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NOT TO BE PUBLISHED

Commonwealth Of Kentucky

Court Of Appeals

NO. 2004-CA-001225-MR

NATASHA COOK — APPELLANT

v.

APPEAL FROM MARION CIRCUIT COURT
HONORABLE DOUGHLAS M. GEORGE, JUDGE
ACTION NO. 03-CI-00210

SPRINGFIELD STATE BANK,
JOHN PRICE, KASSANDRA COOK,
AND FOSTER RAY COOK — APPELLEES

OPINION
AFFIRMING

** ** ** ** **

BEFORE: KNOPF, TAYLOR, AND VANMETER, JUDGES.

KNOPF, JUDGE: Natasha Cook appeals from an order of the Marion Circuit Court, entered May 17, 2004, distributing proceeds of a foreclosure sale to Springfield State Bank. Natasha contends that the Bank's share of the proceeds should have been limited to about $200.00, not the nearly $5,500.00 it was awarded, and

that Natasha and her sister are entitled to the difference. We affirm.

The facts provided by the scant record are not in dispute. In October 1999, John Price borrowed $10,000.00 from the bank, in exchange for which Price gave the bank a note in that amount secured by a mortgage on a house and lots he owned on Fairground Road in Lebanon. The mortgage contained the following future advance clause:

> In addition to the indebtedness above mentioned, this mortgage shall secure any additional indebtedness, whether direct, indirect, existing, future, contingent or otherwise, including any additional sum or sums of money advanced or loaned by the Mortgagee to the Mortgagor at any time, not to exceed the maximum additional indebtedness of $10,000.00; provided, however, the aggregate indebtedness of any kind whatsoever at any time secured hereby shall not exceed the sum of $20,000.00.

The mortgage was duly recorded in the Marion County property records on or about October 30, 1999.

Although Price had agreed not to alienate the Fairground Road collateral without the bank's approval, on December 9, 2000, he transferred it without the bank's knowledge but by duly recorded deed to Steve Cook. The stated consideration was primarily Cook's assumption of the bank's mortgage "in the approximate sum of twenty thousand dollars." Steve Cook died intestate in early 2001, whereupon his interest

in the property passed to his three children: Natasha, Kassandra, and Foster Ray.[1]

In October 2001, Price borrowed an additional $30,612.00 from the bank. Notwithstanding the transfer to Cook, Price's note recites that this amount is to be added to the October 1999 mortgage on the Fairground Road realty. The new loan was also secured by two certificates of deposit. Eventually Price defaulted on both notes. In July 2003, the bank brought the present action to recover principal balances of $100.00 on the 1999 note and $29,958.90 on the 2001 note plus interest and fees. Apparently the bank applied the certificates of deposit to the latter debt and obtained default judgments against Price on both notes in the amounts of $106.07 and $21,628.62 respectively. Contending that the entire indebtedness was secured by the Fairground Road mortgage, the bank then sought to foreclose on the realty.

Natasha resisted the foreclosure. She argued that notwithstanding the future advance clause in the 1999 mortgage, Price's transfer of the property in 2000 precluded his adding to the encumbrance in 2001. The bank's lien, therefore, extended only to the amount still outstanding on the 1999 loan, which Natasha was willing to pay. The trial court rejected Natasha's

[1] Foster Ray has waived any interest in the property or its proceeds; Kassandra has elected not to join in Natasha's appeal.

argument and permitted the foreclosure. The property sold at auction for $9,000.00. After deductions for taxes and other costs, there remained net proceeds of about $5,500.00, which the trial court awarded to the bank. On appeal, Natasha, without citing any supporting authority, reiterates her argument that no part of the bank's 2001 loan to Price could be secured by the 1999 mortgage because prior to the loan Price had transferred his interest in the collateral. Accordingly, Natasha asserts, she and her sister, rather than the bank, are entitled to the net proceeds from the sale. We disagree.

Kentucky's courts, like other courts throughout the country, have long recognized the commercial utility and the validity of mortgage clauses providing for the extension of a given security to advances on a loan made, if and when needed, after the loan and security were first established.[2] The general rule is that the initial security will be extended to future advances if the original agreement clearly intended to cover such advances and if the advance in question is of a type and

[2] Taulbee v. First National Bank of Jackson, 279 Ky. 153, 130 S.W.2d 48 (1939); Kentucky Lumber & Mill Work Company v. Kentucky Title Savings Bank & Trust Company, 184 Ky. 244, 211 S.W. 765 (1919); First Commonwealth Bank of Prestonsburg v. West, 55 S.W.3d 829 (Ky.App. 2000); Shutze v. Credithrift of America, Inc., 607 So.2d 55 (Miss. 1992); Milton Roberts, "Debts Included in Provision of Mortgage Purporting to Cover All Future and Existing Debts (Dragnet Clause)—Modern Status," 3 ALR4th 690 (1981).

for a purpose within that original intention.[3] Furthermore, as the bank notes, KRS 382.385 provides for the extension of a single mortgage to on-going "lines of credit" and "revolving credit plans." Although the Bank's agreement with Price clearly was not a line of credit or a revolving credit plan, the statute does indicate that mortgage clauses providing for future advances are well established in Kentucky law. KRS 382.520, moreover, provides that real estate mortgages "may secure any additional indebtedness, whether direct, indirect, existing, future, contingent, or otherwise, to the extent expressly authorized by the mortgage."

The question then arises as to the effect of a duly perfected future-advance clause when a subsequent equitable interest, that of a second mortgagee, say, or, as in this case, of a purchaser, intervenes between the original mortgage and the advance. KRS 382.520 address this situation as follows:

> 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

[3] 3 ALR4th 690 (1981); In re Smink, 276 B.R. 156 (N.D.Miss. 2001).

> additional indebtedness at the time of the request.

Although this statute refers to "liens and encumbrances" and to "a subsequently created lien," the bank contends that it applies as well to subsequent conveyances such as that between Price and Steve Cook. We need not address that question, because even if the statute does not apply, the general rule, which would otherwise be consistent with Kentucky law, is that a mortgagee, with a duly recorded mortgage and without actual knowledge of an intervening purchaser (constructive notice is not enough), may rely on a valid future advance clause to extend additional credit to its mortgagor. The lien arising under the future advance clause is superior to the interest of the intervening purchaser.[4]

Natasha does not challenge the validity of the 1999 future advance clause, nor does she allege that the bank had actual knowledge of the transfer from Price to her father. Price and the bank clearly intended for that clause to apply to

[4] Shutze v. Credithrift of America, Inc., *supra* (citing Whiteway Finance Co., Inc. v. Green, 434 So.2d 1351 (Miss. 1983)). *Restatement of the Law (Third), Property, Mortgages,* § 2.4 (1997) ("A mortgage may secure future advances that are not made in connection with the transaction in which the mortgage is given, and that are not specifically described in the mortgage or other documents executed as part of that transaction, subject to the following limitations: . . . (c) If mortgaged real property is transferred, the mortgage will secure only advances made prior to the mortgagee's gaining actual knowledge of the transfer.").

the fullest extent possible to Price's 2001 loan. Price's fraud, if any, does not affect the bank's rights vis-à-vis Cook. The clause applied, therefore, at least to the first $10,000.00 of that loan,[5] and, under the priority rule just mentioned, the bank's mortgage securing that amount was, to that extent, superior to Cook's interest notwithstanding the fact that Cook acquired his interest before the bank extended the full amount of its loan to Price.

The answer to Natasha's assertion that Price could not encumber property he no longer owned is that he did not. The encumbrance occurred, at least contingently, in 1999 when Price gave the original mortgage. Cook was on notice of that mortgage, both actually, as evidenced by his deed, and constructively because the mortgage was recorded. If he wished to protect his interest as transferee against future advances to Price, he was obliged to notify the bank of the transfer. The trial court did not err by so ruling. Accordingly, we affirm the May 17, 2004, order of the Marion Circuit Court.

ALL CONCUR.

[5] Because the net proceeds were less than $10,000.00, we need not consider to what extent, if any, the bank's mortgage covered more than that amount of the 2001 loan.

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