains inferior to the subrogee's interest. Equitable subrogation is a flexible, elastic doctrine of equity. *Atlanta Int'l Ins Co v Bell,* 438 Mich 512, 521; 475 NW2d 294 (1991). Its application "should and must proceed on the case-by-case analysis characteristic of equity jurisprudence." *Id.* at 516 n 1. Part of the rationale for the theory of equitable or conventional subrogation is that the junior lienor's position is left unchanged by the conduct of the party seeking subrogation and that he is not wronged by permitting subrogation. *Lentz v Stoflet,* 280 Mich 446, 451; 273 NW 763 (1937). Subrogation is granted, if at all, with due regard to the rights of others, *Fraser, supra* at 245, and will be refused where it is inequitable to grant it, *Gerber v Upton,* 123 Mich 605, 607; 82 NW 363 (1900). Equitable subrogation "will not be enforced where it will work injustice to the rights of those having equal equities." *Board of Co Road Com'rs of Calhoun Co v Southern Surety Co,* 216 Mich 528, 533; 185 NW 755 (1921); *Fraser, supra* at 245.

The record shows that most of the purchase price paid by Jawad to Aoun was used to pay off three recorded mortgages on the property, and thus, those liens were extinguished at that time. However, the record also reveals that there remained a fourth mortgage on the property, the G & S mortgage, which was not paid off by Aoun. Thus, Jawad would be subrogated to the rights of the three mortgagees as relates to the fourth mortgage. This does not disadvantage G & S because when the fourth mortgage was given, it was junior to the three prior mortgages. The only change is that Jawad stepped into the shoes of the prior mortgagees upon providing the money to pay the debt. Thus, upon the sale of the property from the Aouns to Jawad, with the attendant payment of the purchase price and discharge of the three mortgages, G & S' mortgage interest was junior to Jawad's interest to the extent of $70,101.04. This priority is not altered by the subsequent sale of the property to plaintiff, or the subsequent purchase of the property by defendant at the sheriff's sale. While the circumstances of these two events would appropriately be considered in weighing the equities, there is no reason that the fact of the sales should automatically render the doctrine of equitable subrogation inapplicable. Further, although the circuit court determined that the application of the equitable subrogation doctrine would "affect the rights of the Defendant and/or G & S," the court did not set forth how defendant or G & S would be affected beyond being placed in the position either would have been in had the prior mortgages not been paid off by Jawad. We thus conclude that the court erred in granting summary disposition as to equitable subrogation.

IV

Next, we reject plaintiff's claims of error relating to the validity of defendant's title based on the forclosure sale. First, the evidence of title in the form of the Sheriff's Deed on Mortgage Sale was sufficient. Next, there is no requirement that the power of attorney be recorded, even for a foreclosure by advertisement. MCL 600.3204 sets forth no such requirement. Further, insufficient evidence of fraud was presented to create a genuine issue whether the mortgage or the foreclosure were fraudulent. Additionally, Ghada Aoun's rights are not at issue in the instant case, and do not affect plaintiff's position here. Lastly, we will not assume that the mention of title insurance affected the court in this motion for summary disposition.

V

Plaintiff next contends that the circuit court erred in determining the amount of her equitable lien for improvements she and her husband made to the property. We review equitable determinations by a trial court de novo, while we review the court's factual findings for clear error. *Forest City Enterprises, Inc v Leemon Oil Co,* 228 Mich App 57, 67; 577 NW2d 150 (1998).

In an equitable action, a trial court looks at the entire matter and grants or denies relief as dictated by good conscience. *Michigan National Bank & Trust Co v Morren,* 194 Mich App 407, 410; 487 NW2d 784 (1992), quoting *Hunter v Slater,* 331 Mich 1, 7; 49 NW2d 33 (1951). The power of a court in an appropriate case to declare an equitable lien for the value of improvements made in good faith by an innocent party in possession under a mistaken claim of ownership has been recognized by this Court as being within equity jurisdiction. *Acker v Weadel,* 236 Mich 374, 381; 210 NW 212 (1926).

Relying on *Rzeppa v Seymour,* 230 Mich 439; 203 NW 62 (1925), the circuit court held that the "value added to the land" could not exceed the cost of the improvements, and as a result, only awarded plaintiff $9,373.20. Plaintiff argues that the circuit court's ruling is contrary to the express mandate of MCR 3.411(F). MCR 3.411(F) provides:

> (1) Within 28 days after the finding of title, a party may file a claim against the party found to have title to the premises for the amount that the present value of the premises has been increased by the erection of buildings or the making of improvements by the party making the claim or those through whom he or she claims.
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> (2) The court shall hear evidence as to the value of the buildings erected and the improvements made on the premises, and the value the premises would have if they had not been improved or built upon. The court shall determine the amount the premises would be worth at the time of the claim had the premises not been improved, and the amount the value of the premises was increased at the time of the claim by the buildings erected and improvements made.
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> (3) The party claiming the value of the improvements may not recover their value if they were made in bad faith.

MCR 3.411(F)(2) provides that after a proper claim is filed, the court shall hear evidence regarding the value of the improvements made to the property, and the value of the property had the improvements not been made. In this case, the court held an evidentiary hearing and heard testimony from plaintiff's husband relating to the many improvements he made to the property by himself and by hiring others, including installation of an air conditioner. Although plaintiff's husband had saved some of the receipts for purchases of materials used to make the improvements, and some other expenditures, he testified that there were many that he had not kept because he had not anticipated the subject property dispute. The record indicates the total amount of the receipts provided to the court was $11,686.74. The court also heard testimony from an appraiser who testified that the value of the property without the improvements was $90,000, and the value with the improvements was $135,000. In its opinion, the court noted that the property was purchased for $106,000, that an expert had testified that the value with the improvements was $135,000, that plaintiff's claim for improvements and the testimony offered in support exceed the actual amounts that plaintiff can show was expended. The court set the lien at $9,373.20, which was the amount that plaintiff had been able to prove via receipts, excluding the air conditioning costs. The court excluded the air conditioning expense because plaintiff's husband had not procured a permit, and so was not entitled to relief in equity.

Because this is a civil action to determine an interest in land, brought pursuant to MCL 600.2932, MCR 3.411(F) applies. To the extent *Rzeppa* is contrary to this rule, it is not controlling. MCR 3.411(F)(2) provides that based on the evidence, the court shall determine the amount the property would be worth at the time of the claim had the property not been improved, and by what amount the value of the property was increased by the improvements made thereto.[1]

[1] Increases in the value of the property due to the passage of time or market conditions are not to be considered.

On remand, the court shall follow the provisions of the court rule, and in doing so, it shall also consider that a receipt is but one form of evidence that an expenditure was made, and that value is enhanced by the labor involved in an improvement, as well as the cost of the materials.

MCR 3.411(F)(3) provides that a party cannot recover the value of improvements if they were done in bad faith. It does not follow from the failure to obtain a required permit that the work was done in bad faith. However, in assessing the value of the improvement, the court is free to consider that it was done without a permit.

Affirmed in part, and remanded for further proceedings consistent with this opinion. We do not retain jurisdiction.

/s/ Jane E. Markey
/s/ Helene N. White
/s/ Brian K. Zahra