

# Commonwealth Of Kentucky

## Court of Appeals

NO. 2002-CA-001147-MR

PEOPLES BANK OF BULLITT COUNTY

APPELLANT

v. APPEAL FROM BULLITT CIRCUIT COURT  
HONORABLE ROBERT A. MILLER,<sup>1</sup> SPECIAL JUDGE  
ACTION NO. 98-CI-00502

STOUT'S FEED STORE, INC,  
D/B/A STOUT'S BUILDING CENTER;  
FARM CREDIT SERVICES OF MID-AMERICA, ACA;  
JEFFREY A. PHILPOT; BULLITT COUNTY,  
KENTUCKY; AND COMMONWEALTH OF KENTUCKY

APPELLEES

OPINION  
AFFIRMING

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BEFORE: DYCHE, JOHNSON AND SCHRODER, JUDGES.

JOHNSON, JUDGE: Peoples Bank of Bullitt County has appealed from the findings of fact, conclusions of law and judgment entered by the Bullitt Circuit Court on April 29, 2002, which ordered that Stout's Feed Store had priority over Peoples Bank to the remaining proceeds from the sale of a tract of real

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<sup>1</sup> Judge Robert A. Miller was assigned this case as special judge pursuant to an order entered on June 27, 2001, which disqualified Bullitt Circuit Judge Thomas Waller as presiding judge.

estate. Having concluded that the trial court's factual findings were not clearly erroneous and that its ruling that Stout's Feed had priority over Peoples Bank was correct as a matter of law, we affirm.

On May 6, 1993, Jeffrey Philpot executed a promissory note and mortgage (hereinafter "93 Note" and "93 Mortgage")<sup>2</sup> to Peoples Bank with a final maturity date of May 6, 1994. The original principal was \$7,000.00, and the mortgage was on a 20-acre tract<sup>3</sup> located in Bullitt County, Kentucky. Paragraph 13 of the 93 Mortgage provided that if Peoples Bank made future advances to Philpot, such future advances were to be secured by the 93 Mortgage "when evidenced by promissory notes stating said sums are secured thereby." The 93 Mortgage "secure[d] any additional indebtedness whether direct, indirect, existing, future, contingent or otherwise in no event to exceed \$60,000.00 in addition to the amount loaned."

On June 22, 1996, Philpot executed a promissory note and mortgage to Peoples Bank (hereinafter "96 Note" and "96 Mortgage")<sup>4</sup> with a final maturity date of June 22, 1997. The

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<sup>2</sup> Peoples Bank lent Philpot the money for the purpose of purchasing and constructing homes in Bullitt County, Kentucky. The 93 Mortgage was recorded on May 11, 1993, in mortgage book 291, page 170, in the office of the Bullitt County Court Clerk.

<sup>3</sup> This 20-acre tract is also known as the Mt. Elmira Road tract.

<sup>4</sup> The 96 Mortgage was recorded on June 24, 1996, in mortgage book 365, page 188, in the office of the Bullitt County Court Clerk.

original principal was \$21,000.00, and the mortgage was on Lots 8 and 10 of Beech Grove Place, Bullitt County, Kentucky.<sup>5</sup> The 96 Mortgage also contained a future advances clause, which provided that Peoples Bank, at its option, may make future advances to Philpot prior to the release of this mortgage. Any future advances up to \$175,000.00 would be secured by the 96 Mortgage "when evidenced by promissory notes stating said sums are secured thereby."

On April 27, 1997, Stout's Feed filed a mechanic's lien on Lot 8, Beech Grove Place, on a claim against Philpot for \$12,328.00 plus interest and costs. Stout's Feed released its mechanic's lien on November 14, 1997, after it accepted \$3,000.00 and a promissory note from Philpot in the amount of \$13,162.27, with interest at a rate of ten percent per annum that was due and payable on May 14, 1998. To secure the promissory note, Stout's Feed accepted a mortgage from Philpot dated and filed on November 14, 1997 (hereinafter "Stout's Feed Mortgage")<sup>6</sup> on Lot 10, Beech Grove Place and the 20-acre tract. The Stout's Feed Mortgage provided:

Mortgagor warrants and covenants that  
Mortgagor is lawfully seized of the Property

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<sup>5</sup> The trial court found that Lot 8 was subsequently released by a partial release recorded in deed book 448, page 495, in the office of the Bullitt County Court Clerk.

<sup>6</sup> This mortgage was recorded in mortgage book 408, page 270, in the office of the Bullitt County Court Clerk.

and has the right to mortgage and convey same; that the Property is free from all encumbrances, liens, claims and charges, except the following encumbrances of record MTG to Peoples Bank of Bullitt County and that Mortgagor's heirs, executors, administrators, successors, and assigns will defend generally the title to the Property against all other claims and demands.

When Philpot failed to pay the note, Stout's Feed filed a complaint in the Bullitt Circuit Court on July 9, 1998, against Philpot, Peoples Bank, the Commonwealth of Kentucky, and Bullitt County.<sup>7</sup> On the same date the complaint was filed, Stout's Feed filed a notice of lis pendens as to Lot 10 and the 20-acre tract in the office of the Bullitt County Court Clerk.

On July 17, 1998, Peoples Bank filed its answer and cross-claim against Philpot, asserting that it had a first and superior lien on the subject properties. Peoples Bank maintained that on November 14, 1997, Philpot had signed a promissory note for \$34,538.87, with an interest rate of 9.25% per annum, (hereinafter "First 97 Note"), that was secured by the 93 Mortgage to Peoples Bank covering the 20-acre tract.<sup>8</sup> Peoples Bank also maintained that on November 14, 1997, Philpot had signed a promissory note for \$78,981.36, with an interest

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<sup>7</sup> Philpot was indebted to Stout's Feed in the sum of \$14,045.02 as of May 21, 1998, plus interests and costs from that date until paid. Stout's Feed included Peoples Bank, the Commonwealth of Kentucky, and Bullitt County as defendants because of their interest in the real property.

<sup>8</sup> In the First 97 Note under the heading entitled "COLLATERAL," it was stated: "This Note is secured by REAL ESTATE MORTGAGE OF MAY 6 1993. . . ."

rate of 9.95% per annum, (hereinafter "Second 97 Note"), that was secured by the 93 Mortgage to Peoples Bank covering the 20-acre tract and the 96 Mortgage to Peoples Bank covering Lot 10.<sup>9</sup> Peoples Bank alleged that it had a lien on the 20-acre tract for the \$36,692.10, plus interest that it was owed, and a lien on only Lot 10<sup>10</sup> for the \$84,191.65, plus interest that it was owed.<sup>11</sup>

Stout's Feed moved the trial court for a summary judgment and an order of sale, which the trial court entered on October 13, 1998. However, since Philpot had previously filed bankruptcy he moved the trial court to vacate the summary judgment and the order of sale, which the trial court granted on November 2, 1998. The trial court then referred the matter "to the [Master] Commissioner for determination of liens, their priority and amounts." Thereafter, the trial court ordered the Master Commissioner to sell the tracts, adding that the

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<sup>9</sup> In the Second 97 Note under the heading entitled "COLLATERAL," it was stated: "This Note is secured by REAL ESTATE MORTGAGE OF JUNE 22 1996 LOT 10 BEECH GROVE ROAD AND MTG OF MAY 6 1993."

<sup>10</sup> It is unclear why Peoples Bank did not assert a lien on the 20-acre tract for the Second 97 Note since that note referred to the 93 Mortgage which included the 20-acre tract.

<sup>11</sup> Farm Credit Services obtained a default judgment and order of sale against Philpot in Bullitt Circuit Court. Farm Credit Services acknowledged that its lien was inferior to both Stout's Feed's lien and Peoples Bank's lien. Furthermore, as Farm Credit Services has not appealed from the trial court's judgment, the facts regarding its involvement in the case sub judice are not relevant.

"[d]etermination of the priority and amount of liens is reserved until after the sale of the property."<sup>12</sup>

On March 14, 2001, the Commissioner filed his report and recommended that Peoples Bank's 93 Mortgage be deemed superior to the lien of Stout's Feed based on the finding that "the note was an additional advance which was secured by the 1993 mortgage." As to Stout's Feed's equitable argument, the Commissioner recommended a finding that "Mr. Hardy<sup>13</sup> did not intentionally mislead or deceive Mr. Stout [in releasing the mechanic's lien]."

Stout's Feed filed exceptions to the Commissioner's recommendation and report on March 23, 2001, and the matter was submitted to a special circuit court judge for a final determination. The trial court found that Peoples Bank had made additional loans to Philpot between May 6, 1993, and May 14, 1994, which totaled \$84,884.41, and that this amount exceeded the \$60,000.00 future advances clause by \$24,884.41, whereby any future advances in November 1997 would also have exceeded the future advances limitation. The trial court found that Peoples Bank had admitted that the 93 Note was marked "PAID" and delivered to Philpot on or about May 14, 1994. The trial court

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<sup>12</sup> The two real estate tracts were subsequently sold. Peoples Bank purchased Lot 10, Beech Grove Place, for \$45,000.00. Chester and Mary F. Philpot purchased the 20-acre tract for \$40,000.00.

<sup>13</sup> Mr. Hardy was the president of Peoples Bank.

also found that Peoples Bank's computer records indicated that the intervening notes from the 96 Note up to November 14, 1997, were "NEW" loans, rather than advances or extensions. The trial court further found that Peoples Bank had failed to produce any computer records in conformity with discovery requests to establish payments on the November 14, 1997, Promissory Note, and that Peoples Bank had failed to maintain a record of the loan history with copies of loan documents or notes to indicate that any subsequent loans were an extension of the original 93 Note and 93 Mortgage, or that any subsequent loans remained within the future advances clause limitations. The trial court concluded its factual findings by remarking that "[t]his was shoddy bookwork considering the number, size and complexity of the Philpot loans and properties involved[,]" and that Peoples Bank had the opportunity to form a paper trail regarding the loan history and to avoid the issue entirely, yet failed to do so.

The trial court determined that when Peoples Bank realized Stout's Feed had mechanic's liens on both Lots 8 and 10, and that it could not close the sale of Lot 8, Bill Hardy, the president and chief executive officer of Peoples Bank, contacted Kenneth Stout, the president of Stout's Feed, in order to negotiate a release of the mechanic's lien on Lot 8. The trial court found that as a result of these negotiations,

Peoples Bank agreed that Stout's Feed would receive \$3,000.00 and a note for \$13,162.27 from Philpot, with a mortgage on Lot 10 and the 20-acre tract in exchange for a release of its mechanic's lien on Lot 8.

The trial court further found that on November 14, 1997, after Philpot executed the note and mortgage to Stout's Feed and the sale of Lot 8 was closed with \$3,000.00 paid to Stout's Feed, Peoples Bank had Philpot execute two new notes to it. The \$34,538.87 note was secured by the 20-acre tract on the 93 Mortgage and the \$78,981.36 note was secured by Lot 10 on the 96 Mortgage. The trial court concluded that Peoples Bank was attempting to have the two 1997 loans take priority over Stout's Feed's mortgage on Lot 10 and the 20 acres.

The trial court found that the Stout's Feed Mortgage from Philpot to Stout's Feed indicated that the property being secured was free and clear of all liens, claims and encumbrances except "MTG to Peoples Bank of Bullitt County." The trial court determined the term "MTG" is in the singular; and thus, the trial court reasoned that only the 96 Mortgage had any balance owed on it at the time of execution of the Stout's Feed Mortgage.

The trial court also found that Peoples Bank had actual knowledge of Stout's Feed's mechanic's lien against Lots 8 and 10. Thus, the trial court found that Peoples Bank "knew



of the equitable interest of Stout's Feed before, not after, it had Philpot execute the new notes with itself," adding that it "knew it had not maintained copies of records of its prior notes with Philpot." The trial court cited State Street Bank & Trust Co. of Boston v. Heck's, Inc.,<sup>14</sup> which "precluded the creditor who was on notice from claiming priority over an equitable lien." The trial court found that "[Peoples Bank] tried to recover from its lack of diligence by leap frogging its priority back to 1993 over Stout['s] with which it had been negotiating."

The trial court concluded that while KRS 382.520<sup>15</sup> does not limit the length of time in which Peoples Bank could provide

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<sup>14</sup> Ky., 963 S.W.2d 626 (1998).

<sup>15</sup> KRS 382.520 provides, in pertinent part, as follows:

(1) In all cases where a loan is secured by a real estate mortgage, the mortgage originally executed and delivered by the borrower to the lender shall secure payment of all renewals and extensions of the loan and the note evidencing it, whether so provided in the mortgage or not.

(2) The mortgage referred to in subsection (1) of this section may secure any additional indebtedness, whether direct, indirect, existing, future, contingent, or otherwise, to the extent expressly authorized by the mortgage, if the mortgage by its terms stipulates the maximum additional indebtedness which may be secured thereby. Except as provided in subsection (3) of this section, the mortgage lien authorized by this subsection shall be superior to any liens or encumbrances of any kind created after recordation of such mortgage, even to the extent of sums advanced by a lender with actual or constructive notice of a subsequently created lien, provided, however, any mortgagee upon receipt of a written request of a mortgagor must release of record the lien to secure additional indebtedness as exceeds the balance of such additional indebtedness at the time of the request.

Philpot with future advances, that Peoples Bank's lien could not take priority over Stout's Feed's intervening lien. The trial court also ruled that, by its conduct, Peoples Bank should be estopped and barred from asserting priority over Stout's Feed on the proceeds from the 20-acre tract, even though Peoples Bank retained priority to the Lot 10 proceeds. This appeal followed.

In this appeal Peoples Bank claims that regardless of whether the 93 Mortgage had been paid in full or not, the trial court erred in finding that Stout's Feed's lien on the 20-acre tract had priority over its lien.<sup>16</sup> As a reviewing Court, we review the trial court's factual findings under a clearly erroneous standard and the legal issues de novo.<sup>17</sup> Factual findings are not clearly erroneous if they are supported by substantial evidence.<sup>18</sup> "Substantial evidence has been conclusively defined by Kentucky courts as that which, when taken alone or in light of all the evidence, has sufficient probative value to induce conviction in the mind of a reasonable person" [citations omitted].<sup>19</sup>

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<sup>16</sup> Peoples Bank's five-page brief provides this Court with little assistance in resolving the issues before us.

<sup>17</sup> Carroll v. Meredith, Ky.App., 59 S.W.3d 484, 489 (2001).

<sup>18</sup> Id. (citing Kentucky Rules of Civil Procedure (CR) 52.01).

<sup>19</sup> Bowling v. Natural Resources & Environmental Protection Cabinet, Ky.App., 891 S.W.2d 406, 409 (1994).

Peoples Bank contends that the trial court erred by relying upon First Nat'l Bank of Grayson v. Citizens Deposit Bank & Trust,<sup>20</sup> because, unlike the case sub judice, it involved a security instrument controlled by the Uniform Commercial Code. In First Nat'l Bank of Grayson, this Court held that when the bank marked a security agreement<sup>21</sup> "PAID" it had the effect of releasing the bank's security interest. In the case sub judice, the trial court noted that while there was "no corollary statute to the Uniform Commercial Code provisions in the statutes dealing directly with mortgages, [Peoples Bank] failed to meet its burden to establish any notes of Philpot between the payoff of the original \$7,000.00 note to November 14, 1997 were secured by the 93 Mortgage."

We conclude that the trial court's findings of fact were not clearly erroneous, and the trial court correctly ruled that Stout's Feed had priority over Peoples Bank. Peoples Bank's computer records indicate that as of May 14, 1994, the 93 Note had a balance of \$0. Additionally, Peoples Bank's computer records indicate that all intervening notes until November 14, 1997, were "NEW" loans. The debt on the 93 Note was extinguished. When a debt is extinguished, the mortgage

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<sup>20</sup> Ky.App., 735 S.W.2d 328 (1987).

<sup>21</sup> The Court recognized that a note, not a security agreement, is paid.

similarly ends.<sup>22</sup> Stout's Feed correctly cites Nolin Production Credit Association v. Citizens National Bank of Bowling Green,<sup>23</sup> for the rule that if a new note extinguished an old debt, the mortgage securing the old debt must fail in an attempt to enforce a debt on a future advances clause since there is no longer an underlying obligation on the old note to base an advance.

Kentucky adheres to the general rule that "payment of the secured debt extinguishes the lien of the mortgage or deed of trust by itself and instantaneously, for the benefit of whoever is owner of the property at the time of payment" [footnotes omitted].<sup>24</sup> Moreover, "anything which operates to extinguish the debt necessarily operates to discharge the mortgage, on the ground that the incident cannot survive the principal, although it is sometimes declared that nothing short of an actual payment of the debt or an express release will operate to discharge a mortgage" [footnotes omitted].<sup>25</sup> In the case sub judice, the record reflects that the 93 Note was paid

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<sup>22</sup> Warning's Ex'r v. Tabelaing, 280 Ky. 232, 236, 133 S.W.2d 65, 67 (1939). This holding is in accord with the law in other jurisdictions: Matherne v. Purdy, La.Ct.App., 576 So.2d 621, 623 (1991) (citing Thrift Funds Canal, Inc. v. Foy, 261 La. 573, 260 So.2d 628 (1972)); Goetz v. Selsor, Mo.Ct.App., 628 S.W.2d 404, 406 (1982) (citing Voelpel v. Wuensche, Mo., 74 S.W.2d 14, 20 (1934)); 59 C.J.S. Mortgages § 453, pp. 708-711; Spencer-Sauer Lumber Co. v. Ballard, Tex.App., 98 S.W.2d 1054, 1057 (1936).

<sup>23</sup> Ky.App., 709 S.W.2d 466, 467 (1986).

<sup>24</sup> 55 Am.Jur.2d Mortgages § 359 (1996).

<sup>25</sup> Id.

down to \$0. Thus, as there was an actual payment of Philpot's debt, the 93 Mortgage was discharged and its future advances clause could not be utilized to secure a subsequent loan.

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

ALL CONCUR.

BRIEF AND ORAL ARGUMENT FOR  
APPELLANT:

John W. Wooldridge  
Shepherdsville, Kentucky

BRIEF AND ORAL ARGUMENT FOR  
APPELLEE, STOUT'S FEED STORE:

John F. Carroll  
Shepherdsville, Kentucky

ORAL ARGUMENT FOR APPELLEE,  
FARM CREDIT SERVICES OF MID-  
AMERICA:

Logan B. Askew  
Hopkinsville, Kentucky