2011

Insight Assets, Inc. v. Homero Farias : Brief of Appellant

Utah Supreme Court

Case № 20110020 SC

In the Supreme Court of the State of Utah

Insight Assets, Inc.,
Plaintiff *and* Appellant,

-v-

Homero Farias,
Defendant *and* Appellee.

Brief *of* Appellant

Appeal from a final order granting Farias' Motion for Partial Summary Judgment and denying Insight's Motion for Summary Judgment.

This judgment was entered in the Second Judicial District Court, in and for Weber County, the Honorable W. Brent West presiding.

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STATEMENT OF JURISDICTION

The Court of Appeals has jurisdiction over this matter under Utah Code Ann. § 78A-3-102(3)(j) (2010). The Appellant, Insight Assets, Inc., appeals a final order granting Farias' Motion for Partial Summary Judgment, denying Insight's Motion for Summary Judgment, and quieting title to Farias.

STATEMENT OF ISSUES

POINT I. Did the trial court err by denying Insight's *in rem* foreclosure at summary judgment where undisputed facts demonstrate that Insight's Trust Deed (the Phalen Trust Deed) was a vendor purchase money mortgage, the third party mortgagor had notice of the Phalen Trust Deed, and the obligor defaulted on the Phalen Trust Deed? And where there was never a subordination agreement between the Phalens and FFFC, did the trial court err in finding that the Phalen Trust Deed was subordinate to the FFFC Deed?

STANDARD OF REVIEW AND ISSUE PRESERVATION

"Because summary judgment is granted as a matter of law, [appellate courts] give the trial court's legal conclusions no particular deference."[1]

Insight preserved this issue in its motion for summary judgment and memorandum in opposition to Farias' motion for partial summary judgment.[2]

POINT II. Did the trial court err by determining that Appellant's purchase money trust deed was subject to the operation of Utah's Recording Act?

STANDARD OF REVIEW AND ISSUE PRESERVATION

"Because summary judgment is granted as a matter of law, [appellate courts] give the trial court's legal conclusions no particular deference."[3]

Insight preserved this issue in its motion for summary judgment and memorandum in opposition to Farias' motion for partial summary judgment.[4]

POINT III. Did the trial court err in determining that Appellee was a bona fide purchaser for value where Appellee had actual and/or constructive notice that the vendor trust deed had not been reconveyed?

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[1] *Mast v. Overson*, 971 P.2d 928, 931 (Utah Ct. App. 1998) (internal quotations and citation omitted).

[2] R. 000080, 000462.

[3] *Mast* at 931.

[4] R. 000080, 000462.

STANDARD OF REVIEW AND ISSUE PRESERVATION

"Because summary judgment is granted as a matter of law, [appellate courts] give the trial court's legal conclusions no particular deference."[5]

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RULES, STATUTES, AND CONSTITUTIONAL PROVISIONS

The following rules, statutes, and constitutional provisions are relevant to the issues on appeal and are attached at ADDENDUM A:

RULES

- Utah Rule of Civil Procedure 56.

STATUTES

- Utah Code Ann. § 77-8-1(3).

CONSTITUTIONAL PROVISIONS

- Utah Constitution, Article I, Sections 7.
- United States Constitution, Amendments V and XIV.

STATEMENT OF THE CASE

On November 19, 2009, Insight filed an *in rem* foreclosure complaint and named Homero Farias as a necessary party, as current occupant of the property.[7]

On January 15, 2010, Farias answered that complaint, and counterclaimed for quiet title, slander of title, and wrongful lien.[8]

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[5] *Mast* at 931.

[6] R. 000080, 000462.

[7] R. at 000001.

Insight moved for summary judgment on its complaint on February 9, 2010.[9] Farias moved to continue Insight's motion pending further discovery.[10] The trial court granted the motion to continue and discovery ensued.[11]

On September 7, 2010, Farias moved for partial summary judgment on its affirmative defenses and its quiet title counterclaim.[12] The trial court granted Farias' motion for partial summary judgment and denied Insight's summary judgment motion; the court further denied Farias' request for attorney fees.[13] Farias dismissed with prejudice his remaining counterclaims, II & III, by way of stipulation by the parties.[14]

Insight timely filed its Notice of Appeal on December 8, 2010,[15] and Farias cross-appealed the trial court's denial of attorney fees on December 23, 2010.[16]

STATEMENT OF FACTS UNDISPUTED BY FARIAS

Insight Assets filed an *in rem foreclosure* action seeking to foreclose on its trust deed against the real property owned by Homero Farias.[17] Insight's trust deed was assigned

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[8] R. 000047.

[9] R. 000080.

[10] R. 000157.

[11] R. 000205.

[12] R. 000316.

[13] R. 000573, 000580.

[14] R. 000582.

[15] R, 000599.

[16] R. 000605.

[17] R. 000001.

to it by Joseph and Denise Phalen, who owned the property in 2004.[18] The Phalens sold the property to a buyer, and financed a portion of the purchase price.[19] The remaining portion of the purchase price was provided to the buyer by First Franklin Financial Corporation.[20] The Phalens secured their loan to the buyer with a vendor trust deed, and First Franklin secured their loan to the buyer with a third party trust deed against the property.[21] First Franklin and the Phalens knew they were each financing a portion of the property and had knowledge of each other.[22]

Both the Phalen Trust Deed and the First Franklin Trust Deed were recorded simultaneously with the other documents evidencing the sale of the property.[23] The Phalen Trust Deed is a vendor purchase money mortgage; the First Franklin Trust deed is a third party purchase money mortgage.[24]

The buyer defaulted on their obligations under both trust deeds almost immediately, and First Franklin began foreclosing its trust deed less than ten months later.[25] First Franklin's interest in the property was conveyed to Wells Fargo Bank via a Trustee's

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[18] R. 000080 at ¶¶ 9-10; 000171.

[19] R. 000080 at ¶¶ 6-9; 000047 at ¶¶ 6-7; 000171.

[20] R. 000080 at ¶¶ 10-12; 000047 at ¶¶ 10-12; 000171.

[21] *Id.*

[22] R. 0000475-76.

[23] R. 000080 at ¶¶ 6-12; 000047 at ¶¶ 6-12; 000171.

[24] R. 000574.

[25] R. 000080 at ¶¶ 17-18, 35; 000047 at ¶¶ 17-18; 000171.

Deed on June 14, 2005.[26] The Phalen Trust Deed was never reconveyed, and the title record kept at the Weber County Recorder's Office shows that the Phalen Trust Deed still encumbers the property to this day.[27]

Insight Assets, Inc. acquired the Phalen Trust Deed by assignment from Denise and Joseph Phalen.[28] Insight foreclosed on the Phalen Trust Deed immediately by judicial foreclosure.[29]

The trial court denied Insight's motion for summary judgment and granted Farias' partial motion for summary judgment, finding that Farias was a bona fide purchaser for value, and takes the property free and clear of Insight's lien under the Phalen Trust Deed.[30] The trial court found that the Phalen Trust Deed was a vendor purchase money mortgage, but that its priority as a vendor purchase money mortgage was eviscerated by Utah's Recording Statute, and therefore junior to the extinguished First Franklin Trust Deed.[31]

SUMMARY OF ARGUMENT

POINT I. Insight is entitled to summary judgment. Vendors who sell their property and finance all or a portion of the sale are entitled, as a matter of law, to retain a super priority lien status to protect their interest. This is because a third party mortgager, like

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[26] R. 000080 at ¶ 19; 000047 at ¶ 19; 000171.

[27] R. 000080 at ¶¶ 20, ; 000047 at ¶ 19; 000171.

[28] R. 000080 at ¶¶ 9-10; 000171.

[29] R. 000001; 000080 at ¶¶ 9-10; 000171.

[30] R. 000573.

[31] *Ibid.*

a bank, is only out the money they lent if the buyer defaults, but the vendor is out both her money and her property. To protect these vendors, Utah courts have recognized the priority status these vendor purchase money mortgages have over third party mortgages. Insight holds a vendor purchase money mortgage, and the buyer did default. Yet, the trial court improperly denied Insight's motion. Because Insight's Trust Deed (the Phalen Trust Deed) is a vendor purchase money mortgage, and because FFFC had notice of the Phalen Trust Deed, which was recorded simultaneously with FFFC's Trust Deed, the Phalen Trust Deed was superior to the FFFC *at the time of the FFFC Deed's inception*. And, the Phalens never subordinated their Trust Deed to the FFFC Trust Deed. Accordingly, the foreclosure of the FFFC Trust Deed did not foreclose the senior Phalen Trust Deed. Thus, the Phalen Trust Deed runs with the land, still encumbers the property, and Insight is entitled to judgment allowing it to foreclose on its deed. The court erred in denying Insight's motion for summary judgment, and reversal is warranted.

POINT II. While Utah is a race-notice state, this Court has carved out an exception to Utah's Recording Statute in cases where vendors sell their property and retain an interest; the Court called this exception to the recording act the purchase money mortgage doctrine. The doctrine holds that a vendor purchase money mortgage is superior to a third party purchase money mortgage, regardless of the order in which those mortgages were recorded on title. This common law doctrine is supported by the plain language of the recording statute where it states that it does not affect the validity of documents where the parties have notice. The recording act does not apply to purchase money mortgages where the parties have notice of each other. To hold that the recording act applies to purchase money mortgages would be to eviscerate the doctrine itself. If the

recording act applied to purchase money mortgages, there would be no need for the doctrine—why would this Court create it if the recording act always set forth the order of priority between vendors and third parties? The fact is, this Court specifically carved out an exception to Utah's recording statute for vendor purchase money mortgages, and the exception applies in all cases where the parties have notice of each other. If the parties to the sale (the buyer, vendor and third party financer) do not have notice of each other, then this Court has held that no purchase money mortgage exists, and the recording act applies. Because FFFC, the Phalens, and the Boecks had notice of each other and by the nature of the sale, the recording act defers, and the Phalen Trust Deed is superior as a matter of law.

POINT III. Farias is not a bona fide purchaser, allowing him to avoid foreclosure. The trial court's analysis of the bona fide purchaser doctrine and the recording act are incorrect as a matter of law, and the court should reverse on that error alone. Yet the Court can go further in its analysis and find that Farias did have knowledge that the Phalen Trust Deed still encumbered the property. It is undisputed that the Phalen Trust Deed was never reconveyed or otherwise extinguished by documents recorded on title that specifically discussed the Phalen Trust Deed. Because of this, Farias had notice that the Phalen Trust Deed had not been satisfied and still encumbered the property. Yet, Farias assumed, and he readily admits his assumption, that the Phalen Trust Deed had been extinguished under the common law doctrine that holds that junior liens are extinguished by senior liens. And he assumed that the Phalen Trust Deed was junior to the FFFC Deed. However, these assumptions cannot be a bar to Insight's foreclosure on its deed. That Farias contracted with a title company who literally wrote a book on and

advised its employees about the existence of purchase money mortgages further demonstrates that Farias was aware that the Phalen Trust Deed was superior under this doctrine and still encumbered the property. That is precisely why the title company insures its work—because Farias delegated the task of determining whether the title was free and clear to his agent. As such, Farias must have known about the Phalen Trust Deed, and therefore cannot avoid foreclosure as a bona fide purchaser.

* * *

The trial court committed reversible error on each of these issues, and the Court should further clarify the purchase money mortgage doctrine, and reverse and remand with instructions to the trial court to make findings and conclusions consistent with those holdings.

ARGUMENT

POINT I. The trial court erred in denying Insight's *in rem* foreclosure at summary judgment; undisputed facts established that the Phalen Trust Deed was a vendor purchase money mortgage, and superior to the FFFC trust deed as a matter of law because they were recorded simultaneously and FFFC and Phalen knew of each other's deeds.

William and Roberta Boeck bought property and financed it with two mortgages: one from the seller (vendor) and one from a bank. The Boecks defaulted on both loans and the bank foreclosed on its trust deed. Yet under Utah law, vendor mortgages have first priority regardless of recording order and junior liens cannot foreclose senior liens. Therefore, Insight Assets is entitled to foreclose on the Property because its lien still encumbers the property and is in default.

A. Insight Assets' Vendor Trust Deed is a vendor purchase money mortgage.

Insight Assets' bought the Phalen's purchase money mortgage and steps into their shoes as originator.[32] When a property owner sells a property and finances part of the purchase price, he creates a vendor purchase money mortgage. If this property owner assigns his purchase money mortgage, it retains its original status. As the Utah Supreme Court affirmed recently, "the common law puts the assignee in the assignor's shoes, whatever the shoe size."[33]

In *Gray v. Kappos*, the Utah Supreme Court held, "A purchase-money mortgage is a mortgage which is given upon the property sold to secure the balance of the purchase price remaining unpaid. It is a debt created by the purchase."[34] And although in modern times, trusts—instead of mortgages—are used to finance property, Utah law still recognizes these instruments as purchase money mortgages. In *Nelson v. Stoker*, the Utah Supreme Court wrote "we refer to the term 'purchase money mortgage' as encompassing both mortgages and trust deeds which are given by a vendee to secure a purchase price or unpaid balance."[35]

Purchase money mortgages come in two flavors: vendor and third-party. When the seller of property finances a portion of the purchase price, a "seller carry-back" mortgage is created. The legal term for this instrument is vendor purchase money mortgage.

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[32] *Sunridge v. RB&G*, 2010 UT 6, ¶ 13.

[33] *Ibid.*

[34] *Gray v. Kappos*, 61 P.2d 613, 615 (Utah 1936).

[35] *Nelson v. Stoker*, 669 P.2d 390, 394 (Utah 1983).

When a bank finances a portion of the purchase price, a third-party purchase money mortgage is created.[36]

William and Roberta Boeck bought property from the Phalens. When they bought the Property, they financed part of the purchase price with the Phalens. This financing between the Boecks and the Phalens created a vendor purchase money mortgage.

1. *The Phalens assigned Insight Assets their vendor purchase money mortgage.*

Here, Insight Assets bought the Phalen's purchase money mortgage.[37] Under Utah law, this is still a purchase money mortgage. Utah Code Ann. § 70A-9a-103:

> (6) In a transaction other than a consumer-goods transaction, a purchase-money security interest does not lose its status as such, even if:
>
> (a) the purchase-money collateral also secures an obligation that is not a purchase-money obligation;
>
> (b) collateral that is not purchase-money collateral also secures the purchase-money obligation; or
>
> (c) the purchase-money obligation has been renewed, refinanced, consolidated, or restructured. [38]

Accordingly, although the Vendor Trust Deed changed owners, it retained the same rights, status, and priority.

B. *The Phalen Trust Deed is the first priority deed because when vendor trust deeds and third party trust deeds record concurrently, Utah law favors vendors.*

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[36] See Generally *Kemp v. Zions First National Bank*, 470 P.2d 390 (Utah 1970).

[37] R. 000080 at ¶ 9; 000171.

[38] Utah Code Ann. § 70A-9a-103 (2010).

The Phalen Trust Deed is the first priority lien encumbering this property. Generally, mortgage priority is established by recording order. Yet Utah law recognizes that vendor purchase money mortgages supersede Utah's race-notice statute.

Utah is a race-notice state; usually, the first deed to record is the first deed in priority. Utah Code Ann. § 57-3-103 states:

> Each document not recorded as provided in this title is void as against any subsequent purchaser of the same real property, or any portion of it, if:
>
> (1) the subsequent purchaser purchased the property in good faith and for a valuable consideration; and
>
> (2) the subsequent purchaser's document is first duly recorded.[39]

Yet under Utah legal precedent, vendor purchase money mortgages take priority over other mortgages, regardless of which deed records first. In *Kemp v. Zions First National Bank*, the Utah Supreme Court acknowledged this and wrote:

> ...a purchase money mortgage (plaintiffs' mortgage here), executed in connection with a conveyance of land, or in pursuance of an agreement, as part of a transaction, ordinarily takes preference over any other lien attaching through the financing of the transaction ([purchaser's] mortgage to Zions); and further, more specifically, that, "Where the contest is between a purchase money mortgage to a third person who advances part of the purchase price [Zions Bank] and a purchase money mortgage to the vendor [plaintiff] for the balance, the latter is given preference even if he had notice of the former."[40]

In Colorado, which also has a race-notice statute, the Colorado Supreme Court wrote that, "even a third party who loans money to the purchaser that is applied to the purchase, and who takes back a mortgage on the purchased property, cannot acquire

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[39] Utah Code Ann. § 57-3-103 (2010).

[40] *Kemp v. Zions First National Bank*, 470 P.2d 390, 393 (Utah 1970).

rights to the property from the purchaser unencumbered by the vendor's mortgage, regardless of the order in which the documents are signed."[41]

The only instrument that reprioritizes a vendor's purchase-money mortgage is a subordination agreement. In *Nelson v. Stoker*, the Utah Supreme Court held:

> [I]f the purchaser of land, upon receiving a conveyance thereof, as part of the same transaction executes a mortgage to the vendor to secure a part or the whole of the purchase price, such mortgage... is entitled to priority over any preexisting claims... at least in the absence of an agreement between the parties subordinating the purchase money mortgage to other liens or claims.[42]

In this case, on April 22, 2004, the Boecks created a vendor purchase-money mortgage to the Phalens and a third-party purchase-money mortgage to FFFC simultaneously. These were recorded on the same day at virtually the same time, as evidenced by their near sequential numbering.[43] Importantly, no subordination agreement was recorded and presumably, is nonexistent.[44] Therefore, as a matter of law, the Phalen Trust Deed is the first priority deed on the Property.

C. Despite Wells Fargo's foreclosure, the Phalen Trust Deed still encumbers the property and is unforeclosed.

The Phalen Trust Deed is valid because it cannot be foreclosed by a subordinate lien.

In *Dunlap v. Stichting Mayflower Mountain*, the Utah Court of Appeals reiterated long held law that a junior lien cannot foreclose a senior lien:

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[41] *ALH Holding Co. v. Bank of Telluride*, 18 P.3d 742, 745 (Colo. 2000).

[42] *Nelson v. Stoker*, 669 P.2d 390, 394 (Utah 1983).

[43] R. 000080 at ¶ 6 & 8; R. 000171.

[44] R. 000080 at EXHIBIT K.

> ...most importantly, a mortgage foreclosure action can only affect the interests of a mortgagor and others who hold subsequent and inferior interests to the mortgagee.[45]

In this case, Wells Fargo foreclosed on the Property on June 14, 2005. Yet as established above and as a matter of law, the Phalen Trust Deed is the senior lien upon the property and has been since the Phalen-Boeck sale. Therefore, the Phalen Trust Deed is unaffected by Wells Fargo's foreclosure. The Phalen Trust Deed remains valid and in effect, and the trial court erred in not granting Insight's *in rem* foreclosure.

D. A balance upon the Phalen Trust Deed is owed and due.

The Boecks never made any payment towards the Vendor Trust Deed; they are in default. A principal balance of $17,600, plus interest, costs and attorney fees is due.

E. A de facto subordination agreement is no subordination at all.

Farias concedes that no instrument shows the Phalens agreed to subordinate their trust deed to FFFC, and no subordination agreement was ever executed or recorded on title. Yet he argues that some understanding existed between the parties and created a *de facto* subordination agreement. This argument is factually and legally deficient.

Because there was never any agreement—first there was no meeting of the minds between the Phalens and FFFC; second, the parties never exchanged consideration; and third an unwritten agreement is barred by the Statute of Frauds—Farias cannot establish subordination.

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[45] *Dunlap v. Stichting Mayflower Mountain*, 2003 UT App 283, ¶ 15, 76 P.3d 711.

1. *The Phalens may have erroneously thought they were in a junior lien position to FFFC, but they never entered into any such agreement.*

A valid agreement to subordinate requires an offer and acceptance—or a "meeting of the minds" regarding terms—and consideration; the agreement must be between the vendor(s) and the third party financer.[46] Absent a "meeting of the minds" between these parties, no subordination agreement exists. In this case, no subordination agreement exists and Farias cannot demonstrate one through weak parole evidence.

In this case, FFFC and the Phalens never communicated with each other, either in writing or verbally. This was undisputed by Farias.

The Phalens never agreed to be in a junior position and swore to that under oath. Farias took the depositions of both Joseph and Denise Phalen, under oath, and both stated that they never agreed to be in a junior lien position behind FFFC. That testimony was undisputed by Farias.[47]

Joseph and Denise Phalen testified that they never had any conversations with FFFC regarding whose lien would be first or second,[48] that they never entered into any agreement with FFFC to subordinate their lien position,[49] and that they didn't have knowledge about how to record their lien on the property and was relying on their agents at closing to make sure the documents were recorded properly.[50]

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[46] UTAH REAL PROPERTY LAW § 14.02(h)(3) (2008 Ed.).

[47] R. 000320; 000518.

[48] R. 000611, Tr. 46:2-4, 45:3-6; R. 000612, Tr. 38:5-9.

[49] R. 000611, Tr. 45:10-18; R. 000612, Tr. 38:16-19.

[50] R. 000611, Tr. 52:13-53:1; R. 000612, Tr. 42:23-43:2.

This testimony demonstrates that they never "expressly agreed" to subordinate their trust deed to FFFC.

2. *Not only was there no "meeting of the minds" regarding subordination, but there was no consideration either.*

A first priority lien is a valuable position; a first priority lien holder is virtually guaranteed to recover on the security if the debt goes bad. Giving up such a valuable position requires consideration sufficient to support the promise. And the consideration must be present and valuable.[51]

Farias failed to present evidence of any consideration given by FFFC to the Phalens as consideration for the alleged, cobbled together, tacit agreement Farias is advancing. Without this, any such agreement is void on its face.

3. *To be valid and binding, the Statute of Frauds requires any subordination agreement between the Phalens and FFFC to be in writing.*

Utah Code Ann. § 25-5-1, the Statute of Frauds, explicitly requires all real property agreements and conveyances to be in writing. The problems Farias complained of in its motion underscores the purpose of and need for the Statute of Frauds. Parties pass on, memories fade, companies close, and disputes arise regarding what verbal statements and promises meant.

Farias argues both sides of the Statute of Frauds to an illogical conclusion. In one breath, he argues – incorrectly – that Insights Asset's position requires bona fide purchasers to look beyond recorded documents; something they have no obligation to do. Yet in the next breath, he argues that a verbal understanding between the parties to

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[51] 59 C.J.S. MORTGAGES § 17 (1998).

subordinate priority does not need to be in writing; that we can look beyond recorded documents to establish this. Both cannot be correct.

Insight's position on this issue is consistent and clear—a vendor trust deed recorded simultaneously with a third party trust deed in the same transaction is on its face in a first lien position, without further inquiry into the recorded documents. The nature of the vendor trust deed provides clear notice to anyone looking at title that the vendor trust deed is superior, regardless of recording order.

Conversely, a subordination agreement recorded on title provides clear notice to anyone looking at title that the parties have agreed to subordinate according to the plain terms of that recorded document.

This is the only logical position for the Court to adopt, and accords with Utah law. To accept Farias' position, the Court would necessarily require all persons looking at the title to look beyond the terms of the recorded documents to determine whether there is evidence of an agreement regarding the priority of liens.

POINT II. The trial court erred by determining that Insight's purchase money trust deed was subject to the operation of Utah's Recording Act?

In his motion for partial summary judgment, Farias argued that Insight was not entitled to priority as a vendor. He argued that because FFFC had no notice of the Phalens, the recording acts must apply.[52] Farias went on to state that FFFC did not have notice of the Phalens, and therefore the vendor purchase money rule does not apply, and argued the trial court must defer to the recording act. Insight definitively foreclosed Farias' argument by reciting this Court's holding in *Kemp* which found that the vendor purchase

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[52] R. 000336.

money rule supersedes the recording statute "even if [the vendor] had notice of [the third party mortgagor]."[53]

However, in its decision, the trial court did not discuss the issue of notice, and instead held,

> However, the [Supreme] Court also recognized that "in spite of the foregoing generalities, ...an examination of the authorities and the principles involved will show that the result actually depends upon the circumstances of the given case, the equities, *and the effect of the recording act*. This view is in line with the Restatement. "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." In light of these authorities, the Court believes [Insight's] position overstates the scope of the vendor purchase money priority rule. The rule does not apply in every situation, but is rather subject to the operation of the recording act.[54]

For this Court to adopt the trial court's position would be to completely eviscerate the vendor purchase money doctrine is has established. The trial court's holding is this: the recording act prevents a purchase money trust deed from having priority over a third party deed when it is recorded later in time, but simultaneously as the third party deed. This analysis is incorrect as a matter of law, and the Court must review the trial court's decision for correctness, according it no deference.

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[53] R. 000475 (citing *Kemp v. Zions First National Bank*, 470 P.2d 309, 393 (Utah 1970)).

[54] R. 000573 at ¶ A (internal citations omitted)(emphasis in original).

A. *Regardless of notice, the Purchase Money Mortgage Lien Priority Doctrine supersedes recording statutes.*

Though not addressed by the trial court in its order, Farias cited a property restatement for the proposition that "where only one of the parties has notice of the other, the recording acts... should govern..." Yet this Court specifically addressed this notion and found it lacking.

In *Kemp v. Zions First National Bank*, the Court wrote:

> Where the contest is between a purchase money mortgage to a third person who advances part of the purchase price [Zions Bank] and a purchase money mortgage to the vendor [plaintiff] for the balance, *the latter is given preference even if he had notice of the former*.[55]

And Phalen failed to dispute that FFFC had notice of the Phalens through these documents, but rather argued incorrect points of agency law; yet the documents speak for themselves.[56] FFFC clearly knew the Boecks had obtained additional financing for the full purchase price of the property, and is presumed to have read each of the documents at closing that show the Phalens were securing a trust deed on the property.

In *First Nat'l Bank v. Foote*, the Utah Supreme Court held "the knowledge of [an] agent concerning the business which he is transacting for his principal is to be imputed to his principal."[57] In *Macris v. Sculptured Software, Inc.*, it stated that a principal is imputed with "[a]n agent's knowledge of matters within the scope of his or her authority [because] it is presumed that such knowledge will be disclosed to the principal."[58] And

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[55] *Kemp v. Zions First National Bank*, 470 P.2d 390, 393 (Utah 1970) (emphasis added).
[56] R. 000518.
[57] *First Nat'l Bank v. Foote*, 42 P. 205, 207 (Utah 1895).
[58] *Macris v. Sculptured Software, Inc.*, 2001 UT 43, ¶ 21, 24 P.3d 984.

in *Latses v. Nick Floor, Inc.*, it held this rule is broad and encompasses "all notice or knowledge relating to the subject-matter of the agency which the agent acquires or obtains while acting as such agent and within the scope of his authority."[59]

In this case, both the Phalens and First Franklin shared an agent, US Title. US Title acted as the trustee for both the Phalens' and First Franklin's trust deeds. As Farias noted, the Phalens and First Franklin consummated this transaction with Boecks at the US Title Office.[60] The First Franklin Trust Deed lists "US TITLE" as its trustee; the Phalens' note does too.[61] Accordingly, both First Franklin and the Phalens knew of each other as a matter law. Thus, this Court cannot find that the recording act applies because FFFC did not have notice of the Phalens.

B. Because the Phalens and FFFC had notice of each other's trust deed, Utah Code defers to the Purchase Money Mortgage Priority.

The trial court improperly interpreted Utah law regarding the applicability of the recording act. Utah's Recording Act defers to the Purchase Money Mortgage doctrine where deeds are executed simultaneously and the vendor and third-party financer have notice of each other. Utah Code Ann. § 57-3-102(3) states, "[t]his section does not affect the validity of a document with respect to the parties to the document and all other persons who have notice of the document."

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[59] *Latses v. Nick Floor, Inc.*, 99 Utah 214, 222, 104 P.2d 619, 623 (1940).

[60] R. 000316 at ¶ 10.

[61] R. 000316 at Exhibit I, ¶ (D), and Exhibit B, p. 1, respectively.

This language is nearly identical to the statutory language in the *ALH Holding* case in the Colorado Supreme Court.[62] In that case, the third-party financer (Bank of Telluride) argued that it was entitled to protection from the Recording Act in its State. The holding in the *ALH* case is directly on point to the issues here and favored the vendor. The court's analysis of the applicability of the recording statute and its interaction with the Purchase Money Mortgage doctrine provides significant guidance to this Court in determining the very similar issues under a nearly identical statute.

The Colorado Supreme Court held in *ALH* that the recording statute did not apply because the vendor and Bank of Telluride had notice of each other's trust deeds. The relevant language of Colorado's recording statute reads, "No ...document shall be valid as against any class of persons with any kind of rights who first records, except between the parties thereto and such as have notice thereof."[63]

The *ALH* court held, "[a]ccording to the plain language of the statute, even though the later grantee's instrument was recorded first, it still cannot benefit from the recording statute if it has notice of the earlier unrecorded instrument."[64]

The court went on to hold,

> [w]here a security agreement, or mortgage, is executed between a purchaser and a vendor as part of the same transaction in which the purchaser acquires title to the property, execution of the deed and mortgage are considered simultaneous acts. As a matter of law, such a purchaser never has an unencumbered title to property in which he can assign further rights. Therefore, even a third party who

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[62] *ALH Holding Co. v. Bank of Telluride*, 18 P.3d 742 (2000).

[63] Colorado Revised Statutes § 38-35-109(1) (2000).

[64] *Id.* at 744 (holding, "Therefore, although the Bank's deed of trust was recorded first, the recording statute would confer no priority upon it if it were aware of [vendor's] unrecorded deed of trust before acquiring its own rights in the property.").

> loans money to the purchaser that is applied to the purchase, and who takes back a mortgage on the purchased property, cannot acquire rights to the property from the purchaser unencumbered by the vendor's mortgage, regardless of the order in which the documents are signed.[65]

The court's analysis describes in detail the real property legal underpinnings of the purchase money mortgage doctrine.

In this case, where Phalen conveyed title to Boecks in the same transaction where Boecks gave Phalen a trust deed, the Phalen Trust Deed encumbered the property at the time FFFC took its trust deed on the property. Therefore, the Phalen Trust Deed had priority over the FFFC Deed, despite the fact that the FFFC Trust Deed recorded first. The only way the FFFC Deed could acquire priority over the Phalen Trust Deed would have been if FFFC did not have notice of the Phalen Trust Deed.

However, "[b]y acquiring its rights to the property in the same transaction, with full knowledge that the loan of the vendor [ ] would be secured by deed of trust, the Bank necessarily had notice of [vendor's] unrecorded instrument *within the meaning of the recording statute*...The statute therefore, could not resolve the question of priorities in favor of the Bank."[66] Meaning, because FFFC knew that Phalen was lending Boecks the $17,600 to buy the Property and that Phalen was taking a trust deed to secure their purchase money loan, the recording act cannot provide protection to either FFFC, or Farias.

When the priority of rights in real property is not dictated by the operation of the recording states, the purchase money mortgage doctrine applies.[67]

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[65] *Id.* at 745 (internal citations and quotations omitted).

[66] *Ibid.* (emphasis added).

[67] *Kemp v.* Zions *First National Bank*, 470 P.2d 390 (Utah 1970).

Under Utah law, vendor purchase money mortgages take priority over other mortgages, regardless of which deed records first. In *Kemp v. Zions First National Bank*, the Utah Supreme Court acknowledged this and wrote:

> ...a purchase money mortgage (plaintiffs' mortgage here), executed in connection with a conveyance of land, or in pursuance of an agreement, as part of a transaction, ordinarily takes preference over any other lien attaching through the financing of the transaction ([purchaser's] mortgage to Zions); and further, more specifically, that, "Where the contest is between a purchase money mortgage to a third person who advances part of the purchase price [Zions Bank] and a purchase money mortgage to the vendor [plaintiff] for the balance, the latter is given preference even if he had notice of the former."[68]

This is exactly what the Colorado Supreme Court held in *ALH*, "even a third party who loans money to the purchaser that is applied to the purchase, and who takes back a mortgage on the purchased property, cannot acquire rights to the property from the purchaser unencumbered by the vendor's mortgage, regardless of the order in which the documents are signed."[69]

And as argued in Point I herein, the *Stoker* and Kemp cases hold that regarding vendor purchase money mortgage priority, Utah law is uniform. Insight Assets' Vendor Trust Deed is superior to the Third-Party Deed despite race notice. Thus, the trial court's holding that the recording act eviscerates Insight's priority status under the vendor purchase money mortgage doctrine was an error, and this court should reverse and remand with instructions to the trial court that it must not use the recording act to bar Insight's *in rem* foreclosure.

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[68] *Id.* at 393.

[69] *ALH Holding Co. v. Bank of Telluride*, 18 P.3d 742, 745 (Colo. 2000).

POINT III. The trial court erred in determining that Farias was a bona fide purchaser for value where Farias had actual and/or constructive notice that the vendor trust deed had not been reconveyed?

The trial court's decision holds that portions of Utah's Recording Act creates a bona fide purchaser defense. This is incorrect as a matter of law; the bona fide purchaser affirmative defense is a creature of common law as defined by this Court in *Baldwin v. Burton*.[70] Farias led the trial court into this error because it took this portion of its holding directly from Farias' memorandum in support.[71]

Accordingly, this Court should vacate that portion of the trial court's decision which states,

> Because the vendor purchase money priority rule is subject to the operation of the recording act, the first issue that must be decided by this Court is whether [Farias] is entitled to the protection of Utah's recording act as a bona fide purchaser for value.[72]

The trial court failed to correctly analyze the bona fide purchaser doctrine, and make findings in accordance with that law. This Court should remand on that issue alone.

As a matter of common law, Farias is not entitled to protection as a bona fide purchaser in any event. A bona fide purchaser is "one who pays valuable consideration for a conveyance, acts in good faith, and takes without notice of an adverse claim or others' outstanding rights to the seller's estate."[73]

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[70] *Baldwin v. Burton*, 850P.2d 1188, 1197-98 (Utah 1993).

[71] R. 000330-31.

[72] R. 000575.

[73] *Baldwin v. Burton*, 850P.2d 1188, 1197-98 (Utah 1993).

The trial court's analysis focused only on the notice issue, holding "the question for the Court is whether [Farias] had constructive notice that the priority between the FFFC trust deed and the Phalen trust deed was other than reflected by the order of the recording of the documents."[74]

As Insight demonstrates herein, Farias did have knowledge of the Phalen Trust Deed and therefore cannot take the property free and clear, either under the Recording Act or the bona fide purchaser doctrine.

A. *Farias is not a bona fide purchaser. He had actual notice that the Phalen Trust Deed had not been reconveyed and still encumbered the Property.*

The trial court found that Farias is a bona fide purchaser of the Property—and exempt from foreclosure—because he relied on recorded documents, Utah's race notice statute, and the "axiomatic" *common law* doctrine that upon foreclosure, a senior lien forecloses and extinguishes junior liens. Yet the trial court reached its bona fide purchaser assertion with piecemeal common law. When examining common law as a whole, including the purchase money mortgage doctrine, Farias is not a bona fide purchaser.

1. *In this case and as a matter of law, race-notice is inapplicable*

The trial court found that Farias was a bona fide purchaser because Utah's race notice statute absolves him of any responsibility to look past recording order to determine priority. Accordingly, Insight Assets' Vendor Trust Deed is moot. This argument is plainly false.

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[74] R. 000576.

As stated *supra* in Point I.B. herein, under Utah law, vendor purchase money mortgages take priority over other mortgages, regardless of which deed records first.

And in *Nelson v. Stoker* the Utah Supreme Court specifically held:

> The overwhelming weight of authority recognizes *the special priority accorded* a vendor's purchase money mortgage.(fn2) This Court has also acknowledged that priority. *See Kemp v. Zions First National Bank*, 24 Utah 2d 288, 470 P.2d 390 (1970).[75]

The footnote referenced by the Court points to *nine* treatises for support. Moreover in that case, the Court reaffirms its holdings by concluding that "...this Court recognizes and follows the doctrine granting purchase money mortgages a special priority."[76]

Utah recognizes that Vendor Purchase Money Mortgages are superior to all other liens, specifically Third-Party Vendor Purchase Money Mortgages.

Again, in *Nelson* and quoted at length, the Utah Supreme Court noted that:

> It is familiar learning that a purchase money mortgage, executed at the same time as the deed of purchase of land, or in pursuance of agreement as part of one continuous transaction, takes precedence over any other claim or lien attaching to the property through the vendee-mortgagor. *This is so even though the claim antedates the execution of the mortgage to the seller....*
>
> This rule, of course, is not confined to judgments and attachments; on the contrary, *it extends to all liens legal or equitable*, that otherwise might clasp the land at and with its acquisition by the mortgagor. All such liens, indifferently, yield to the purchase money mortgage.[77]

Regarding vendor purchase money mortgage priority, Utah law is uniform. Insight Assets' Vendor Trust Deed is superior to the Third-Party Deed despite race notice.

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[75] *Nelson v. Stoker*, 669 P.2d 390, 393 (Utah 1983) (emphasis added).

[76] *Id.* at 396.

[77] *Id.* at 394.

2. *The documents recorded on the Property's title show an outstanding lien.*

The trial court held that Farias took possession of the property without notice of an adverse claim or others' outstanding rights to the seller's title and that recorded documents fail to show any outstanding lien. That finding is claim is facially incorrect and wrong as a matter of law.

Under Utah Code, notice is imparted to purchasers regarding "each document executed, acknowledged, and certified...from the time of recording within the appropriate county recorder."[78] And also under Utah Code, "when an obligation secured by a trust deed has been satisfied, the trustee shall, upon written request by the beneficiary, reconvey the trust property."[79]

Where a title record shows a recorded trust deed but no recorded reconveyance, a purchaser has notice that the trust deed still encumbers the property. And in *Baldwin v. Burton*, the Utah Supreme Court held that a purchaser is "required to make inquiry if his findings would prompt further investigation."[80]

Here, Farias had notice of all of the Property's recorded documents. The Property's title shows that the Phalens took a trust deed—the Phalen Trust Deed—on the property they sold to the Boecks. The title also shows, through omission, that the Phalen Trust Deed was never reconveyed. Accordingly, this missing reconveyance notified Farias that a problem with the Phalen Trust Deed may exist; that notice required Farias to in-

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[78] Utah Code Ann. § 57-3-1-2(1) (2010).

[79] Utah Code Ann. § 57-1-33.1(1)(a) (2010).

[80] *Baldwin v. Burton*, 850 P.2d 1188, 1201 n. 46 (Utah 1993) (citing *Diversified Equities, Inc. v. American Savings & Loan Ass'n*, 739 P.2d 1133, 1137 n. 5 (Utah Ct. App. 1987)).

quire about the Vendor Trust Deed and whether it has been satisfied, extinguished, or if it still encumbers the Property.

But Farias never made a proper inquiry into the Property's title because he relied on common law.

3. *Farias cannot use one common law doctrine (Extinguishment by Foreclosure) to determine it is a bona fide purchaser while ignoring another common law doctrine (Vendor Purchase Money Mortgage) which proves it is not.*

As established above: The Phalen Trust Deed is recorded on title; the FFFC Trust Deed is recorded on title; FFFC's foreclosure is recorded on title. The Third Party Mortgage's reconveyance is recorded on title; The Phalen Trust Deed *has no reconveyance because it is nonexistent.*

This is the complete notice that Farias had by examining recorded documents.

Yet the trial court then concluded—wrongly—that the Third Party's foreclosure extinguished the Phalen Trust Deed. It used common law to reach this conclusion.

But this conclusion is the trial court's logical paradox. The trial court used common law—extinguishment by foreclosure—to establish that Farias had no notice that the Phalen Trust Deed still existed. Yet another common law doctrine—the purchase money mortgage doctrine—holds that the Phalen Trust Deed encumbered the Property. And the purchase money mortgage doctrine always supersedes the extinguishment by foreclosure doctrine because, necessarily, the mortgage precedes the foreclosure.

The trial court cannot pick and choose which common law it relies on to establish notice. And in establishing notice, it cannot elevate one doctrine over the other.

B. *As a matter of law and evidenced by Farias's exhibits, FFFC knew the Phalens were financing some of the sale of the Property.*

Farias stated in its memorandum in support of motion for summary judgment, "there is no evidence that [FFFC] knew that the Phalens were providing seller financing."[81] Yet the exhibits he provides prove otherwise.

In *First Nat'l Bank v. Foote*, the Utah Supreme Court held "the knowledge of [an] agent concerning the business which he is transacting for his principal is to be imputed to his principal."[82] In *Macris v. Sculptured Software, Inc.*, it stated that a principal is imputed with "[a]n agent's knowledge of matters within the scope of his or her authority [because] it is presumed that such knowledge will be disclosed to the principal."[83] And in *Latses v. Nick Floor, Inc.*, it held this rule is broad and encompasses "all notice or knowledge relating to the subject-matter of the agency which the agent acquires or obtains while acting as such agent and within the scope of his authority."[84]

In this case, both the Phalens and First Franklin shared an agent, US Title. US Title acted as the trustee for both the Phalens' and First Franklin's trust deeds. As Farias noted, the Phalens and First Franklin consummated this transaction with Boecks at the US Title Office.[85] The First Franklin Trust Deed lists "US TITLE" as its trustee; the Phalens' note does too.[86] Accordingly, both First Franklin and the Phalens knew of each other as a matter law.

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[81] R. 000337.

[82] *First Nat'l Bank v. Foote*, 42 P. 205, 207 (Utah 1895).

[83] *Macris v. Sculptured Software, Inc.*, 2001 UT 43, ¶ 21, 24 P.3d 984.

[84] *Latses v. Nick Floor, Inc.*, 99 Utah 214, 222, 104 P.2d 619, 623 (1940)

[85] R. 000320 at ¶ 10.

[86] *Id.* at Exhibit I, ¶ (D), and Exhibit B, p. 1, respectively.

* * *

If Farias relied on common law at all to supplement his understanding of recorded documents – which he freely admits he did – then he must rely on common law *in its entirety*, including the purchase money mortgage doctrine. If he relied solely on recorded documents, he should have noticed the absence of the Phalen Trust Deed reconveyance.

Farias cannot claim notice ignorance because one common law doctrine is more axiomatic than another. Moreover, Farias' agent, Equity Title Insurance Agency, conducted the title search in this case. Equity Title is aware of the vendor purchase money mortgage lien priority doctrine because in both 2001 and 2005, it published articles instructing its closing agents on the priority of vendor trust deeds and subordination agreements.[87] Farias had record notice that the Vendor Trust Deed encumbered the property. Farias is not a bona fide purchaser.

This is reversible error.

CONCLUSION

WHEREFORE, Insight asks the Court to vacate the trial court's decision, reverse and remand for findings that Insight is entitled to judgment on its *in rem* foreclosure because Farias is not a bona fide purchaser and the vendor purchase money mortgage doctrine prioritizes the Phalen Trust Deed such that it still encumbers the property. Moreover, Insight is entitled to its attorney fees on appeal under the terms of the Phalen Trust Deed and Note.[88]

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[87] R. 000462 at Exhibit D & E.

[88] R. 000001 at Exhibit B & C.

RESPECTFULLY SUBMITTED on this 1 day of ~~July~~ August, 2011.

LAW OFFICES OF
KELLY ANN BOOTH
PLLC

Kelly Ann Booth
Attorney for Appellant

CERTIFICATE *of* SERVICE

This is to certify that on the 1 day of ~~July~~ August, 2011, two true and correct copies of the foregoing were served by the method indicated below, and addressed to the following:

Rodger Burge
Counsel for Farias
PARR BROWN GEE & LOVELESS, P.C.
185 South State Street, Suite 800
Salt Lake City, Utah 84111
(801) 532-7750 Facsimile

- ☒ Hand Delivery
- ☐ U.S. Mail
- ☐ Overnight Mail
- ☐ Facsimile
- ☐ e-Mail

ADDENDUM A

RULES

UTAH RULE OF CIVIL PROCEDURE 56

(a) For claimant. A party seeking to recover upon a claim, counterclaim or cross-claim or to obtain a declaratory judgment may, at any time after the expiration of 20 days from the commencement of the action or after service of a motion for summary judgment by the adverse party, move for summary judgment upon all or any part thereof.

(b) For defending party. A party against whom a claim, counterclaim, or cross-claim is asserted or a declaratory judgment is sought, may, at any time, move for summary judgment as to all or any part thereof.

(c) Motion and proceedings thereon. The motion, memoranda and affidavits shall be in accordance with Rule 7. The judgment sought shall be rendered if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law. A summary judgment, interlocutory in character, may be rendered on the issue of liability alone although there is a genuine issue as to the amount of damages.

(d) Case not fully adjudicated on motion. If on motion under this rule judgment is not rendered upon the whole case or for all the relief asked and a trial is necessary, the court at the hearing of the motion, by examining the pleadings and the evidence before it and by interrogating counsel, shall if practicable ascertain what material facts exist without substantial controversy and what material facts are actually and in good faith controverted. It shall thereupon make an order specifying the facts that appear without substantial controversy, including the extent to which the amount of damages or other relief is not in controversy, and directing such further proceedings in the action as are just. Upon the trial of the action the facts so specified shall be deemed established, and the trial shall be conducted accordingly.

(e) Form of affidavits; further testimony; defense required. Supporting and opposing affidavits shall be made on personal knowledge, shall set forth such facts as would be admissible in evidence, and shall show affirmatively that the affiant is competent to testify to the matters stated therein. Sworn or certified copies of all papers or parts thereof referred to in an affidavit shall be attached thereto or served therewith. The court may permit affidavits to be supplemented or opposed by depositions, answers to interrogatories, or further affidavits. When a motion for summary judgment is

made and supported as provided in this rule, an adverse party may not rest upon the mere allegations or denials of the pleadings, but the response, by affidavits or as otherwise provided in this rule, must set forth specific facts showing that there is a genuine issue for trial. Summary judgment, if appropriate, shall be entered against a party failing to file such a response.

(f) When affidavits are unavailable. Should it appear from the affidavits of a party opposing the motion that the party cannot for reasons stated present by affidavit facts essential to justify the party's opposition, the court may refuse the application for judgment or may order a continuance to permit affidavits to be obtained or depositions to be taken or discovery to be had or may make such other order as is just.

(g) Affidavits made in bad faith. If any of the affidavits presented pursuant to this rule are presented in bad faith or solely for the purpose of delay, the court shall forthwith order the party presenting them to pay to the other party the amount of the reasonable expenses which the filing of the affidavits caused, including reasonable attorney's fees, and any offending party or attorney may be adjudged guilty of contempt.

STATUTES

TITLE 38 PROPERTY- REAL AND PERSONAL

CHAPTER 35 CONVEYANCING AND RECORDING

SECTION 109 INSTRUMENT MAY BE RECORDED- VALIDITY OF UNRECORDED INSTRUMENTS- LIABILITY FOR FRAUDULENT DOCUMENTS.

COLORADO REVISED STATUTES § 38-35-109(1)

(1) All deeds, powers of attorney, agreements, or other instruments in writing conveying, encumbering, or affecting the title to real property, certificates, and certified copies of orders, judgments, and decrees of courts of record may be recorded in the office of the county clerk and recorder of the county where such real property is situated; except that all instruments conveying the title of real property to the state or a political subdivision shall be recorded pursuant to section 38-35-109.5. No such unrecorded instrument or document shall be valid against any person with any kind of rights in or to such real property who first records and those holding rights under such person, except between the parties thereto and against those having notice thereof prior to acquisition of such rights. This is a race-notice recording statute. In all cases where by law an instrument may be filed in the office of a county clerk and recorder, the filing thereof in such office shall be equivalent to the recording thereof, and the recording thereof in the office of such county clerk and recorder shall be equivalent to the filing thereof.

TITLE 57 PROPERTY- REAL ESTATE

CHAPTER 1 CONVEYANCES

SECTION 33.1 RECONVEYANCE OF A TRUST DEED – ERRONEOUS RECONVEYANCE

Utah Code Ann. § 57-1-33.1(1)(a)

(1) (a) When an obligation secured by a trust deed has been satisfied, the trustee shall, upon written request by the beneficiary, reconvey the trust property.

TITLE 57 PROPERTY- REAL ESTATE

CHAPTER 3 RECORDING OF DOCUMENTS

SECTION 103 EFFECT OF FAILURE TO RECORD

Utah Code Ann. § 57-3-103.

Each document not recorded as provided in this title is void as against any subsequent purchaser of the same real property, or any portion of it, if:

(1) the subsequent purchaser purchased the property in good faith and for a valuable consideration; and

(2) the subsequent purchaser's document is first duly recorded.

TITLE 57 PROPERTY- REAL ESTATE

CHAPTER 3 RECORDING OF DOCUMENTS

SECTION 102 RECORD IMPARTS NOTICE- CHANGE IN INTEREST RATE- NOTICE OF UNNAMED INTERESTS- CONVEYANCE BY GRANTEE

Utah Code Ann. § 57-3-102(1).

> (1) Each document executed, acknowledged, and certified, in the manner prescribed by this title, each original document or certified copy of a document complying with Section 57-4a-3, whether or not acknowledged, each copy of a notice of location complying with Section 40-1-4, and each financing statement complying with Section 70A-9a-502, whether or not acknowledged shall, from the time of recording with the appropriate county recorder, impart notice to all persons of their contents.

TITLE 70A UNIFORM COMMERCIAL CODE

CHAPTER 9A UNIFORM COMMERCIAL CODE- SECURED TRANSACTIONS

SECTION 103 PURCHASE MONEY SECURITY INTEREST- APPLICATION OF PAYMENTS- BURDEN OF ESTABLISHING

Utah Code Ann. § 70A-9a-103.

(1) In this section:

(a) "purchase-money collateral" means goods or software that secures a purchase-money obligation incurred with respect to that collateral; and

(b) "purchase-money obligation" means an obligation of an obligor incurred as all or part of the price of the collateral or for value given to enable the debtor to acquire rights in or the use of the collateral if the value is in fact so used.

(2) A security interest in goods is a purchase-money security interest:

(a) to the extent that the goods are purchase-money collateral with respect to that security interest;

(b) if the security interest is in inventory that is or was purchase-money collateral, also to the extent that the security interest secures a purchase-money obligation incurred with respect to other inventory in which the secured party holds or held a purchase-money security interest; and

(c) also to the extent that the security interest secures a purchase-money obligation incurred with respect to software in which the secured party holds or held a purchase-money security interest.

(3) A security interest in software is a purchase-money security interest to the extent that the security interest also secures a purchase-money obligation incurred with respect to goods in which the secured party holds or held a purchase-money security interest if:

(a) the debtor acquired its interest in the software in an integrated transaction in which it acquired an interest in the goods; and

(b) the debtor acquired its interest in the software for the principal purpose of using the software in the goods.

(4) The security interest of a consignor in goods that are the subject of a consignment is a purchase-money security interest in inventory.

(5) In a transaction other than a consumer-goods transaction, if the extent to which a security interest is a purchase-money security interest depends on the application of a payment to a particular obligation, the payment must be applied:

(a) in accordance with any reasonable method of application to which the parties agree;

(b) in the absence of the parties' agreement to a reasonable method, in accordance with any intention of the obligor manifested at or before the time of payment; or

(c) in the absence of an agreement to a reasonable method and a timely manifestation of the obligor's intention, in the following order:

(i) to obligations that are not secured; and

(ii) if more than one obligation is secured, to obligations secured by purchase-money security interests in the order in which those obligations were incurred.

(6) In a transaction other than a consumer-goods transaction, a purchase-money security interest does not lose its status as such, even if:

(a) the purchase-money collateral also secures an obligation that is not a purchase-money obligation;

(b) collateral that is not purchase-money collateral also secures the purchase-money obligation; or

(c) the purchase-money obligation has been renewed, refinanced, consolidated, or restructured.

(7) In a transaction other than a consumer-goods transaction, a secured party claiming a purchase-money security interest has the burden of establishing the extent to which the security interest is a purchase-money security interest.

(8) The limitation of the rules in Subsections (5), (6), and (7) to transactions other than consumer-goods transactions is intended to leave to the court the determination of the proper rules in consumer-goods transactions. The court may not infer from that limitation the nature of the proper rule in consumer-goods transactions and may continue to apply established approaches.

ADDENDUM B