

Commonwealth of Kentucky
Court of Appeals

NO. 2006-CA-000507-MR

CITIFINANCIAL MORTGAGE COMPANY, INC.
f/k/a ASSOCIATES HOME EQUITY SERVICES

APPELLANT

v. APPEAL FROM WARREN CIRCUIT COURT
HONORABLE JOHN R. GRISE, JUDGE
ACTION NO. 03-CI-00512

AMERICAN BUILDERS AND CONTRACTORS
SUPPLY COMPANY, INC.

APPELLEE

OPINION
REVERSING AND REMANDING

** **

BEFORE: ABRAMSON AND DIXON, JUDGES; HOWARD,¹ SPECIAL JUDGE.

HOWARD, SPECIAL JUDGE: Citifinancial Mortgage Company, Inc., formerly known as Associates Home Equity Services (hereinafter “Citifinancial”) appeals from a summary judgment entered by the Warren Circuit Court in favor of American Builders and Contractors Supply Company, Inc. (hereinafter “ABC”) in a case involving a dispute

¹ Special Judge James I. Howard completed this opinion prior to the expiration of his Special Judge assignment effective February 9, 2007. Release of the opinion was delayed by administrative handling.

over the priority of liens, between a previously recorded judgment lien and a purchase money lien. Based upon *Kentucky Legal Systems Corporation v. Dunn*, 205 S.W.3d 235 (Ky. App. 2006), rendered by this Court after the circuit court entered its summary judgment herein, we reverse.

On January 5, 2001, ABC recorded in the office of the Warren County Clerk a previously obtained judgment lien against Donald R. Gordon (hereinafter “Gordon”). This lien stated that it attached to “all of the right, title and interest of the Defendant, Donald R. Gordon, Jr., in and to any real property located in Warren County, Kentucky.” At the time the lien was recorded, Gordon owned no real property in Warren County. On April 24, 2001, Citifinancial closed a loan to Gordon, financing his purchase of the real estate involved herein. A deed to Gordon and a mortgage from Gordon to Citifinancial were both executed on that date and both were recorded ten days later, on May 3, 2001. No argument is made that the deed and mortgage were not part of the same transaction.²

Gordon ultimately defaulted on his payments to Citifinancial and this foreclosure action was filed against him on April 7, 2003. Citifinancial properly named ABC as a defendant in this action, to assert its lien. There has never been any question that both parties had valid liens against the property; the only question has been the priority of those liens. Both parties filed motions in the circuit court for summary judgment. A hearing was held and the circuit court entered a partial summary judgment

² The deed was actually recorded on May 3, 2001 at 9:24:59 a.m., according to the stamp affixed thereto by the Warren County Clerk. The mortgage was recorded less than three minutes later, at 9:27:44 a.m.

on November 4, 2005 in favor of ABC, finding that its previously recorded judgment lien had priority over Citifinancial's purchase money lien. Subsequently, a final judgment and order of sale was entered March 2, 2006, recognizing both liens and incorporating the prior partial summary judgment regarding the priority of those liens. Citifinancial brings this appeal from both the partial summary judgment and the final judgment, but only on the question of the priority of the liens. Both parties appear to agree that there was no genuine issue as to any material fact, which would preclude summary judgment under CR 56.03, and that the issue is purely one of law.

Citifinancial urges that both the *Restatement (Third) of Property* and the trend in numerous other jurisdictions support its position that a purchase money lien should have priority over a preexisting judgment lien. It also argues that equity demands the same result, as the judgment lien creditor, ABC in this case, would have no real estate to which its lien could attach had Citifinancial not made the purchase money loan.

ABC argues that Kentucky courts have never adopted this theory, and that doing so would represent a “drastic change” from “long established Kentucky statutory and case law.” It also urges that equity demands that its lien be held superior, because Citifinancial was on notice of ABC's prior lien, properly recorded in the Warren County Clerk's office. Because this Court just last year, in *Kentucky Legal Systems Corporation v. Dunn*, *supra*, adopted the *Restatement* position, we reverse.³

KRS 382.280, relied on by the circuit court, provides,

³ At the time ABC filed its brief herein, it was technically correct that Kentucky had not adopted the *Restatement* position. While this Court had issued its opinion in *Kentucky Legal Services*, that opinion was not yet final at that time.

All bona fide deeds of trust or mortgages shall take effect in the order that they are legally acknowledged or proved and lodged for record.

KRS 382.270 provides,

No deed or deed of trust or mortgage conveying a legal or equitable title to real property shall be valid against a purchaser for valuable consideration, without knowledge thereof, or against creditors, until such deed or mortgage is acknowledged or proved according to law and lodged for record. As used in this section, “creditors” includes all creditors irrespective of whether or not they have acquired a lien by legal or equitable proceedings or by voluntary conveyance.

Taken together, these two statutes create what is known as a “race-notice” rule for priority of liens or claims of ownership in real property. That is, with limited exceptions, the first to record without notice of the other lien or claim is superior. *Minix v. Maggard*, 652 S.W.2d 93 (Ky. App. 1983). Thus, if there is no exception applicable in this case, ABC's lien, as the first recorded and without knowledge of Citifinancial's subsequent lien, is entitled to priority. This was the basis of the circuit court's ruling.

However, *Kentucky Legal Systems Corporation v. Dunn*, *supra* recognizes just such an exception. In *Kentucky Legal Systems*, this Court adopted the position of the *Restatement (Third) of Property*, § 7.2 (1997), stating,

... we hold that Kentucky should adopt this logical rule that third parties who lend money used to purchase real estate in exchange for a mortgage hold special priority over all other recorded liens and judgments except where agreed otherwise by the parties or specified by statute. *Kentucky Legal Systems*, 205 S.W.3d at 237.

The application of this rule to the present situation, as well as the rationale for the rule, is explained in the *Restatement*, as quoted by *Kentucky Legal Systems*:

Under this section the vendor's purchase money mortgage is senior to any previous judgment liens that arise against the purchaser-mortgagor. This is true even though a judgment attaches as a lien to the judgment debtor's after-acquired real estate and the vendor takes the mortgage with actual knowledge of the judgment. ... Because this long-established rule makes it unnecessary for a purchase money lender to examine for preexisting judgments and other liens against the purchaser-mortgagor, it reduces title risk in connection with such transactions and thus encourages purchase money financing by vendors. Moreover, the rule is justified on grounds of fundamental fairness. The vendor-mortgagee should prevail because the lien creditor has not extended credit or perfected the lien in reliance on the right to be repaid out of any specific property, much less out of the real estate previously owned by the vendor. This is obvious, since the judgment was obtained before the debtor acquired the real estate to which the judgment lien attached. ...

This section extends the same priority preference to third party purchase money lenders. ... While it is true that such lenders, unlike vendors, do not give up ownership of specific real estate, they nevertheless part with money with the expectation that they will have security in that real estate. Without this advance of money, the purchaser-mortgagor would never have received the property and the other claimants would never have had the opportunity to satisfy their claims from such a convenient source. As in the vendor purchase money context, this section seeks to avoid conferring a windfall on those claimants. *Kentucky Legal Systems*, 205 S.W.3d at 236.

This holding is also consistent with those from numerous other jurisdictions, dating from both before and after the publication of the *Restatement (Third)*. See *Guffey v. Creutzinger*, 984 S.W.2d 219 (Tenn. App. 1998); *Citibank Mortgage Corp. v. Carteret Savings Bank, F.A.*, 612 So.2d 599 (Fla. App. 1992); *Slate v.*

Marion, 408 S.E.2d 189 (N.C.App.1991); *Belland v. O. K. Lumber Co., Inc.*, 797 P.2d 638 (Alaska 1990); *Montgomery v. Keppell*, 75 Cal. Rptr. 128 (1988); *Garrett Tire Center, Inc. v. Herbaugh*, 740 S.W.2d 612 (Ark. 1987); *Aetna Casualty & Surety Co. v. Valdosta Federal Savings & Loan Ass'n*, 333 S.E.2d 849 (Ga. App. 1985); *Huntingburg Prod. Credit Assoc. v. Griese*, 456 N.E.2d 448 (Ind.App.1983); *Martin v. First Nat'l Bank of Opelika*, 184 So.2d 815 (Ala.1966) and *Emery v. Ward*, 191 P. 99 (Col. 1920). We are unaware of and have not been cited any authorities from any other jurisdictions that have rejected this approach.

Finally, ABC argues that even if Kentucky adopts the *Restatement* position (as has now occurred in *Kentucky Legal Systems*), this case should fall within an exception which it proposes to that rule. ABC does not define exactly what the boundaries would be to this exception. However, none of the rules set out in cases which ABC cites from other jurisdictions would appear to benefit it in this case. ABC particularly relies on a Tennessee case, *ATS, Inc. v. Kent*, 27 S.W.3d 923 (Tenn. App. 1998). But *Kent* does not, in fact, support ABC's position. In *Kent*, a judgment lien was filed against an individual who owned real property at that time. He then sold that property, to which the judgment lien had already attached. His buyer borrowed money to purchase the property, and the dispute was between the *buyer's* purchase money lender and the *seller's* judgment creditor. The Tennessee court held that under these circumstances, the judgment lien had priority, as it had attached before the sale of the property ever took place. They distinguished *Guffey v. Creutzinger, supra*, on exactly these grounds. A purchase money lien is superior to a previously existing judgment lien

because it attaches the instant the purchaser acquires title. In *Slate v. Marion, supra*, the North Carolina court stated,

[w]hen a deed and a purchase money deed of trust are executed, delivered, and recorded as part of the same transaction, the deed of trust attaches at the instant the vendee acquires title and constitutes a lien superior to *all* others. (emphasis in original) *Slate*, 408 S.E.2d at 191.

In *Kent*, the judgment lien had attached long prior to the buyer acquiring the property, when it was still in the hands of the seller. We find no authority in *Kent* or elsewhere, nor any reason of policy, to carve out a new exception to the rule so recently adopted in *Kentucky Legal Systems*.

For the reasons set out above, the summary judgment of the Warren Circuit Court is reversed and this case is remanded for further proceedings consistent with this opinion.

ALL CONCUR.

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