VIRGINIA:

In the Supreme Court of Virginia held at the Supreme Court Building in the City of Richmond on Thursday the 24th day of October, 2019.

Present: All the Justices

Thoburn Limited Partnership, Appellant,

against Record No. 181448
Circuit Court No. CL-2017-7975

Brisa Fund LLLP, et al., Appellees.

Upon an appeal from the judgment rendered by the Circuit Court of Fairfax County.

Upon consideration of the record, briefs, and argument of counsel, for the reasons set forth below, the Court is of opinion that there is no reversible error in the judgment that is the subject of this appeal. However, because there is agreement that the amount recited in the final order as being owed on the debt secured by the first deed of trust is inaccurate, we will remand the case to the circuit court, limited to its determination of the correct amount due and owing on the debt secured by the first deed of trust.

BACKGROUND

John Thoburn (Thoburn) was a general partner in Thoburn Limited Partnership (TLP), which owned property in Vienna, Virginia (the Property). During its ownership of the Property, Thoburn and TLP entered into several loans using the Property as collateral. On December 8, 1989, Thoburn borrowed $320,000 and secured that loan with the Property via a deed of trust (DOT 1), currently held by Wilmington Savings Fund Society (Wilmington). On August 5, 2009, TLP borrowed $185,000 and secured that loan with the Property via a second deed of trust (DOT 2), currently held by Brisa Fund, L.L.L.P. (Brisa), and, on March 8, 2011, Thoburn borrowed an additional $180,000 and secured that loan via a third deed of trust (DOT 3) on the Property. DOT 3 is also held by Brisa.

In February 2012, TLP filed a petition for bankruptcy in the United States Bankruptcy Court for the Eastern District of Virginia. During the bankruptcy proceedings, TLP and Oakcrest

School (Oakcrest), which owned land neighboring the Property, entered into a settlement agreement to resolve disputes about easements granted in a prior development agreement. Pursuant to that settlement agreement, Oakcrest agreed to purchase several rights-of-way (ROWs) on the Property from TLP.

The bankruptcy court approved the settlement agreement and incorporated it into an order (Approval Order), which allowed the ROWs to be transferred free of the liens on the Property. It also provided that the proceeds from the settlement would be substituted for the ROW property as collateral for the lienholders. The Approval Order states, in part:

> [T]he Debtors, or any successor, are hereby directed: (i) to transfer the ROWs by deed of dedication in accordance with the provisions of the Settlement Agreement and the terms of this Order, *free and clear of all Liens* . . . . [A]ll such Liens shall be released, terminated and discharged as to the ROWs and . . . *such Liens shall attach to the net proceeds of the sale of the ROWs in the order of their priority*, with the same validity, force and effect as they now have against the ROWs.

(Emphases added.)

The bankruptcy court ordered the creation of an escrow account to hold Oakcrest's payments for the ROWs and appointed James Towarnicky (Towarnicky), counsel for Brisa, as escrow trustee. The court ordered that the funds in the escrow account could not be spent or otherwise distributed absent an order from a court of competent jurisdiction or an agreement of the parties. The bankruptcy court noted that the Approval Order incorporated the escrow agreement and was to remain in effect; it subsequently signed an order dismissing TLP's petition for bankruptcy.

On May 17, 2016, QEAA, LLC (QEAA)—the substitute trustee of DOT 3—foreclosed on the Property pursuant to DOT 3. Brisa purchased the Property at the foreclosure sale for $50,000 via a contract of sale. The contract of sale indicated that title to the Property would be subject to "liens, encumbrances, and rights, actual or inchoate, having priority over [DOT 3]." Brisa assigned its contract of sale for the Property to Hunter Mill Vista, LLC (Hunter Mill), a corporation created by Brisa, and the substitute trustee transferred title to the Property, as purchased pursuant to the terms of the foreclosure sale, to Hunter Mill.

On June 6, 2017, Brisa, Hunter Mill, QEAA, and Towarnicky (collectively, the Creditors) filed a declaratory judgment action in the Circuit Court of Fairfax County. The Creditors sought a declaratory judgment directing Towarnicky to distribute the proceeds from the ROWs to the

lienholders according to their priority and a declaration that TLP had no entitlement to those proceeds.

TLP filed a counterclaim for declaratory relief claiming the merger and/or extinguishment of DOT 2 upon Brisa's purchase of the Property at the DOT 3 foreclosure sale. TLP also sought a declaration that it would be subrogated to Wilmington's rights under DOT 1 if the proceeds held in escrow fully satisfied the amount due on DOT 1, or that TLP would be equitably subrogated to Wilmington's rights if TLP paid "*the difference between the indebtedness and the amount satisfied by the funds* held in escrow." (Emphasis added.) It also requested a declaration that Wilmington be ordered to foreclose on the Property prior to any order requiring distribution of the funds held in escrow to the lienholders.

The circuit court held a trial on the Creditors' claims and TLP's counterclaims, and subsequently entered an order granting the Creditors' motion to strike the counterclaims and granting the declaratory relief requested by the Creditors.

The circuit court found, regarding the counterclaim, that the DOT 3 foreclosure sale of the Property was subject to all prior liens, that Hunter Mill, not Brisa, was granted the trustee's deed after the foreclosure sale, that there was no evidence that Brisa intended to extinguish DOT 2, and that such intention was necessary for merger to be established. It concluded that DOT 2 was not merged or extinguished by the trustee's deed issued after the foreclosure sale regarding DOT 3. It also found that TLP was not the owner of the Property, nor the holder of the liens encumbering the Property, and that a necessary element of TLP's subrogation claim—that the entire lien had been paid off—was not met. It also concluded that because TLP was the defaulter on the liens, equity could not require the debtor to be the subrogee of the holder of DOT 1.

The circuit court ruled that the funds from the ROWs in the escrow account are subject to the liens attaching to the Property in the order of such liens' priority, that the amount due on the debt secured by DOT 1 is $340,818.04, that the ROWs proceeds in escrow are to be paid to the holder of DOT 1, and that to the extent the ROWs proceeds did not satisfy the debt secured by it, DOT 1 remains intact. It also ruled that the debt secured by DOT 2 in favor of Brisa was not extinguished and still encumbers the Property.

TLP moved the circuit court to reconsider, arguing that the circuit court erred in calculating the amount of the debt secured by DOT 1, and no party requested in its pleading that the circuit calculate the amount due on that underlying debt. The circuit court denied the motion.

More than 30 days after entry of the final order, Wilmington, the holder of DOT 1, moved the circuit court to amend the final order for "clerical error" pursuant to Code § 8.01-428(b), asserting that the amount it was owed on the debt secured by DOT 1 was $300,666.30, rather than the incorrect amount stated in the final order. The circuit court has not ruled on that motion.

TLP appeals.

ANALYSIS

TLP asserts that the circuit court "erred in setting a specific amount due and owing under the lien of Wilmington where there was no affirmative request for the relief, the relief was not necessary to the ruling, and there was an insufficient and incorrect factual basis for the relief granted."

Whether an action is sufficiently pled is a legal issue this Court reviews de novo. *TC MidAtlantic Dev., Inc. v. Commonwealth*, 280 Va. 204, 210 (2010). "It is firmly established that no court can base its judgment or decree upon facts not alleged or upon a right which has not been pleaded and claimed." *Ted Lansing Supply Co. v. Royal Aluminum & Constr. Corp.*, 221 Va. 1139, 1141 (1981).

In its counterclaim, TLP sought to be subrogated to Wilmington's rights by having the circuit court declare that the amount in escrow fully satisfied the amount of the indebtedness secured by DOT 1 and if it did not, that TLP could pay "the remainder of Wilmington's indebtedness, the difference between the indebtedness and the amount satisfied by the funds held in escrow," and thereupon be subrogated to Wilmington's rights. The "indebtedness" is the amount TLP owes Wilmington on the debt secured by DOT 1. Thus, the relief requested by TLP required the circuit court to determine the amount owed on the lien created by DOT 1, which is held by Wilmington. TLP cannot seek such relief from the circuit court in its counterclaim and then argue on appeal that the circuit court did not have the authority to determine the amount of the debt secured by DOT 1. A party cannot "approbate and reprobate"—it cannot occupy inconsistent positions within the same litigation. *Matthews v. Matthews*, 277 Va. 522, 528 (2009). The circuit court did not exceed its authority in determining the amount due and owing to Wilmington that is secured by DOT 1 because such a determination was incident to evaluating TLP's request for relief in its counterclaim.

However, we note that there appears to be agreement by both TLP and Wilmington, the holder of DOT 1, that the amount of the debt secured by DOT 1 was stated inaccurately in the circuit court's final order. Therefore, we will remand the case to the circuit court to allow it to determine the correct amount due and owing on that debt.

TLP also asserts that the circuit court "erred in not requiring the secured parties to look to the land first for satisfaction of their liens" prior to the circuit court ordering distribution of the funds held in escrow. It claims that the circuit court ignored that the proceeds from the sale of the ROWs were collateral "above and beyond" the Property.

The circuit court did not err in refusing to require the secured parties to look to the Property first for satisfaction of the debts secured by the DOTs prior to releasing funds from the escrow account to the holder of DOT 1. The bankruptcy court's Approval Order states that DOTs 1, 2, and 3 "shall attach to the net proceeds of the sale of the ROWs in the order of their priority with the same validity, force, and effect as they now have against the ROWs." Thus, the proceeds from the ROWs were not collateral "above and beyond" the Property.

Both the Full Faith and Credit Clause of the United States Constitution and Code § 8.01-389(B) "require Virginia courts to give full faith and credit to the judicial proceedings of other state courts, and of federal courts." *Nottingham v. Weld*, 237 Va. 416, 419 (1989) (citations omitted). Virginia courts must thus give preclusive effect to an order from a federal court of competent jurisdiction. *Id.* at 420. The bankruptcy court's Approval Order provides the holders of the DOTs a security interest in the ROW sale proceeds, and provides that such security interest has the same priority, validity, force, and effect as the security interest that the holders of the DOTs have in the Property. Neither the Approval Order nor the escrow order requires that the lienholders foreclose on the Property itself prior to asserting a claim to the escrowed proceeds held as security for their loans to TLP. The order which created the escrow account states that the escrowed proceeds can be disbursed if authorized by court order or an agreement between the parties. It is undisputed that TLP has defaulted in the repayment of the debts secured by the DOTs. The circuit court ordered that the proceeds from the sale of the ROWs, held in escrow as security for those debts, be used toward satisfaction of those debts according to the priority of the liens, as required by the bankruptcy court's Approval Order. The circuit court did not err in refusing to order the foreclosure of the Property itself, prior to releasing the funds in the escrow account being held as security for the defaulted debts owed by TLP.

Further, TLP argues that the circuit court "erred as a matter of law in ruling that merger required the showing of intent on behalf of the merging party." TLP also argues that the circuit court abused its discretion in refusing to equitably merge and extinguish DOT 2 because of Brisa's purchase of the Property at the foreclosure sale.

"The merger doctrine deals with extinguishing a previous contract by an instrument of higher dignity, the deed." *Abi-Najm v. Concord Condo., LLC*, 280 Va. 350, 357 (2010) (citation and internal quotation marks omitted). "When one acquires absolute title to property which secures his debt, *in the absence of evidence showing a contrary intention* it is presumed that he intended to merge his secured interest into the legal title acquired." *Joyner v. Graybeal*, 204 Va. 543, 545 (1963) (emphasis added).

If the intention not to merge has been expressed, however, it controls. *Rorer v. Ferguson*, 96 Va. 411, 414 (1898). Whether a party has expressed intention to merge is an issue of fact. *Ciejek v. Laird*, 238 Va. 109, 113 (1989). This Court will not reverse a circuit court's findings of fact unless they are "plainly wrong or without evidence to support them." *Morris v. Mosby*, 227 Va. 517, 522 (1984).

In the present case the circuit court was not plainly wrong in finding that Brisa expressed intent not to merge DOT 2 upon its winning offer on the Property at the DOT 3 foreclosure sale. The contract of sale of the Property upon foreclosure stated that title to the Property would be transferred subject to "liens, encumbrances, and rights, actual or inchoate, having priority over [DOT 3]." Additionally, Brisa transferred its sales contract to Hunter Mill, and the Property was deeded to Hunter Mill, not Brisa. Thus, not only does the language of the contract of sale expressly state that DOT 2 would still be enforceable against the Property after the foreclosure sale, but the Property was also deeded to an entity other than Brisa. These facts clearly support the circuit court's conclusion regarding Brisa's intent. The circuit court's finding that Brisa expressed its intention not to merge and/or extinguish DOT 2 is supported by evidence and is not plainly wrong.

A court of equity will refuse to merge a debt and a property acquisition "if that is required *by the outstanding claim of a third party* or is necessary in view of the proprietor's own situation." *Ciejek*, 238 Va. at 112 (emphasis added) (citation and internal quotation marks omitted). This Court reviews a circuit court's decision to award or deny an equitable remedy for abuse of discretion. *Callison v. Glick*, 297 Va. 275, 290 (2019). The abuse of discretion

standard means "the circuit court has a range of choice, and that its decision will not be disturbed as long as it stays within that range and is not influenced by any mistake of law." *Sauder v. Ferguson*, 289 Va. 449, 459 (2015) (citation and internal quotation marks omitted).

The circuit court here did not abuse its discretion in refusing to equitably merge DOT 2 into the deed acquired after the DOT 3 foreclosure sale. DOT 1 represents an outstanding claim by Wilmington, and DOT 2 secures a separate and still outstanding debt owed to Brisa. Those debts are secured not just by the Property, but also by the sales proceeds from the ROWs. Application of the merger doctrine would have left Brisa without possible recourse to recover, and the advantage provided by, its security interest in the sales proceeds. Given Brisa's express intent not to merge its interests and the outstanding debts secured by DOTs 1 and 2, it was clearly within the circuit court's discretion to deny equitable merger.

Finally, TLP asserts that the circuit court "erred by not subrogating TLP to the rights of Wilmington after deciding the ROW [p]roceeds should be distributed to Wilmington."

"Subrogation is the substitution of another person in the place of the creditor to whose rights he succeeds in relation to the debt" and is a "creature of equity." *Federal Land Bank of Baltimore v. Joynes*, 179 Va. 394, 401 (1942). This Court reviews a circuit court's decision to award or deny an equitable remedy for abuse of discretion. *Callison*, 297 Va. at 290.

Subrogation arises "where one having a liability . . . in the premises pays a debt due by another under such circumstances that he is in equity entitled to the security or obligation held by the creditor." *Federal Land Bank*, 179 Va. at 401. Subrogation to the rights of another cannot occur, however, "until the whole debt is paid" by the party seeking subrogation. *Combs v. Agee*, 148 Va. 471, 475–76 (1927) (citation and internal quotation marks omitted). Additionally, subrogation is generally "not appropriate where intervening equities are prejudiced." *Centreville Car Care, Inc. v. North Am. Mortg. Co.*, 263 Va. 339, 345 (2002).

In the present case, the circuit court did not abuse its discretion in refusing to subrogate TLP to Wilmington's rights. Although the parties disagree as to the exact amount, it is undisputed that the amount of the escrow funds is not sufficient to satisfy the debt secured by DOT 1. Further, TLP has not satisfied the debt secured by DOT 1. Thus, subrogation cannot occur. There is no applicable equitable principle which would support allowing the subrogation requested by TLP. Additionally, allowing TLP to be subrogated to the rights of Wilmington would prejudice other "intervening equities." Subrogating TLP to Wilmington's rights would

permit the debtor to interfere with the rights of its secured creditor; TLP could foreclose on the Property and potentially eliminate Brisa's secured interest under DOT 2. Accordingly, the circuit court did not err as a matter of law in denying TLP's subrogation claim.

CONCLUSION

For the foregoing reasons, we affirm the judgment of the circuit court except for its determination of the amount due and owing on the debt secured by DOT 1. We will remand this case to the circuit court for the sole purpose of allowing the circuit court to determine the amount due and owing on the debt secured by DOT 1.

This order shall be certified to the Circuit Court of Fairfax County.

A Copy,

Teste:

Clerk