IN THE SUPREME COURT OF FLORIDA
Supreme Court Building
500 South Duval Street
Tallahassee, Florida 32399-1927

CARTERET SAVINGS BANK, F.A.,

Petitioner,

v.

CITIBANK MORTGAGE CORPORATION,

Respondent.
_____/

CASE NO: 81,375

District Court of Appeal,
4th District - No. 91-2185

PETITIONER'S INITIAL BRIEF

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PREFACE

This foreclosure action presents a question of priority between a property acquisition and development mortgage and a prior general judgment lien. Petitioner, Carteret Savings Bank, F.A. (Carteret), was the plaintiff in the trial court foreclosure proceedings, and the appellee before the Fourth District Court of Appeal. Respondent, Citibank Mortgage Corporation (Citibank), was a defendant in the foreclosure proceedings before the trial court, and was the appellant before the Fourth District Court. The parties will be referred to by name. The following symbol will be used:

(R _) Record on appeal.

STATEMENT OF THE CASE

Carteret filed this foreclosure action against its borrower, Omni Development Corp. (Omni), and named Citibank as a defendant on account of its outstanding judgment lien against Omni (R 1-71). Carteret and Citibank stipulated to the transfer of Citibank's judgment lien to a surety bond pursuant to Fla. Stat. § 55.10(6), thereby allowing the foreclosure of the property to go forward. The parties submitted the merits of the lien priority question to the trial court on stipulated facts (R 160), and upon Citibank's motion to withdraw the certified cash bond (R 148).

On July 3, 1991, the Circuit Court entered its final order holding that the mortgage held by Carteret was a purchase money

mortgage in its entirety, and thus entitled to priority over the judgment lien of Citibank. The Circuit Court therefore denied Citibank's motion to withdraw the cash bond and directed the clerk to release the bond to Commonwealth Land Title Insurance Company, who had filed the bond on behalf of Carteret (R 162). Citibank timely appealed this order to the Fourth District Court of Appeal (R 164).

On December 23, 1992, the Fourth District Court issued its opinion reversing the trial court's order, holding that Carteret's purchase money mortgage priority extended only to the amount of the loan proceeds used to acquire land ($678,521), and that the balance of the loan proceeds which had been earmarked and used for construction of improvements on the property were not entitled to purchase money mortgage priority.

Acting pursuant to the motion of Carteret, the Fourth District extended the time for filing a request for certification to January 22, 1993. On January 21, 1993, Carteret timely filed its motion for certification with the Fourth District Court. On February 16, 1993, the Fourth District Court certified the following question to this Court as a question of great public importance:

> WHERE A THIRD PARTY MORTGAGE LOAN IS USED NOT ONLY FOR THE PURPOSE OF PURCHASING PROPERTY, BUT IN ADDITION, FOR CONSTRUCTING IMPROVEMENTS ON THE PROPERTY, IS THE ENTIRE AMOUNT OF THE MORTGAGE ENTITLED TO PRIORITY AS A PURCHASE MONEY MORTGAGE OVER A GENERAL JUDGMENT CREDITOR OF THE MORTGAGOR?

On March 8, 1993, this Court issued an order postponing decision on jurisdiction and setting a schedule for briefing of the merits.

STATEMENT OF THE FACTS

On August 31, 1987, Citibank obtained a judgment against Omni in the amount of $66,628.40 (R 148). This judgment was recorded on November 25, 1987 in Palm Beach County, Florida (R 148). This judgment was based upon Omni having delivered to Citibank a worthless check in the amount of $16,000 (R 153).

On September 29, 1988, Carteret agreed to lend Omni $3,330,000 for the acquisition and commercial development of a tract of land located in Boynton Beach, Palm Beach County, Florida (R 148). On that date, Omni executed a promissory note in the amount of $3,330,000 in favor of Carteret (R 76). On that same date, Omni and Carteret executed a mortgage and security agreement in which they agreed that the subject land together with any buildings, improvements, fixtures, or personalty to be used in connection with the land would be impressed with a lien for the full $3,330,000 loan (R 81). Also on that same date, Carteret and Omni executed a construction loan agreement governing the parties rights and duties with respect to the construction phase of the project (R 105).

At closing, Omni was required to put up $541,159 in cash equity representing partial payment towards the $1,219,680 cost to acquire the land (R 107). Accordingly, the $678,521 balance of the land purchase price was paid out of the loan proceeds (R 149). The balance of the $3,330,000 loan was budgeted towards the various expenses of building the "mini-storage" facilities upon the purchased land, together with other miscellaneous costs associated

with completion of the commercial project (i.e., landscaping, architects fees, legal fees, etc.) (R 107, 160).

The mortgage and security agreement describes the mortgaged property as including the land, buildings, improvements, fixtures, machinery, equipment, furniture, and other personal property of every nature which was then or thereafter situated on the property. The mortgage and security agreement further included a specific "after acquired property" clause, which states:

> The lien of this mortgage will automatically attach, without further act, to all after acquired property attached to or used in the operation of the property or any part thereof (R 87).

The parties further agreed that the mortgage and security agreement would constitute a security agreement under the Uniform Commercial Code for purposes of creating a lien on the personal property and fixtures described (R 96).

The parties have stipulated that the entire loan proceeds in excess of the $678,521 in land acquisition costs were used for the described construction and land development purposes (R 160).

SUMMARY OF ARGUMENT

The common law rule which grants priority to purchase money mortgage liens over the general floating liens of judgment creditors is but one example of a larger principle, that those who provide financing, materials or services so as to bring a specific piece of collateral into existence or increase its value are entitled to preference over creditors who did not contribute to the

collateral's existence or value.

The specific rule to be applied in this case (and that broader general principle which is applied throughout the law) is based upon policy considerations of fairness and encouragement of commercial enterprise and development. Application of these underlying and controlling policy considerations requires an interpretation of the common law rule which will encompass the type of acquisition and development loan which is at issue at bar.

This case offers this Court an opportunity to clarify the law in this area and thereby dispel the counterproductive chilling effect upon acquisition and development lending which has been created by the unnecessary uncertainty in the law on this point.

POINT ON APPEAL

CARTERET'S ACQUISITION AND DEVELOPMENT MORTGAGE WAS ENTITLED TO PURCHASE MONEY MORTGAGE PRIORITY

The irrationality of the Fourth District Court's holding can be most clearly crystallized and appreciated by way of a hypothetical. Suppose that Bob Brown and Sam Smith each have $10,000 judgments recorded against them. Bob Brown borrows $200,000 from Bradenton Bank to purchase a lot with an existing building on it, executing a mortgage for the entire $200,000. Smith decides to purchase the vacant lot next door, and build an identical building on it. As part of a single transaction, Sarasota Savings lends Smith $200,000; $100,000 for the purchase of the land, and $100,000 for the construction of the building. Both Smith and Brown end up with identical pieces of property with

identical improvements. Bradenton Bank's mortgage has priority over the prior judgment lien to the full extent of the $200,000 loan. However, under the Fourth District's holding, Sarasota Savings has priority over the prior judgment lien only to the extent of the $100,000 land costs.

Effectively, the Fourth District Court's holding expresses a common law legal preference for the financing of existing structures, and a prejudice against the financing of new construction. This is exactly the opposite of the policy preference which motivated the creation of the mortgage priority in the first instance, a legal doctrine developed to "encourage commercial and real estate transactions...". County of Pinellas v. Clearwater Federal Savings & Loan Assoc., 214 So. 2d 525, 529 (Fla. 2d DCA 1968).

The Florida common law has long recognized that a mortgage executed in conjunction with the purchase of real property and given as security for a portion of the purchase price is superior to general or "floating" liens, such as judgment liens, mortgages on after acquired property, and claims of dower or homestead. Cheves v. First National Bank of Gainesville, 79 Fla. 34, 83 So. 870, 872 (Fla. 1920); Sarmiento v. Stockton, Whatley, Davin & Co., 399 So. 2d 1057 (Fla. 3d DCA 1981); Associates Discount Corp. v. Gomes, 338 So. 2d 552, 553 (Fla. 3d DCA 1976).

This longstanding common law rule is the embodiment of a larger principle which finds its expression throughout the law. This principle holds that in a contest between a party who has

enabled the purchase, creation, or improvement of collateral, and one who has not, the lien of the former shall have priority of that of the latter. Or, as Professor Nickles has stated this broad principle:

> The interest of a creditor who enabled a debtor to acquire property is preferred to conflicting claims of other creditors who contributed nothing to the debtor's acquisition of the property.

Nickles, Setting Farmers Free: Righting the Unintended Anomaly of UCC § 9-312(2), 71 Minn.L.Rev.1135,1136 (May 1987).

The Florida legislature has shown its approval of this broad principle through its adoption of Article 9 of the Uniform Commercial Code, Fla. Stat. Chapter 679. Under UCC Article 9, the secured creditor who finances acquisition of raw components which are then turned into manufactured goods has a priority in both the constituent elements and the manufactured goods superior to any pre-existing general liens. Fla. Stat. § 679.315. The UCC also applies this same principle in favor of those who finance fixtures which are subsequently attached to real estate. Fla. Stat. § 679.313.

While lien priority has been granted to UCC financiers by statute, the common law has expressed this same underlying principle in the case of purchase money mortgages through the expedient of a legal fiction. This legal fiction holds that where a purchase money mortgage is executed in conjunction with a conveyance to a grantee, the purchase money mortgage rights becomes vested either before or in the exact point of time as the grantee

acquires title. County of Pinellas v. Clearwater Federal, supra, at 528. The automatic and simultaneous vesting of the purchase money mortgagee's rights allows no opportunity for the pre-existing floating lien of the judgment lienor to attach to the collateral ahead of the purchase money mortgage. Thereafter, the rights of the purchase money mortgage holder stand as a "buffer" between the interest of the grantee in the land and the prior general lien-holders. Id.

Consistent application of this legal fiction to the facts at bar requires recognition of the subject acquisition and development loan as having full priority. If Carteret's lien attached to the land simultaneously with the conveyance, it must also have attached to the buildings to be built thereon even before they existed. If there was insufficient opportunity for Citibank's lien to attach to the real property ahead of Carteret, how could it possibly have attached to something which did not even exist?

It would, of course, be a different case had Omni owned this property outright from the outset, and had Carteret only financed construction of the building. Under that scenario, the legal fiction could arguably be held not to apply, since the preexisting attachment of Citibank's lien to the land might arguably have "infected" the subsequent construction thereon. But whatever this Court's ruling might be in that more difficult case, here this Court need only decide that where a single mortgage is executed to secure a single loan for both the purchase of land and subsequent construction thereon, that mortgage will have priority in its

entirety.

Beyond the technicalities of the legal fiction are the fundamental policies which warranted its creation. These policies unambiguously demand recognition of total priority for Carteret's acquisition and development loan. The two policies which have been suggested by both Florida courts and legal commentators to support the purchase money mortgage priority (as well as the larger "enabling interest" priority, generally) are the twin policy considerations of fairness and economics.

The fairness rationale was clearly expressed by the court in County of Pinellas, supra:

> This fiction has been promulgated by the law for the logical and commendable reason that it is only through the contribution of the purchase money mortgagor [sic] that the security ever came into being, and by granting to the purchase money mortgagor [sic] priority other lienors are in no wise damaged or injured or detrimented, for as was stated, if it were not for the willingness of the purchase money mortgagor [sic] to convey to the grantee, nothing would exist to which the other liens could attach even in a subordinate position.

County of Pinellas, supra at 528-29; see also, Nickles, supra at 1171.

Not only was Citibank not damaged by Carteret's financing of the subject property, but had the project proved profitable (as everyone obviously expected at the outset) Citibank would actually have benefitted from the transaction to the extent that Omni would have ultimately ended up with a building (either free and clear, or with a positive equity) out of which Citibank's subordinate lien

could then have been satisfied. Without Carteret, this potential benefit could not have existed.

Obviously, this fairness rationale argues for recognition of Carteret's priority on the facts at bar. It was only through Carteret's contribution that Omni ever came to own either the land, or the structure built upon it. Similarly, Citibank is in no way damaged, since without Carteret's financing, nothing would exist to which its lien could attach. In effect, Citibank is seeking to be unjustly enriched by the collateral which Carteret paid for. See Nickles, supra, at 1136.

The fundamental economic policy which also supports the priority was also succinctly stated by the court in County of Pinellas, supra:

> This [priority] principle derives its virtue from the policy that encourages commercial and real estate transactions generally, and provides a lien debtor the opportunity to continue making transactions requiring the giving back of mortgages when otherwise he would be prohibited from doing so for the reason that no owner of property would sell with the knowledge that the property conveyed to the grantee would be subject to paramount claims over and above his. Id at 529.

Once again, the policy argument applies fully to require the granting of priority to lenders who finance projects such as the one at bar.

The Fourth District Court's opinion purports to tally authorities from other jurisdictions, and purports to base its decision upon the "weight" of authority. However, a close examination of those authorities demonstrates that only two of them

faced the question at bar, and those two cases reached divergent results. Moreover, none of the cases cited by the Fourth District went beyond a simplistic, conclusory approach, to address the fundamental policies which underlie the priority doctrine.

The case of Van Patten v. Van Patten, 784 P. 2d 218 (Wyo. 1989) was decided upon an evidentiary deficiency, namely the plaintiff's failure to show that the money lent was used to buy the land in question. Unlike the facts at bar, there was no evidence in Van Patten to show that the loan funds were used either to buy the land or to construct improvements thereon. For all we know, the plaintiff in Van Patten spent the money on a lavish vacation.

Similarly, in Westinghouse Electric Co. v. Vann Realty Co., 568 S.W. 2d 777 (Mo. 1978) the court merely held that a mechanic's lien was not superior to a purchase money mortgage. The issue at bar was neither raised nor decided.

In Federal Land Bank of Columbia v. Bank of Lenox, 192 Ga. 543, 16 S.E. 2d 9 (1941) the decision only discloses that money was lent partially for the purchase of land and partially for "other purposes." The opinion does not disclose the purpose for the excess loan or how the money was spent, again rendering this decision inapposite. Carteret is not suggesting that one can render any loan a purchase money mortgage by allocating some portion of it to the purchase of land without regard to the purposes for which the balance of the funds were lent. Rather, consistent with the principles previously examined, Carteret only asks recognition that where all of the loan funds are to be used

for the acquisition and development of a particular parcel of land, the entirety of the loan must be given purchase money mortgage priority.

So far as research has disclosed, the only two courts which have ever faced the issue before this court are a 1929 New York trial court and a 1972 Georgia Court of Appeals. The 1929 New York trial court held in Syracuse Savings and Loan Association v. Hass, 134 Misc. 82, 234 N.Y.S. 514 (N.Y. Sup. 1929), without any real analysis or explanation, that the construction portion of a loan similar to the one at bar was not entitled to priority. On the other hand, the 1972 Georgia Court of Appeals held in Hand Trading Co. v. Daniels, 126 Ga. App. 342, 190 S.E. 2d 560 (1972), that a purchase and construction loan like the one at bar was entitled to priority in its entirety over a prior judgment lien.

Obviously, this court writes on an essentially clean slate. This uncertainty in the law has undoubtedly created a chilling effect on acquisition and construction lenders to the detriment of everyone concerned, and most especially to the detriment of the economy of the State of Florida. This court is thus given the opportunity in this case to clarify in a fundamental way what is obviously an unclear area of the law and thereby remove this unnecessary and counterproductive impediment to commercial development lending.

CONCLUSION

This court should answer the certified question in the affirmative, declaring the entire amount of this acquisition and development mortgage to have priority over the lien of the general judgment creditor.

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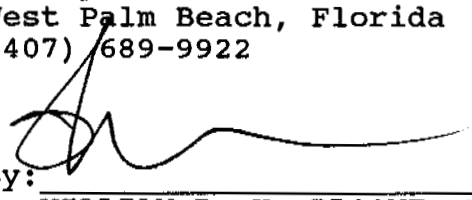

By: _____
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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing has been furnished by U.S. Mail to KENNETH S. HOFFMAN, ESQ., Attorney for Petitioner, 799 Brickell Plaza, Suite 702, Miami, FL, 33131; JESSE H. DINER, ESQ., Atkinson, Jenne, Diner, Stone, Cohen & Klausner, P.A., 1946 Tyler Street, P.O. Drawer 2088, Hollywood, FL, 33022-2088 and ALFRED A. LASORTE, ESQ., Alfred A. LaSorte, Jr., P.A., 501 South Flagler Drive, Flagler Center, Suite 503, West Palm Beach, FL, 33401 this 22nd day of April, 1993.

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