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TO BE PUBLISHED

Commonwealth of Kentucky

Court of Appeals

NO. 2009-CA-002091-MR

W.M. SPECIALTY MORTGAGE, LLC

APPELLANT

v.

APPEAL FROM PULASKI CIRCUIT COURT
HONORABLE DAVID A. TAPP, JUDGE
ACTION NO. 03-CI-01058

COMMUNITY TRUST BANK, INC.;
DAVID FLOYD; AND KIM FLOYD

APPELLEES

OPINION
AFFIRMING

** ** * * * * *

BEFORE: TAYLOR, CHIEF JUDGE; KELLER, JUDGE; LAMBERT,¹ SENIOR JUDGE.

TAYLOR, CHIEF JUDGE: W.M. Specialty Mortgage, LLC, (Specialty Mortgage) brings this appeal from a September 14, 2009, summary judgment of the Pulaski Circuit Court adjudicating the priority of liens upon a tract of real property owned by David Floyd and Kim Floyd (the Floyds). We affirm.

¹ Senior Judge Joseph E. Lambert sitting as Special Judge by assignment of the Chief Justice pursuant to Section 110(5)(b) of the Kentucky Constitution and Kentucky Revised Statutes (KRS) 21.580.

We are called upon to review the circuit court's determination that Community Trust Bank, Inc., (Community Trust) held a prior and superior lien upon residential real property owned in fee simple by the Floyds. The record demonstrates that Community Bank extended a loan to the Floyds for the purchase of residential property and that Community Bank recorded a purchase-money mortgage lien upon such property on December 8, 1997. Thereafter, in 1999, Community Bank extended a commercial loan to the Floyds. As security for the commercial loan, Community Bank obtained liens upon two tracts of real property owned by the Floyds, one of which was the residential real property, previously encumbered by Community Bank's purchase-money mortgage. Community Bank recorded the mortgages upon the two tracts of real property on October 27, 1999.

The Floyds subsequently refinanced the mortgage debt on the residential property with Specialty Mortgage.² Specialty Mortgage forwarded Community Bank the full payoff amount of the loan and recorded a purchase-money mortgage lien on April 1, 2003. Unfortunately, the title examiner for Specialty Mortgage overlooked the prior recorded lien by Community Bank, which was obtained as additional collateral to secure the commercial loan to the Floyds in 1999.

Eventually, the Floyds defaulted upon the commercial loan and Community Bank initiated a foreclosure action against the Floyds to enforce the

² David and Kim Floyd originally refinanced the mortgage on the residential real property with Ameritrust Mortgage Company. However, W.M. Specialty Mortgage, LLC, is the successor in interest of Ameritrust, and we simply refer to Specialty Mortgage for simplicity and ease of reading.

liens against the two tracts of real property, including the residential property. Specialty Mortgage was named a defendant as it also held a recorded lien in the residential real property.

The foreclosure action was stayed after the filing of a bankruptcy proceeding by Kim Floyd in the United States Bankruptcy Court, Eastern District of Kentucky (bankruptcy court). The bankruptcy court ultimately lifted the stay, and the Pulaski Circuit Court thereupon adjudicated the priority of Community Bank's and Specialty Mortgage's respective lien claims to the residential real property owned by the Floyds. On September 14, 2009, the court granted Community Bank a summary judgment, holding that its lien claim was prior and superior to that of Specialty Mortgage. This appeal follows.

Summary judgment is proper where there exists no material issue of fact and movant is entitled to judgment as a matter of law. Kentucky Rules of Civil Procedure 56; *Steelvest, Inc. v. Scansteel Service Center, Inc.*, 807 S.W.2d 476 (Ky. 1991). The material facts of this case are undisputed and resolution centers upon a determination of the priority of Community Bank's and Specialty Mortgage's respective liens against the residential real property owned by the Floyds.

It is undisputed that Community Bank's lien upon the residential property was recorded on October 27, 1999, and constitutes the first in time recorded lien. Specialty Mortgage's lien was not recorded until April 1, 2003, some three and one-half years after the recording of Community Bank's lien. It is

also undisputed that Specialty Mortgage was unaware of Community Bank's prior recorded lien due to an error by its title examiner. If no such error had occurred, Community Bank's prior recorded lien would have been discovered by Specialty Mortgage at the time it refinanced the Floyds' indebtedness to Community Bank.

In this Commonwealth, the priority of liens upon real property is governed by Kentucky Revised Statutes (KRS) 382.280, which reads:

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.

This priority is commonly referred to as "race notice." Under our race-notice statute, the lien recorded first in time has priority and is superior over later recorded liens in the same real property. *See Midland-Guardian Co. v. McElroy*, 563 S.W.2d 752 (Ky. App. 1978). Thus, pursuant to the plain terms of KRS 382.280, Community Bank's lien has priority over Specialty Mortgage's lien upon the residential real property.

To avoid application of KRS 382.280, Specialty Mortgage urges this Court to apply the doctrine of equitable subrogation and cites to *Louisville Joint Stock Land Bank v. Bank of Pembroke*, 225 Ky. 375, 9 S.W.2d 113 (1928), as authority.³ Specialty Mortgage contends that its lien in the residential property was

³ We note that *Louisville Joint Stock Land Bank v. Bank of Pembroke*, 225 Ky. 375, 9 S.W.2d 113 (Ky. 1928) was rendered prior to enactment of KRS 382.280, our race-notice recording statute.

superior to Community Bank's lien under the doctrine of equitable subrogation.⁴

Specifically, Specialty Mortgage's argument is as follows:

The doctrine of equitable subrogation is long established in Kentucky and holds that one who satisfies a prior lien against real property steps into the shoes of that first lien holder, or to use the language of the cases, is "equitably subrogated" to the rights of the first lien holder, and so holds a prior, and superior lien. The basis for this doctrine is that it would not be equitable, and a form of unjust enrichment, for a second lien holder to be promoted to a position of priority when only the identity of the first lien holder to be promoted to a position of priority when only the identity of the first lien holder has changed but the debt owed has not. The "payoff" of the first lien is equivalent to an assignment of the lien to a different creditor by operation of law and does not extinguish the priority. (Citations omitted.)

.....

... Had appellant not substituted its loan for that of Community Trust, the second lien of Community Trust would still be second to the existing first mortgage, as had always been intended. Application of the doctrine of equitable subrogation merely maintains the status quo and preserves the lien of Community Trust in the same priority as when it was created. The application of equitable subrogation in no way impairs the expectations or rights of Community Trust. However, it does do equity to meet the expectations of [Specialty Mortgage] and Floyd that [Specialty Mortgage's] mortgage would be a first, prior, and superior lien on Floyd's residence when the only known encumbrances, Community Trust's first mortgage, delinquent taxes and mechanics liens, were paid from [Specialty Mortgage's] loan proceeds. Had that not been the expectation, the loan by Ameriquest would never have been made and the first

⁴ We observe that Specialty Mortgage advances no argument under the recent Kentucky Court of Appeals opinion of *Kentucky Legal Systems Corp. v. Dunn*, 205 S.W.3d 235 (Ky. App. 2006). However, we take this opportunity to question the soundness of the reasoning and holding in that decision based upon applicable real property law regarding lien priority in Kentucky.

mortgage of Community Trust would not have been paid in full.

Specialty Mortgage's brief at 5-7. We believe Specialty Mortgage's argument to be without merit.

In *Louisville Joint Stock Land Bank*, the Court applied the doctrine of equitable subrogation and explained that doctrine as follows:

Subrogation is a creature of equity, and rests upon principles of natural justice. Without attempting a comprehensive classification of cases in which the doctrine of subrogation may be applied, it is generally held that the right of subrogation will arise where the party claiming it has advanced money to pay a debt which, in the event of default by the debtor, he would be bound to pay; or where the one making the payment had some interest to protect; or where the money advanced to pay the debt was under an agreement with the debtor, or the creditor, express or implied, that he should be subrogated to the rights and remedies of the creditor.

Id. at 115. The Court summarized equitable subrogation as providing that a mortgage released or satisfied by mistake may be restored in equity to its original priority if the intervening third party would not be prejudiced thereby. *Id.*

However, pivotal to the Court's decision in *Louisville Joint Stock Land Bank* was the fact that an agreement existed between the borrower and the bank that the bank's prior recorded lien would be subordinate to the later in time recorded lien of a new lienholder.

By contrast, there existed no agreement between the Floyds and Community Bank that the bank's prior recorded lien would be subordinate to the later in time recorded lien of Specialty Mortgage. Without such an agreement, we

view *Louisville Joint Stock Land Bank* distinguishable from the instant case, and we are unwilling to broaden the scope of *Louisville Joint Stock Land Bank* to the facts at hand. *See id.*

Additionally, it must be observed that application of the doctrine of equitable subrogation rests upon the equities of any given case. *See id.* Herein, the record reveals that Community Bank extended a commercial loan to the Floyds and that the Floyds defaulted under the terms of said loan. In conjunction with the commercial loan, Community Bank obtained as additional collateral, which is customary in Kentucky to fully secure a loan or personal guaranty, a mortgage lien upon the Floyds' residential property. Thereafter, Specialty Mortgage obtained and recorded a mortgage lien upon the same residential real property. Through an error of the title examiner, Specialty Mortgage was unaware of Community Bank's prior lien. Considering these facts and the equities herein, we do not believe the circuit court erred by declining to apply the doctrine of equitable subrogation to re-prioritize the liens upon the Floyds' residential real property. The equities of this case simply do not favor application of equitable subrogation. Consequently, we hold that Community Bank held the prior and superior lien in the residential real property; thus, the circuit court properly rendered summary judgment so concluding.

We view any remaining arguments as moot or without merit.

For the foregoing reasons, the summary judgment of the Pulaski Circuit Court is affirmed.

ALL CONCUR.

BRIEFS FOR APPELLANT:

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BRIEF FOR APPELLEES:

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