

DIRT Daily Development for Friday, February 1, 2013
Insight LLC v. Gunter

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Insight LLC v. Gunter, Idaho Supreme Court, (January 24, 2013) WL 264359

SYNOPSIS: Idaho Supreme Court again rejects Restatement of Mortgages § 7.2(c), allowing third party purchase money lender to prevail in mortgage lien priority dispute against purchase money seller.

FACTS: Summitt, Inc. (Summitt) owned a 142-acre parcel that it wanted to develop into a residential subdivision. Pat and Monica Gunter owned an adjacent 18 acres which they agreed to sell to Summitt for \$799,000 by a written contract of April 21, 2006, with closing scheduled for June 19, 2006. Independent Mortgage Ltd. Co. (IM) agreed to loan Summitt \$616,000, as long as Summitt's principals executed personal guarantees and the mortgage loan covered the entire 160 acres.

When Summitt realized it could not raise the full \$799,000 cash price, the Gunters agreed to finance \$200,000 of the price, with the Gunters agreeing to take a purchase money deed of trust from Summitt. Neither the Gunters nor the closing agent who prepared the Gunters' deed of trust knew about the Summitt/IM mortgage. IM apparently knew of the Gunters' deed of trust, because IM considered seeking a subordination agreement from the Gunters.

On the scheduled closing date of June 19, 2006, there were two separate closings. At the first, Summitt executed the mortgage to IM at IM's offices. Later that day, at the second (held at the office of the closing agent handling the sale), the Gunters executed a deed to Summitt, which executed a deed of trust in favor of the Gunters. All of the documents were delivered to Sandpoint Title for recording; IM instructed Sandpoint to record the IM mortgage first. IM's mortgage was recorded immediately after the deed to Summitt; the Gunters' deed of trust was then recorded one minute later. At some point after closing, IM assigned its mortgage to Insight LLC (Insight).

In 2007, Summitt defaulted on both obligations. In August 2008, Insight sued Summitt, its principals, and the Gunters, and asserted that its mortgage was entitled to priority over the Gunters' deed of trust. In November 2008, the Gunters answered and argued that their deed of trust was a purchase money deed of trust entitled to priority over Insight. The trial court found that the closing of the Gunter deed of trust was a separate and independent transaction from the IM mortgage, not part of "one continuous transaction," and thus concluded that the IM mortgage was not a purchase money

mortgage. The trial court also found that notwithstanding the order of the closings, the Gunters' deed of trust was the "first encumbrance" and that the IM mortgage did not create a valid lien on the 18 acre parcel until after the sale transaction closed. Further, the trial court found that IM was not entitled to claim the status of a good faith purchaser under the recording act because it was aware of the purchase money financing between Summitt and the Gunters.

On appeal, Insight argued that the IM mortgage had priority as a matter of law because it was also a purchase money mortgage and was recorded first. It also contended that the Gunters were not good faith purchasers entitled to the protection of the recording act because they had imputed knowledge of IM's mortgage through the closing agent. In a unanimous decision, the Idaho Supreme Court reversed and concluded that Insight had priority over the Gunters.

ANALYSIS: The Idaho Supreme Court concluded that the IM mortgage was a purchase money mortgage. The IM mortgage clearly met the Idaho statutory definition of a purchase money mortgage as one "given for the price of real property, at the time of its conveyance." Idaho Code § 45-112. Prior Idaho decisions (consistent with the Restatement of Mortgages) have recognized that purchase money status is available not only to the financing seller, but also to third party lenders whose loan enables the buyer to purchase the land securing the mortgage. Restatement (Third) of Property – Mortgages § 7.2(a). As the Court correctly observed, Summitt granted the IM mortgage to enable Summitt to purchase the 18-acre parcel, and the IM mortgage was part of a continuous transaction involving the sale of that parcel (even if the IM mortgage and the deed of conveyance were executed at two separate closings). Further, while the Gunters argued that the IM mortgage was not a purchase money mortgage because IM took additional security (the 162-acre parcel owned by Summitt and personal guarantees of Summitt's principals), the Court concluded that the taking of this additional security did not destroy the purchase money status of the IM mortgage.

The case thus presents a priority dispute between the lien of a purchase money lender (IM/Insight) and the lien of a purchase money seller (the Gunters). The Court ruled that under Idaho's race-notice recording statute, the IM mortgage had priority:

A purchase money mortgage is given priority against other liens subject to the recording laws.... Our race-notice statute only voids a prior conveyance if (1) the subsequent conveyance was made in good faith and for valuable consideration; and (2) the subsequent conveyance is the first duly recorded....

Here, the Summitt/IM mortgage was executed ... before the Summitt/Gunter deed of trust was executed. Therefore, the IM mortgage was the prior conveyance and the Gunters' deed of trust was the subsequent conveyance. Since the Gunters' deed of trust was the subsequent encumbrance, the only

way it could take priority over the IM mortgage as the first encumbrance – where IM by default is a good faith encumbrancer against subsequent encumbrancers – is if the Gunters were the first to record. The Gunters were not the first to record. Therefore, their deed of trust is junior to the IM mortgage.

COMMENT 1: Although the Court’s conclusion that IM’s mortgage was a purchase money mortgage is clearly correct, the rest of the court’s reasoning is pretty dismal. Under the Restatement of Mortgages, a dispute between a purchase money vendor and a purchase money lender would be resolved in favor of the purchase money vendor (in this case, that would have been the Gunters). 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.”). As the commentary to the Restatement notes:

[T]he equities favor the vendor. Not only does the vendor part with specific real estate rather than money, but the vendor would never relinquish it at all except on the understanding that the vendor will be able to use it to satisfy the obligation to pay the price. This is the case even though the vendor may know that the mortgagor is going to finance the transaction in part by borrowing from a third party and giving a mortgage to secure that obligation. In the final analysis, the law is more sympathetic to the vendor’s hazard or losing real estate previously owned than to the third party lender’s risk of being unable to collect from an interest in real estate that never previously belonged to it. [Restatement § 7.2, comment d.]

The Gunters asked the Court to adopt § 7.2(c), but the Court refused to do so (without meaningful explanation), other than to note it had rejected § 7.2(c) in a prior decision, *Estate of Skvorak v. Security Union Title Ins. Co.*, 89 P.3d 856 (2004).

COMMENT 2: Furthermore, for the Court to conclude that the IM mortgage is the “first encumbrance” simply because it was executed first temporally is highly questionable. As between a purchase money vendor and a purchase money lender, ordinarily “neither mortgagee can meaningfully be said to be subsequent to the other, since both mortgages arise from the same transaction.” Restatement § 7.2, comment d. As between an institutional lender like IM and a financing seller like the Gunters, it seems reasonable to expect that an institutional lender – being more likely to appreciate the consequences of the Court’s priority rule – could easily require the buyer to “pre-execute” the mortgage in an earlier closing, thereby qualifying itself as the “first encumbrancer.” The decision thus opens the door for purchase money lenders in subsequent transactions to structure the closing in a fashion likely to disadvantage

the unsuspecting purchase money seller. This seems particularly outrageous in a case like this one, 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.

As the comments to the Restatement noted:

[W]here only one of the parties has notice of the other, the recording acts ... should govern and should award priority to the party lacking notice. Even though delivery of the mortgages is essentially simultaneous, the party lacking notice must in fairness be treated as the subsequent taker and thus eligible for the protection of the recording acts. [Restatement § 7.2, comment d]

In this regard – given the undisputed trial court findings that IM knew that the Gunters would be taking a purchase money deed of trust and that the Gunters were not aware that Summitt was obtaining a mortgage loan from IM – the recording act properly should have protected the Gunters, not IM/Insight.