DIRT Periodic Development for Thursday, August 15, 2013
Insight Assets, Inc. v Farias

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Insight Assets, Inc. v. Farias, Supreme Court of Utah, ___P.3d___, 2013 WL 3990783 (August 6, 2013)
Link to Opinion: http://www.utcourts.gov/opinions/supopin/Insight1347080613.pdf

SYNOPSIS: Although vendor purchase money mortgagee may generally have a superior claim to priority over a third-party purchase money mortgagee under the Restatement, vendor purchase money mortgagee was barred from asserting that priority by the doctrine of laches.

FACTS: In 2004, the Phalens sold land in Ogden, Utah to the Boecks for $88,000. The Boecks financed the purchase with a $70,300 institutional mortgage loan from First Franklin Financial Corp. (First Franklin) and $17,600 in seller purchase money mortgage financing from the Phalens. At closing, the Boecks executed deeds of trust to First Franklin and the Phelans. After closing, the title company recorded the two deeds of trust together, but with First Franklin's deed of trust being recorded first. First Franklin later assigned its mortgage to Wells Fargo.

After closing, the Boecks defaulted to both Bank and to Sellers. In June 2005, Wells Fargo foreclosed on the property and acquired the property by a trustee's deed. The Phelans did not attempt to foreclose on the property. Wells Fargo sold the property, which ultimately passed by intervening conveyances to Farias.

In 2009, the Phelans assigned their interest under their deed of trust to Insight Assets ("Insight"), who executed a substitution of trustee, recorded a notice of default, and instituted foreclosure proceedings. Farias sought summary judgment, claiming that he had held free and clear title as a bona fide purchaser. The district court entered judgment for Farias, and Insight appealed.

On appeal to the Utah Supreme Court, Insight argued that as a matter of law, the Phelans' seller deed of trust was entitled to priority over First Franklin's deed of trust under Restatement (Third) of Property — Mortgages § 7.2(c) ("A purchase money mortgage given to a vendor of real estate, in the absence of a contrary intent of the parties to it and subject to the operation of the recording acts, has priority over a purchase money mortgage on that real estate given to a person who is not its vendor."). By contrast, Farias made three arguments: (1) that First Franklin did not know of the Phelans' seller purchase money mortgage and thus the Restatement rule should not apply; (2) that even if First Franklin did know of the seller purchase money mortgage, that knowledge was irrelevant because Farias was a bona fide purchaser who took free and clear of the mortgage; and (3) that Insight's claims was otherwise barred by the doctrine of laches.

ANALYSIS: The Supreme Court of Utah rejected Farias's bona fide purchase argument, noting (correctly and obviously) that the recording act cannot protect Farias against a prior properly-recorded mortgage. The Court also noted that while the Restatement rule generally gives a vendor purchase money mortgage priority over a third-party purchase money mortgage, that rule was subject to a caveat — "where only one of the parties has notice of the other," the recording acts should govern and award priority to the party lacking notice.

Insight argued that its vendor purchase money mortgage should still prevail, because (a) First Franklin had actual knowledge of the Phelans' seller purchase money mortgage and (b) the title company's knowledge of the Phelans' seller purchase money mortgage was imputed to First Franklin. The court did not reach this argument, however, concluding that Insight's priority claim was barred under the equitable doctrine of laches. Although Insight did file its notice of default within the applicable six-year statute of limitations, the court stated that this did not preclude the possible application of laches. The court concluded that application of laches was appropriate due to the Phelans' lack of diligence and Farias's resulting injury. The court noted that during the five years between the Boecks' default and the Phelans' assignment to Insight, the Phelans "took no action to clarify or assert their rights to the property." The court held that this was inaction unreasonable because the Restatement rule involves a "multi-factor balancing test under which priority is determined by 'the circumstances of the given case, the equities, and the effect of the recording act.'" Thus, in the court's view, the Phelans "could not have rationally assumed that their interest had priority" without having brought an action to establish that priority. By failing to bring such a claim during the Wells Fargo foreclosure proceedings, the Phelans "risked forfeiting their security interest entirely."

The court also concluded that Farias would be injured if Insight's untimely claim was allowed to proceed, noting that Farias had negotiated the price for his home without considering the $17,600 debt owed to Insight and that when Farias purchased the home years after the Phelans' default, "it was reasonable for him to infer from [their] inaction that their security interest had been extinguished" by the Wells Fargo foreclosure. The court also noted that the passage of time had harmed Farias by making it difficult to gather evidence in his defense, as First Franklin was now out of business (making it difficult for Farias to locate records or former employees who might have information relevant to the question of First Franklin's knowledge).

COMMENT: This is the second 2013 periodic development involving a case where the title company recorded a third-party purchase money mortgage prior to a vendor purchase money mortgage. In the earlier case, Insight LLC v. Gunter, the Idaho Supreme Court rejected the Restatement rule and held that the third-party mortgage had priority under the recording act. As noted in the critique of *Gunter*, http://dirt.umkc.edu/February%202013/InsightLLCvGunter.pdf, that decision wrongly opened the door for purchase money lenders to structure closings in a fashion likely to disadvantage the unsuspecting purchase money seller, particularly where the purchase money lender knew of the purchase money seller and could have easily required a subordination agreement as a condition of making the purchase money loan. Gratifyingly, the Utah court rejected the reasoning of *Gunter*, noting that the Restatement rule is the appropriate starting principle for vendor vs. third party lender purchase money priority disputes.

The Utah court's judgment regarding the application of laches is harder to evaluate without the ability to review the factual record in greater detail. On the one hand, the court is correct to note that because the Restatement rule is subject to the application of the recording act if the third party mortgagee lacks notice of the vendor mortgagee (or vice-versa), then the Phelans couldn't be certain of their priority over First Franklin without a court decree. On the other hand, Farias's actions also seem similarly unreasonable. Because the Phelans' mortgage was recorded (and could have been entitled to priority over the First Franklin mortgage), Farias also couldn't have been certain he was getting clear title without a court decree. It's not obvious where the equities lie here.