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JUN 10 1993
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IN THE SUPREME COURT OF FLORIDA
Supreme Court Building
500 South Duval Street
Tallahassee, Florida 32399-1927

CASE NO. 81,375
District Court of Appeal,
4th District - No. 91-2185

CARTERET SAVINGS BANK, F.A.,

Petitioner,

vs.

CITIBANK MORTGAGE CORPORATION,

Respondent.
_____/

REPLY BRIEF OF RESPONDENT

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TABLE OF CONTENTS

TABLE OF CITATIONS

STATEMENT OF THE CASE

Carteret's Statement of the Case adequately states the issue before the Court and need not be restated. Citibank concedes that there is probable jurisdiction pursuant to §9.030(a)(2)(A)(v), Fla.R.Civ.P.

STATEMENT OF THE FACTS

The following symbol will be used: (R_____) Record on appeal. Citibank adopts Carteret's Statement of Facts with the following additions: On September 27, 1988, William R. Baker conveyed the real property (the "Property") which was the subject of the foreclosure suit from which this appeal arose to Elmore Watkins (the "Seller") for an indicated consideration of $1,150,000.00. This deed was recorded on October 11, 1988 (R 149). On September 28, 1988, the Seller conveyed the Property to the mortgagors for an indicated consideration only one day later of $1,219,000.00. This deed was also recorded on October 11, 1988. (R 149)

On September 29, 1988, the mortgagors executed a promissory note in the amount of $3,330,000.00, mortgage and security agreement and other loan documents in favor of Carteret (the "Loan"). The mortgage and assignment of rents were recorded on October 11, 1988. (R 15, 20)

Carteret instituted the foreclosure suit against the mortgagors and alleged that Citibank's judgment lien was inferior to the lien of Carteret's mortgage because the mortgage was a purchase money mortgage. (R 5) Citibank filed its Answer alleging that its judgement was superior to Carteret's mortgage because the mortgage was not a purchase money mortgage. (R 72)

Carteret and Citibank have stipulated that all proceeds of the Loan over the amount of $678,521.00 were used for construction and land development purposes. (R 160) After commencement of the foreclosure action, Commonwealth Land Title Insurance Company ("Commonwealth"), the title insuror of Carteret's mortgage, posted a certified cash bond pursuant to §55.10, Florida Statutes, so that the foreclosure could continue to conclusion. The certified cash bond was recorded in Official Records Book 6811, at Page 1308 of the Public Records of Palm Beach County, Florida. The order initially appealed was an Order Denying Citibank's Motion to Withdraw Certified Cash Bond. Accordingly, Commonwealth is the real party in interest in this appeal, as noted by the Fourth District in the decision under appeal.

SUMMARY OF ARGUMENT

There is no dispute that a true purchase money mortgage has priority over prior recorded liens. However, a "true" purchase money mortgage can only arise when the mortgage proceeds are paid to the seller of land for the land acquisition costs. Money paid by a mortgagee to the purchaser of land for construction of improvements on the land is not purchase money. If, in fact, Carteret's mortgage is construed to be a purchase money mortgage, then it can only constitute a purchase money mortgage with priority over Citibank's judgment to the extent of $678,521.00, the stipulated portion of the purchase price funded by the loan and the only amount actually funded at closing.

Carteret states that its argument is enhanced by the treatment accorded a purchase money security interest under Article 9 of the Uniform Commercial Code.

However, if the requirements for perfecting a purchase money security interest are ignored, the result would be the same priority accorded Carteret's mortgage by the Fourth District.

The question under review would be moot if Carteret and/or Commonwealth, its agent, had followed the generally accepted practice in Florida with respect to judgment liens. If they had done so, Citibank's judgment would have been listed on the title insurance commitment issued to Carteret by its agent as a requirement to be removed at or prior to closing and Citibank's judgment would have been discharged at or prior to Carteret's loan closing. It would be inequitable under the circumstances of this transaction to give any priority to the remainder of Carteret's loan over Citibank's Judgment.

The real party in interest in this matter is Commonwealth, which issued the title insurance policy insuring Carteret's mortgage and posted the bond pursuant to §55.10, Florida Statutes (1992) and which failed in its duty to secure the satisfaction of Citibank's prior lien. This case really concerns the title insuror's error in not advising Carteret of the existence of Citibank's judgment prior to closing the loan. The transaction would not have been impeded if Carteret simply required payment of Citibank's judgment, then approximately $45,000.00, as a condition precedent to closing the loan, a requirement of relatively minor significance in a $3,000,000.00 loan transaction. This would have accomplished Carteret's desired result of having a valid first mortgage.

The economic reality of this case is that Carteret, through its agent, committed negligence by failing to require satisfaction of Citibank's judgment as a condition precedent to closing the loan. If it had, there would be no issue to review. The responsibility for this error rests squarely on the shoulders of Carteret and Commonwealth. In fact, Commonwealth acknowledged this responsibility by posting the certified cash bond to cover Citibank's judgment. The trial court ordered the certified cash bond to be released to Commonwealth which had filed the same on behalf of the Carteret. It would be inequitable to give Carteret's mortgage any priority over the prior recorded certified judgment of Citibank.

POINT ON APPEAL

CARTERET'S MORTGAGE IS A PURCHASE MONEY MORTGAGE, IF AT ALL, ONLY TO THE EXTENT OF $678,521.00, THE STIPULATED AMOUNT OF THE LOAN PROCEEDS DISBURSED FOR LAND ACQUISITION AT THE LOAN CLOSING

The priority of mortgages in which the entire loan proceeds were advanced solely for the purchase of the mortgaged property is well settled in Florida. Cheves v. First Nat'l Bank of Gainesville, 73 Fla. 34, 83 So. 870 (1920), County of Pinellas v. Clearwater Fed. Sav. and Loan Ass'n, 214 So. 2d 525 (Fla. 2d DCA 1968), Associates Discount Corp. v. Gomes, 338 So. 2d 552 (Fla. 3d DCA 1976) and Sarmiento v. Stockton, Whatley, Davin & Co., 399 So. 2d 1057 (Fla. 3d DCA 1981). In these cases the courts do not discuss construction or other non-land acquisition monies being secured by a purchase money mortgage.

This case presents a question of first impression in Florida on the issue of whether a mortgage, the proceeds of which are used partly to fund the acquisition of property and partly for other purposes, is a purchase money mortgage entitled to the super priority usually only afforded purchase money mortgages. Citibank Mortgage Corp. v. Carteret Sav. Bank, 612 So. 2d 599 (Fla. 4th DCA 1992). This Court now has the opportunity to affirm the Fourth District's decision to join the trend of decisions holding that a mortgage in which some of the loan proceeds are not advanced for acquisition of the mortgaged property is a purchase money mortgage, if at all, only to the extent of the mortgage proceeds actually used to fund the acquisition of the mortgaged property.

Citibank believes this Honorable Court should follow the precedent set forth in a long line of cases beginning with Gorham v. Farson, 119 Ill. 425, 10 N.E. 1 (1887) in which the Illinois Supreme Court determined that when additional sums other than the initial purchase monies are secured by a mortgage, the Court will not give priority to these additional sums over a judgment creditor with a prior recorded lien. In Gorham the contract for the purchase of the lots in question recited a $1,300.00 purchase price. The Court refused to give priority to the total mortgage of $3,000.00 which included proceeds used for purposes other than acquisition of the mortgaged property.

In Syracuse Sav. and Loan Ass'n v. Haas, 134 Misc. Rep. 82, 234 N.Y.S. 514 (N.Y.Sup. Ct. 1929), the Court gave priority only to that part of the loan proceeds used for the acquisition of the mortgaged property, deciding the very issue sub judice. The $3,000.00 mortgage consisted of $120.50 applied to the purchase of the lot and the $2,850.00 balance expended to erect a dwelling on the lot.

> To render a mortgage a purchase money mortgage, the whole of the principal must have been applied towards the payment of the purchase price. A mortgage given to secure money loaned for the improvement of real property is not a purchase money mortgage within any definition of the term, so far as we have been able to discover. Id. at 517-518.

The Court expressly rejected the contention that because a part of the principal of the mortgage was applied to the purchase price, the whole mortgage became a purchase money mortgage, holding that the mortgage was a purchase - money mortgage only to the extent of $120.50. Id.at 517-518.

Similarly, the Nebraska Supreme Court has held that "a purchase money mortgage is given for the unpaid purchase money on a sale of land as part of the same transaction as the deed, and its funds are actually used to buy the land". (Emphasis supplied) Commerce Sav. of Lincoln, Inc. v. Robinson, 213 Neb. 596, 331 N.W. 2nd 495, 497-98 (1983).

In Van Patten v. Van Patten, 784 P.2d 218, 221 (Wyo. 1989) the Supreme Court of Wyoming clearly held that for a purchase money mortgage to exist, the money must be loaned with the express purpose and intention that it be used in paying the purchase price of the land. Evidence must show that the money was actually used to pay for the land involved in transaction. The mere inference that loan proceeds were used to pay off a contract for deed, based on the fact that the deed and mortgage were recorded at the same time was insufficient. The Court required evidence to show that the land had been paid for and called this "the most critical element of proof of a purchase money mortgage". Id. at 221.

A Federal District Court has also held that "incidental expenses incurred by a purchaser of real estate, in addition to the purchase price to be paid to the vendors, is not property to be considered a part of the 'purchase money' for the property" within the meaning of the Maryland statute which prefers a purchase money mortgage to previous judgment creditors. In re Shapiro, 35 F. Supp. 579 (D.C.D. Md 1940). The Court also recognized that the general law on the subject in other jurisdictions was that the term "purchase money" was limited to purchase price and did not include other elements of cost to the vendee. Id. at 582. The Court further

noted that one of the express reasons for requiring recitation of the actual amount paid in an affidavit is to prevent transfers for a fictitious consideration to the prejudice of creditors. In re Shapiro at 585. That is, preference as a purchase money mortgage should be given only as to the actual amount of money received by the vendor for acquisition of the land or chattel real, sold or conveyed.

Other courts have also separated the concept of "purchase money" used for acquisition of land from other monies which are included in the loan proceeds. In Thomas v. Hoge, 58 Kan. 166, 48 P. 844 (Sup Ct. 1897), the mortgagee lent money for purchase of the land and for land improvements made prior to the conveyance of the property. The Court differentiated the money loaned for the purchase of the land as "purchase money" from the monies loaned for construction of the improvements. Similarly, in New Jersey Bldg., Loan & Inv. Co. v. Bachelor, 54 N.J. Eq. 600, 35 A. 745 (N.J. App. 1896) the Court separated the money paid to purchase the land as "purchase money", and held that the balance of the loan proceeds given to the purchaser were non purchase-monies, stating:

"Had the money which went to pay the purchase money been secured by one mortgage, and the rest of the money lent been secured by another, given at the same time, the former mortgage would in my view have priority over the mechanic's lien claim and the latter would not. That the mortgagor has secured the whole loan by a single mortgage cannot change the results." Id. at 757.

Also in Noll v. Graham, 27 P.2d 277 (Kan. 1933), the Court expressly refused to consider the entire mortgage a purchase money mortgage. In Noll, only part of the

loan proceeds represented the purchase price of the land. The Court divided the mortgage so that only the money paid for the lots was received the purchase money priority. Id. at 282, rev'd on other grounds, Shade v. Wheatcraft Ind., Inc., 248 Kan. 531, 809 P.2d 538 (Kan. 1991).

In Westinghouse Elec. Co. v. Vann Realty Co., 568 S.W.2d 777 (Mo. 1978), $177,000.00 of the total funds advanced by the lender were used to purchase the tract on which apartments were to be built. The balance of the $2,150,000.00 loan was to be used for construction of the apartment buildings. The Court held that only the $177,000.00 used to purchase the land constituted a purchase money mortgage. Id. at 781.

In C & L Lumber and Supply, Inc. v. Texas American Bank/Galeria, 110 N.M. 291, 795 P.2d 502 (Sup Ct. 1990), the court refused to treat any part of the entire $120,000.00 mortgage as a purchase money mortgage when $60,000.00 was used to pay off debt incurred in the prior acquisition of the property. "We first point out that the loan from Texas American Bank for $120,000.00 was far in excess of that needed to pay off the real estate contract. That in itself should suggest problems with treating the mortgage to secure it as a 'purchase money mortgage' superior to all other liens affecting the property". Id. at 506.

All of the proceeds of Carteret's loan, above the $678,521.00 paid for acquisition of the property, were "used for construction and land development purposes". (R. 160). The loan documents themselves refer to the fact that this was a construction loan. (R. 15-45). The full amount of the mortgage proceeds were not

disbursed simultaneously with the purchase of the property. Only approximately twenty percent of the loan proceeds were disbursed at closing. (R. 143, 144). Even when Carteret's loan went into default, the loan was not fully funded. (R. 3). Additionally, Carteret has not demonstrated that all of the proposed construction was in fact completed at the time of the foreclosure. In Gellis et al. v. B.L. I. Construction Company, Inc., 148 Ga. App. 527, 251 S.E. 2d 800 (Ct. App. 1978) a construction loan was not a purchase money mortgage which could defeat the lien of a contractor who commenced work prior to the mortgage. The Court clearly stated that a loan made solely to construct improvements on property is not a purchase money mortgage. The result should be the same in our case.

The only case cited by Carteret in support of its position is Hand Trading Company v. Daniels, 126 Ga.App. 342, 190 S.E. 2d 560 (Ga. App. 1972). The Hand Trading decision was an appeal of a declaratory judgment holding the mortgage to be a purchase money mortgage. In this very brief (one-half page) decision, there is no indication by the Court as to the distribution of the loan proceeds, and the Court cites no authority for its holding. The only authorities cited in the decision support the Court's holding that a purchase money mortgage may be made by other than the seller of the property, a position Citibank does not contest. Additionally, this Georgia Appellate Court decision appears to be contradicted by an earlier Georgia Supreme Court decision, Federal Land Bank of Columbia v. Bank of Lenox, 192 Ga. 543, 16 S.E.2d 9 (1941), which held that "priority in favor of a purchase money security deed or mortgage does not, extend however, beyond money advanced or paid in buying the

property, so as to cover sums used for other purposes." Id. at 17. The Georgia trial court gave the two mortgagees priority only as to the $7,783.75 purchase money.

In Federal Land the mortgagor reacquired property by executing two mortgages. The $9,000.00 total of the two mortgages was in excess of the amount of the purchase price, $7,783.75. Carteret begins its brief by using a hypothetical to illustrate the "irrationality of the Fourth District Court's holding" and asks this Court to consider the chilling effect upon acquisition and development lending which has been created by uncertainty in the law on this issue. However, Carteret ignores the obvious. The purchase money mortgage to Bob Brown and the portion of the mortgage used for acquisition by Sam Smith both encumbered what was purchased. The properties are not identical in that Sam Smith has a new building on the property and Bob Brown's building is not. More importantly, Sarasota Savings can eliminate any priority problem, as could Carteret, by requiring that Sam Smith satisfy his judgment prior to the Sarasota Savings loan closing. Indeed, given the realities of commercial lending, it is doubtful that Bradenton would make a loan to Bob Brown with a judgment outstanding.

Carteret argues extensively that the Fourth District holding expresses a prejudice against financing new construction, but such is not the case. The Fourth District has examined decisions from other jurisdictions and determined that purchase money priority should only be extended to monies used for acquisition and for no other purposes. Clearly the lending environment in Florida has not been impeded by the uncertainty claimed by Carteret as acquisition, development and construction

lending in Florida was at its zenith in the 1980's.

Carteret also suggests that the doctrine of purchase money priority is related to the principle in Article 9 of the Uniform Commercial Code, Fla. Stat. Chapter 679, which gives a secured creditor priority over general creditors on the raw materials which it finances and the finished products produced from these raw materials. An analysis of the Article 9 treatment of purchase money security interests suggests otherwise. To receive purchase money priority over previously filed security interests, the secured party must comply with specific statutory requirements, including notification to parties with conflicting security interests. §679.312, Fla. Stat. (1992). Therefore, a missed security interest and no notification would accord a secured party claiming a purchase money security interest the same priority given Carteret. See e.g., National Bank of Sarasota v. Dugger, 335 So. 2d 859 (Fla. 2d DCA 1976). Accordingly, if this case was to be decided under Article 9, Carteret would not be entitled to judgment in its favor. Commonwealth would not have found Citibank's judgment lien and Carteret would not have sent the required purchase money notification. Their lien would therefore be inferior to Citibank's prior recorded judgment lien. Furthermore, there would be a question under Article 9, as to whether Carteret's security interest constitutes a purchase money security interest. Any analogy to Article 9 is therefore welcomed by Citibank as the treatment of a security interest that is not a purchase money security interest is consistent with the position advocated by Citibank.

Lien priority is generally fixed by the recording sequence of competing

liens with the "first in time being first in rank." 34 Fla. Jur.2d Liens, §33 (1982) citing United States v. First Fed. Sav. and Loan Assoc., 155 So. 2d 192 (Fla. 2d DCA 1963). The purchase money legal fiction was developed to foster the acquisition of property. But the courts have consistently refused to extend the doctrine to encompass loan proceeds used for purposes other than acquisition as evidenced by the cases cited herein. The reality of commercial real estate transactions is that when a lender makes a loan and the title insurer fails to except a previously recorded certified judgment in its loan policy, the lender or the title insurer must satisfy the judgment and obtain the necessary releases. Shada v. Title & Trust Co. of Fla., 457 So. 2d 553 (4th DCA 1984). First Am. Title Ins. Co. v. First Title Serv. Co., 457 So. 2d 467 (Fla. 1984). Carteret hired Commonwealth to search the title to the Property and advise Carteret of any prior liens. Citibank should not bear the burden of a negligent search by Commonwealth.

Commonwealth obviously recognized its potential liability and posted the certified cash bond on behalf of Carteret to cover Citibank's judgment (R. 168). The appellate court acknowledged the fact that Commonwealth had filed the same "pursuant to Section 55.10, Florida Statutes." Citibank, 612 So. 2d at 600. There is no mystery that the real party in interest in this appeal is an insurance company seeking to avoid compensating an innocent party for its clearly negligent act. However, that is irrelevant to the issues to be decided. The only relevant issue is that Citibank got a judgment based on a worthless check, recorded it in accordance with applicable law, and has been frustrated in its efforts to collect the judgment by

Carteret and Commonwealth attempting to utilize an inapplicable legal fiction to avoid the result of their negligence.

Carteret conceded that "had Carteret known of the judgment, it could have simply required its payment as a condition of making the loan, a matter which would have been relatively minor in significance relative to the amounts involved in the transaction." P.14, Fourth District Reply Brief of Carteret. Unfortunately for Carteret, knowledge of the judgement is imputed to it. Erskine Fla. Properties, Inc. v. First Am. Title Ins. Co. of St. Lucie County, 557 So. 2d 859 (Fla. 1989). Commercial reality recognizes that Carteret would not have closed the loan if it had knowledge of the judgment lien. Citibank is not seeking a result other than what should have occurred prior to the closing of Carteret's loan, to wit, satisfaction of its judgment. The equities compel Citibank's judgment to be satisfied, not discarded because of a last ditch attempt by a negligent Carteret and its title insurer to hide behind the fiction of a purchase money mortgage.

An Attorney's Title Insurance Fund Title Note clarifies the commercial realities of this case:

> When a mortgage secures purchase money and additional sums, its status as a priority lien is unclear. The majority view appears to be that the priority in favor of a purchase money mortgage does not extend beyond the money advanced or paid in buying the property so as to cover sums used for other purposes. 59 C.J.S., Mortgages, Sec. 231 (a). Therefore, when a loan will be used in part for purchase money and in part for other purposes, a Fund mortgagee policy should contain exceptions for any existing claims or liens against the mortgagor. §18.04.01, Fund Title Notes, Attorneys' Title Insurance Fund, Inc. (1990).

The title insuror committed an error by not excepting Citibank's judgment in its mortgagee policy and/or requiring its satisfaction prior to Carteret's loan closing. Carteret concedes that error. But for the error of the title insuror, Citibank's judgment would have been paid off prior to Carteret's loan closing. "Carteret certainly would not have risked the priority of its mortgage on such a matter." P. 14, Answer Brief of Carteret.

CONCLUSION

The only just and equitable resolution of this cause is affirm the Fourth District decision which would compel Carteret to pay the entire amount of Citibank's judgment. This recognizes the correct application of the law with respect to Carteret's mortgage and avoids an injustice to holders of liens against realty. This places Carteret and Citibank in exactly the same position they would have been in but for Commonwealth's error, to which Citibank should not bear the burden.

Respectfully submitted,

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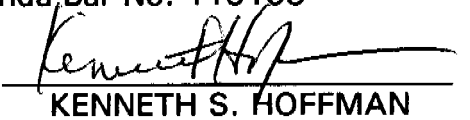
By: 
KENNETH S. HOFFMAN

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing was mailed this 7th day of June, 1993, to: William R. H. Broome, Esq. Broome, Kelley & Aldrich, P.A., 801 Spencer Drive, West Palm Beach, Florida 33402, Alfred A. LaSorte, Jr., Esq., Alfred A. LaSorte, Jr., P.A., 501 South Flagler Center, Suite 503, West Palm Beach, Florida 33401 and to Jesse H. Diner, Esq., Atkinson, Jenne, Diner, Stone, Cohen & Klausner, P.A., P. O. Drawer 2088, Hollywood, Florida 33022-2088.

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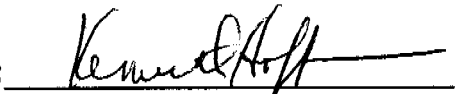
By: 
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