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Commonwealth Of Kentucky

Court of Appeals

NO. 2003-CA-001512-MR

JEFF JONES AND
ANN JONES

APPELLANT

v. APPEAL FROM LINCOLN CIRCUIT COURT
HONORABLE WILLIAM T. CAIN, JUDGE
ACTION NO. 01-CI-00437

PBK BANK

APPELLEE

OPINION
VACATING AND REMANDING

** ** * * *

BEFORE: JOHNSON, TACKETT, AND SCHRODER, JUDGES.

JOHNSON, JUDGE: Jeff Jones and his wife, Ann Jones, have appealed from an order of the Lincoln Circuit Court entered on March 12, 2003, which granted summary judgment to PBK Bank. The trial court ruled that PBK Bank had properly applied loan proceeds received on behalf of the Joneses from Bank One, NA¹ to a chattel mortgage and that PBK Bank had a first and superior

¹ Bank One, NA was a defendant in this action, but was not named a party on appeal. It received judgment on its cross-claim on April 9, 2003.

mortgage lien upon the Joneses' real estate. Having concluded that the trial court erred by determining that there was no genuine issue as to any material fact and that PBK Bank was entitled to judgment as a matter of law, we vacate and remand.

On December 27, 1999, the Joneses signed a promissory note in favor of Peoples Bank of Kentucky, the predecessor of PBK Bank, in the amount of \$32,352.55 and executed a mortgage on the same date, securing the note with real estate. This 1999 note was a refinancing of a note and second real estate mortgage dated September 12, 1998. The 1998 and 1999 loans were both negotiated by PBK Bank loan officer, Jeff Singleton. The Joneses' business, Maverick Environmental Construction Services, also had loans with PBK Bank that were supervised by PBK Bank loan officer, Bob Folger. Thus, PBK Bank had both a personal banking and business banking relationship with the Joneses. In fact, at the time of filing this suit against the Joneses, PBK Bank had a pending lawsuit against Maverick.

On September 25, 2000, the Joneses borrowed money from Bank One, and executed in its favor a promissory note and real estate mortgage for \$194,000.00. The real estate secured a first mortgage to Farmers National Bank and the second real estate mortgage to PBK Bank. In addition to the second mortgage lien on the real estate, the Joneses also had a debt to PBK Bank

of approximately \$26,000.00 secured by liens on a 1996 Dodge truck and 1981 Case tractor.

Evidence before the trial court at the time summary judgment was granted included the Joneses' depositions and the in-court testimony of Jeff Jones and Bruce Edgington, Chief Executive Officer of PBK Bank, who was a loan officer and director of lending at the time the loans were made. The Joneses testified that the purpose of the Bank One loan was to refinance and pay off the real estate loans in favor of Farmers National Bank and PBK Bank. According to Jones's testimony, the loan with Bank One originated in the late summer or early fall of 2000, when Singleton asked him if he had considered refinancing the loans on the real estate to take advantage of lower interest rates. Jones asked Singleton if he and Ann were in a position to refinance and whether refinancing would cause them any problems with PBK Bank. Singleton stated that PBK Bank was trying to move some of its notes to other institutions. He stated that he had contacts at Collateral One Mortgage, Inc., a title company in Lexington that would help with the refinancing.² Collateral One supervised the details of the Bank One loan closing.

As part of the application process, Jeff Jones told Bank One that there was a second mortgage on the real estate

² Singleton eventually went to work at Collateral One.

with PBK Bank. Jones testified that Bank One told him it had to collect this information itself, so he told Bank One that it should contact Singleton. Jones asserted that Singleton provided whatever information was needed by Bank One after completion of the initial loan application by the Joneses, including the PBK Bank loan numbers. It is not clear from the evidence whether Collateral One or the closing attorney for Bank One received the account numbers from PBK Bank. Jones testified that he never checked to see that the proper account number for the note and mortgage was given because Bank One was dealing with Singleton who had a business relationship with the mortgage broker, Collateral One. However, Edgington testified there was no record in the PBK Bank loan file that Singleton had communicated with Bank One or Collateral One.

The Joneses asserted that Bank One required the balance remaining on Farmers National Bank's first mortgage and PBK Bank's second mortgage to be paid off and their mortgages released against the real estate, giving Bank One a first, prior and superior mortgage lien against the real estate. Prior to closing, Collateral One faxed a request to PBK Bank requesting a payoff amount for loan #67204186370, which was the note and real estate mortgage that had been executed in 1998. The previous mortgage that evidenced this loan, dated September 12, 1998, had not been released even though the loan had been refinanced in

December 1999, and a new mortgage filed. Edgington contended that the 1998 mortgage would not have been released until requested by the borrower if the line of credit provision was elected by the borrower and noted on the mortgage. However, it appears from the evidence of record that this provision was not elected by the Joneses on this mortgage, so there is no evidence in the record to support it not being released.

PBK Bank faxed a notice to Collateral One on September 18, 2000, stating that loan #6704186370 had been "paid out." However, it is unclear from the evidence in the record whether PBK Bank informed Collateral One that the note had been refinanced by the note and mortgage dated December 27, 1999. Edgington testified that even though the note had not been paid off, but rather refinanced, he did not feel that it was misleading to state that the note had been "paid out." Edgington did acknowledge that by PBK Bank receiving a payoff request that PBK Bank was being made aware of the fact that a customer was attempting to refinance. Collateral One then faxed a request for a payoff on account #67204186820, which did not involve the real estate, but rather evidenced the loan secured by a 1996 Dodge truck and a 1981 Case tractor.

At the closing of the loan with Bank One, the proceeds of \$97,388.40 were disbursed to Farmers National Bank and applied to its first mortgage, which it released; and proceeds

of \$26,496.50 were disbursed to PBK Bank, which it applied to the tractor/truck loan, rather than the real estate second mortgage. Thus, PBK Bank did not release its mortgage on the Joneses' real estate. When the disbursed proceeds exceeded the payoff on the tractor/truck loan, Edgington attributed this surplus to payments made by the Joneses' before the payoff was made, and the \$782.19 in excess proceeds were placed by PBK Bank into the Joneses' checking account at PBK Bank.

The check issued by Collateral One to PBK Bank, designated its purpose as "mortgage payoff." The stub of the check contained the notations "REAL ESTATE CLOSING" and "For: Mortgage Payoff." These were the only instructions given to PBK Bank by Collateral One. Edgington testified that to his knowledge no one at PBK Bank had communicated with Bank One regarding the fact that the check included the notation "mortgage payoff" because the amount of the check matched the previously requested payoff on the chattel loan. Further, Edgington testified that PBK Bank had never received a request for release of the mortgage from Bank One.

Edgington testified regarding three of the payments Jeff Jones made to PBK Bank after the date the tractor/truck loan was paid off: (1) a check dated December 16, 2000, in the amount \$2,032.56 (equivalent to three monthly payments of \$677.52 on the second mortgage); (2) a check dated

May 1, 2001, in the amount of \$1,038.08, which included the notation "2nd mortgage on farm;" and (3) a check dated May 11, 2001, in the amount of \$2,700.00, which included the notation "2nd mortgage." Edgington testified that he did not know of any communication between PBK Bank and the Joneses regarding the second mortgage after the Bank One closing. However, he testified that there was less correspondence in the Joneses' PBK Bank file than was customary.

Apparently, the May 11, 2001, payment was the last payment received by PBK Bank and attributed by it to the debt secured by the second mortgage. PBK Bank wrote the Joneses a letter dated November 29, 2001, questioning their failure to pay on the loan secured by the real estate mortgage. On December 14, 2001, Jones wrote a letter to PBK Bank stating that he and Ann thought the second mortgage on the real estate had been paid off through the Bank One loan and that any subsequent monies they had paid PBK Bank had been applied to other debts.

Then, on December 27, 2001, PBK Bank filed a complaint to collect the debt allegedly owed by the Joneses and to foreclose on the real estate. PBK Bank alleged that it had a valid first and prior mortgage lien on the real estate and that the Joneses had defaulted on their obligations under the

promissory note dated December 27, 1999.³ On January 22, 2002, the Joneses filed an answer and counterclaim. They claimed that PBK Bank's loan on the real estate had been voluntarily paid off with proceeds from the Bank One loan at the time of their refinancing in September 2000, but that PBK Bank had chosen to apply the proceeds to another loan it had with the Joneses, which was not secured by a mortgage on the real estate. They alleged that PBK Bank had refused to release its mortgage, in violation of KRS⁴ 382.365.⁵ The Joneses further alleged that PBK

³ There were two counts originally in PBK Bank's complaint. Count two was dismissed by the trial court on March 29, 2002.

⁴ Kentucky Revised Statutes.

⁵ KRS 382.365 provides in relevant part as follows:

- (1) A holder of a lien on real property, including a lien provided for in KRS 376.010, shall release the lien in the county clerk's office where the lien is recorded within thirty (30) days from the date of satisfaction.
- (2) A proceeding may be filed by any owner of real property or any party acquiring an interest in the real property in District Court or Circuit Court against a lienholder that violates subsection (1) of this section. A proceeding filed under this section shall be given precedence over other matters pending before the court.
- (3) Upon proof to the court of the lien being satisfied, the court shall enter a judgment releasing the lien. The judgment shall be with costs including a reasonable attorney's fee. If the court finds that the lienholder received written notice of its failure to release and lacked good cause for not releasing the lien, the lienholder shall be liable to the owner of the real property in the amount of one hundred dollars (\$100) per day for each day, beginning on the fifteenth day after receipt of the

Bank had misappropriated, concealed, misapplied, and converted the proceeds paid to it by Bank One, causing damages in the amount of the payoff made to PBK Bank, with interest. The Joneses further demanded punitive damages.

PBK Bank filed a motion for summary judgment and order of sale. After a hearing was held on January 13, 2003, the trial court concluded that there was no genuine issue as to any material fact and that PBK Bank was entitled to judgment as a matter of law. The trial court entered an order on March 12, 2003, finding PBK Bank to have a first and superior mortgage lien on the real estate and granting it summary judgment. In summary the trial court found: (1) that there was no misconduct by PBK Bank and no misapplication of the payoff from Bank One, but, rather, that PBK Bank had followed the request for payoff made by the Joneses as a direct result of their meeting with Collateral One, and therefore did not violate any duty to the Joneses; (2) that it was the duty of the Joneses to ensure that

written notice, of the violation for which good cause did not exist.

- (4) A lienholder that continues to fail to release a satisfied real estate lien, without good cause, within forty-five (45) days from the date of written notice shall be liable to the owner of the real property for an additional four hundred dollars (\$400) per day for each day for which good cause did not exist after the forty-fifth day from the date of written notice, for a total of five hundred dollars (\$500) per day for each day for which good cause did not exist after the forty-fifth day from the date of written notice. The lienholder shall also be liable for any actual expense including a reasonable attorney's fee incurred by the owner in securing the release of real property by such violation.

Collateral One had the proper loan account number to pay off the mortgage and that it was the obligation of Collateral One or Bank One to verify the account which was being paid off; and (3) that the existing loan to PBK Bank was not paid off, as evidenced by the Joneses' own checks to PBK Bank after the date of Bank One's mortgage. The Joneses filed a motion to vacate the order and a hearing was held on May 30, 2003. The trial court denied the motion by order dated July 10, 2003. This appealed followed.

Under Kentucky law, "[t]he standard of review on appeal of a summary judgment is whether the trial court correctly found that there were no genuine issues as to any material fact and that the moving party was entitled to judgment as a matter of law."⁶ The trial court must review the pleadings, depositions, and discovery evidence to determine whether summary judgment is proper.⁷ Since "factual findings are not at issue,"⁸ an appellate court need not defer to the trial court's decision on summary judgment. An appellate court will review the issue de novo since it "involves only legal questions and the existence of any disputed material issues of fact."⁹ The Supreme

⁶ Scifres v. Kraft, Ky.App., 916 S.W.2d 779, 781 (1996); Kentucky Rules of Civil Procedure (CR) 56.03.

⁷ CR 56.03.

⁸ Barnette v. Hospital of Louisa, Inc., Ky.App., 64 S.W.3d 828, 829 (2002).

⁹ Lewis v. B & R Corp., Ky.App., 56 S.W.3d 432, 436 (2001).

Court has stated that "[t]he proper function for a summary judgment . . . 'is to terminate litigation when, as a matter of law, it appears that it would be impossible for the respondent to produce evidence at the trial warranting a judgment in his favor and against the movant.'"¹⁰ The term "impossible" is to be applied in a practical sense, not in an absolute sense.¹¹

However, summary judgment is not considered a substitute for a trial, so the trial court must review the evidentiary record not to decide any issue of fact, but to determine if any real factual issue exists and whether the non-movant cannot prevail under any circumstances.¹²

Moreover, "[t]he record must be viewed in a light most favorable to the party opposing the motion for summary judgment and all doubts are to be resolved in his favor."¹³ The movant bears the initial burden of convincing the trial court by evidence of record that there is no genuine issue as to any material fact, which then shifts the burden to the party opposing summary judgment. "[A] party opposing a properly supported summary judgment motion cannot defeat it without

¹⁰ Paintsville Hospital Co. v. Rose, Ky., 683 S.W.2d 255, 256 (1985) (quoting Roberson v. Lampton, Ky., 516 S.W.2d 838, 840 (1974)). See also Steelvest, Inc. v. Scansteel Service Center, Inc., Ky., 807 S.W.2d 476, 480 (1991).

¹¹ Perkins v. Hausladen, Ky., 828 S.W.2d 652, 654 (1992).

¹² Steelvest, 807 S.W.2d at 480.

¹³ Id.

presenting at least some affirmative evidence showing that there is a genuine issue of material fact for trial,"¹⁴ but, the threshold is quite low.¹⁵ The key phrase is "properly supported summary judgment motion." In other words, the evidence presented by the moving party in support of its summary judgment "must be of such a nature that no genuine issue of fact remains to be resolved."¹⁶ Otherwise, summary judgment is improper even when the party opposing summary judgment presents no contradicting evidence.¹⁷

The Joneses argue that the trial court decided factual questions on the merits since there were genuine and substantial disputes regarding the version of the evidence accepted by the trial court. The Joneses further assert (1) that the trial court erred in applying the law regarding involuntary payments because the "mortgage payoff" to PBK Bank by Bank One was a voluntary payment and should have been applied to the real estate loan as designated; (2) that the trial court, without any supporting legal authority, imposed a legal duty on the Joneses and Bank One to ensure that the proper loan account number

¹⁴ Id. at 482.

¹⁵ Commonwealth, Transportation Cabinet, Dept. of Highways v. R.J. Corman Railroad Company/Memphis Line, Ky., 116 S.W.3d 488, 498 (2003).

¹⁶ Hartford Insurance Group v. Citizens Fidelity Bank & Trust Co., Ky.App., 579 S.W.2d 628, 631 (1979).

¹⁷ Hartford, 579 S.W.2d at 631; and Carter v. Jim Walter Homes, Inc., Ky.App., 731 S.W.2d 12, 14 (1987).

accompanied the payment to PBK Bank; (3) that the trial court incorrectly supported its granting of summary judgment with evidence of the Joneses' payments to PBK Bank subsequent to the application of the Bank One proceeds, because the payments had no relevance to the fact that PBK Bank misapplied the proceeds in the first place; and (4) that PBK Bank confused Collateral One by failing to disclose that its initial payoff request was for a note that had been refinanced, not paid in full, and that it confused the trial court by stating that the original payoff request did not involve the real estate, when in fact it did.

The Joneses contend that the proceeds from the Bank One loan were a voluntary payment to PBK Bank on their real estate loan that had been specifically designated as a mortgage payoff. Under Kentucky law, when a debtor designates the manner of payment, a creditor must make the requested application. However, the rule does not apply when there is no designation.¹⁸ When the debtor does make a designation of payment, it does not need to be expressed in writing or delivered in any particular manner. It is sufficient if the intention is manifest and comes to the attention of the other party at the proper time.¹⁹ The debtor's intention may also be implied from the circumstances at

¹⁸ McDaniel v. Barnes, White & Co., 5 Bush 183 (1868); Hargis Bank & Trust Co. v. Gambill, 234 Ky. 538, 28 S.W.2d 769, 770 (1930).

¹⁹ Tayloe v. Sandiford, 20 U.S. 13, 5 L.Ed. 384 (1822).

the time of payment.²⁰ Even if a creditor enjoys a right to unilaterally apply the payment, this right may be denied for the protection of a third party's superior equity, or where the creditor had reason to know that the funds were derived from a source unrelated to the debt to which it now attempts to apply the payment.²¹ If a debtor is under a duty to a third person to apply a payment to the discharge of a particular debt, and the creditor knows or has reason to know of such duty, the payment must be so applied.²² The determination of whether the payment was voluntary or involuntary is an issue that must be addressed in order to determine whether the proceeds were properly applied.

In its order, the trial court imposed a duty on the Joneses to give Collateral One the proper loan account number to ensure that the mortgage loan was paid off and it imposed a duty on Collateral One and Bank One to verify the account number. However, neither PBK Bank nor the trial court cites any legal authority to support this position. Pursuant to Beck, supra, PBK Bank may have had a duty to verify that it correctly applied the Bank One proceeds if it had knowledge of the Joneses' attempt to refinance, either through custom or direct

²⁰ Id. 20 U.S. at 20.

²¹ Ellingsen v. Western Farmers Association, 529 P.2d 1163, 1166 (Wash. App. 1974).

²² United States for Use of Carroll v. Beck, 151 F.2d 964, 966 (6th Cir. 1945).

involvement with the Joneses' loan with Bank One. Edgington testified that when a payoff request came to PBK Bank, it understood that the client might desire to refinance. Further, it is unclear what Singleton's role, and thus PBK Bank's role, was in securing the Joneses' loan with Bank One.

The trial court based its decision, in part, on the belief that Jeff Jones provided account numbers for the payoffs; and that as a direct result of a meeting between the Joneses and Collateral One, the specific payoffs were requested. Jones testified that he took no part in obtaining the loan numbers for the payoffs, and that Singleton was the person who had provided this information. Further, PBK Bank's file contained no proof to show who provided the account numbers for the payoff. Thus, there is nothing in the record to support PBK Bank's allegations, nor the trial court's findings, that Jones provided Bank One with the account to be paid off. Furthermore, Jones's testimony regarding his relationship with PBK Bank and Singleton definitely presented a factual question as to PBK Bank's involvement and its knowledge of the Joneses' refinancing attempts, and whether PBK Bank had correctly applied the loan proceeds.

The trial court also relied upon the three subsequent payments by the Joneses to PBK Bank after the payoff of the tractor/truck loan. However, there was a dispute as to whether

the Joneses understood that this money was being applied to the mortgage debt instead of the chattel debt. Edgington testified that the Joneses never raised any issue regarding the subsequent payments. However, Jones testified that due to his and Ann's personal and business relationships with PBK Bank, it was customary for Singleton or another bank employee to call them and to tell them to make a payment, and they made the payments without questioning the account to which the payments were to be applied. PBK Bank did not dispute this claim. Thus, since the purpose of the subsequent payments is in dispute, the trial court erred in relying on these subsequent payments to award summary judgment.

Regardless of the purpose of these payments, it must first be determined whether PBK Bank misapplied the Bank One proceeds. Jones's testimony provided motives for PBK Bank's possible deliberate misapplication of the proceeds, including proof of the lawsuit pending by PBK Bank against Maverick and the fact that the second mortgage lien on the real estate was PBK Bank's only recourse on the Maverick loans. Jones contended that he and Ann felt deceived by PBK Bank; they alleged that misapplication of the loan proceeds from Bank One was part of a scheme to improve its own embarrassing financial condition by obtaining mortgage payoff proceeds without releasing the mortgage. Jones testified that he had been told of this scheme

indirectly by Folger and John Nichols, another employee of PBK Bank.

The trial court's decision was also predicated on the belief that the initial payoff request was for a loan that did not involve the real estate. These facts are disputed by the Joneses and, in fact, even PBK Bank filed a correction in the record stating that the loan, for which a payoff was initially requested, did involve the real estate. This erroneous finding by the trial court is significant because it is unclear whether PBK Bank informed Collateral One that its initial payoff request was on a loan that had been refinanced into a loan for which PBK Bank had a mortgage lien at the time of the Bank One closing. If the trial court had understood that the initial payoff request was for the real estate loan, it may have ruled differently because of the possible misunderstanding by Collateral One as to the existence of a PBK Bank real estate mortgage.

Accordingly, we conclude that these genuine issues of material fact should have precluded the trial court from determining that it was impossible for the Joneses to prevail at trial. Further, even if the evidence in the record shifted the burden of proof to the Joneses, Jones's testimony regarding his discussions with Singleton, which PBK Bank could not explain and did not deny, met the threshold to defeat summary judgment.

Thus, viewing the record most favorably to the Joneses and resolving all doubts in their favor, we conclude that there were genuine issues as to material facts regarding the allegations of PBK Bank's complaint so as to preclude summary judgment.

For the foregoing reasons, the order of the Lincoln Circuit Court granting summary judgment to PBK Bank is vacated and this matter is remanded for further proceedings consistent with this Opinion.

ALL CONCUR.

BRIEFS AND ORAL ARGUMENT FOR
APPELLANT:

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BRIEF AND ORAL ARGUMENT FOR
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