

Case No. A09-312

**STATE OF MINNESOTA
IN SUPREME COURT**

Riverview Muir Doran, LLC,

Respondent,

vs.

JADT Development Group, LLC, et al.,

Respondents,

First Choice Bank,

Respondent,

Darg, Bolgrean, Menk, Inc., et al.,

Defendants,

and

First Choice Bank,

Respondent,

vs.

JADT Development Company, LLC, et al.,

Respondents,

Riverview Muir Doran, LLC,

Respondent,

Darg, Bolgrean, Menk, Inc.,

Defendant,

KKE Architects, Inc.,

Appellant,

and

KKE Architects, Inc.,

Appellant,

vs.

JADT Development Company, LLC,

Respondent,

First Choice Bank, et al.,

Respondents,

Darg, Bolgrean, Menk, Inc., et al.,

Defendants.

The appendix to this brief is not available for online viewing as specified in the *Minnesota Rules of Public Access to the Records of the Judicial Branch*, Rule 8, Subd. 2(e)(2).

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STATEMENT OF THE ISSUES

1. For purposes of determining priority between a mortgagee and a design professional, under Minn. Stat. § 514.05, subd. 1, may a mortgagee claim to be a bona fide mortgagee without actual notice when the mortgagee has actual notice of prior design services provided by an architect or may the mortgagee ignore such notice absent additional notice of an unpaid bill for such services?

The district court decided that “actual notice” refers to notice of the services provided by a design professional and that Mortgagees had actual notice of the services provided by Appellant. Under Minn. R. Civ. P. 56.01, upon motion of Mortgagees, the district court had the authority to enter judgment in favor of Appellant and did so. *See* Mortgagees’ Notice of Motion and for Partial Summary Judgment, Appellant’s Appendix, AA-21-23.

Mortgagees challenged the district court’s judgment in their Notice of Appeal and Appellant submitted a Notice of Review raising the issues regarding bona fide status. *See* Notice of Appeal, AA-49-51, Notice of Review, AA-52-53. The court of appeals decided that “actual notice” requires, not only notice of services provided, but also notice of a debt owed for the work and the court of appeals subordinated Appellant’s lien to the Mortgagees’ on the grounds that they did not know that there was a debt owed for Appellant’s work. Appellant challenged the court of appeals’ decision in their Petition for Further Review. *See* Petition for Further Review, AA-59-65.

Apposite authority:

Minn. Stat. § 514.05, subd. 1.

Kirkwold Construction Company v. M.G.A. Construction, Inc., 513 N.W.2d 241, 245 (Minn. 1994).

STATEMENT OF THE CASE

Between 2003 and 2006, Appellant KKE Architects, Inc. (“Appellant” or “KKE”) performed architectural services for JADT Development Group, L.L.C. (“JADT”) related to the development of a housing project on Parcel I. Trial Stipulation ¶¶ 1, 3, 6-7 (attached to Appellant’s Appendix, hereafter “AA-”), AA-16-17. On March 22, 2005, JADT gave First Choice Bank and Riverview Muir Doran, L.L.C. (collectively

“Respondents” or “Mortgagees”) separate mortgages against the property for the housing project. *Id.* at ¶¶ 12-17, AA-18. The mortgages were closed on March 22, 2005 and recorded on March 23, 2005. *Id.* at ¶¶ 14, 17, AA-18. After the closing, Mortgagees’ closing agent issued KKE a check for \$97,139.33. *Id.* at ¶ 21, AA-19. The agent also drafted and sent KKE a partial lien waiver form expressly stating that payment of \$97,139.33 constituted partial payment for KKE’s work. *Id.* at ¶¶ 21-22, AA-19. In fact, the amount was less than the amount due to KKE. *Id.* at ¶ 23, AA-19. KKE cashed the check and executed the form. *Id.*

JADT defaulted on the mortgages and did not pay KKE for its work in full. *Id.* at ¶¶ 4-5, 23, AA-17, 19. KKE served and recorded its mechanic’s lien statement on November 27, 2006 and served and recorded an amended mechanic’s lien statement on December 29, 2006. *Id.* ¶¶ 8-11, AA-17. On November 27, 2006 and May 18, 2007, respectively, Mortgagees Riverview Muir Doran, L.L.C. and First Choice Bank commenced separate mortgage foreclosure actions. On June 19, 2007, KKE commenced an action to foreclose its mechanics’ lien. KKE’s Complaint, AA-1-5. The Hennepin County District Court, the Honorable Robert A. Blaeser presiding, consolidated the three cases.

On April 18, 2008, Mortgagees jointly moved for partial summary judgment against KKE and the owners of the property. Notice of Motion and Motion, AA-21-23. After a hearing and supplemental briefing by the parties, the court issued an order dated June 30, 2008. Order, AA-24-31. The court found that Mortgagees had actual notice of KKE’s services before they closed and recorded their mortgages. *Id.* ¶ 13, AA-30. The

court ruled that KKE's mechanics' lien was prior and superior to Mortgagees' mortgages and entered judgment for KKE. *Id.*, AA-31.

On November 7, 2008, KKE moved to amend the Findings of Fact, Cconclusions of Law and order dated June 30, 2008. KKE's Notice of Motion and Motion, AA-32-33. In an order dated December 16, 2008, the court granted KKE's motion in part. Order, AA-34-44. The court made additional findings supporting its original determination that Mortgagees had actual notice of KKE's services before the closing and recording of their mortgages and that KKE's mechanics' lien was prior and superior to Mortgagees' mortgages. *Id.* The court also made findings regarding the amount of KKE's lien and awarded attorneys' fees. *Id.*

Mortgagees appealed. Notice of Appeal, AA-49-51. KKE also sought review raising issues about whether a subsequent mortgagee who seeks to claim the status of bona fide mortgagee without actual notice of a prior lien must assert the status as an affirmative defense, who bears the burden of proof regarding such status, and what are the elements of the claim. Notice of Review, AA-52-53. The court of appeals reversed in an opinion filed September 15, 2009. Opinion, AA-54-58. The court decided that actual notice required notice of services and unpaid debt and that Mortgagees did not have notice that JADT owed money to KKE before they closed and recorded their mortgages. *Id.* The court also implied that KKE had the burden of informing Mortgagees that JADT owed KKE money to protect the priority of its lien and that KKE had failed to do so. *Id.*

This Court granted KKE's petition for further review (AA-59-65) on December 15, 2009.

STATEMENT OF FACTS

A. JADT's Housing Project

JADT owned three parcels of land (Parcels I, II, and III) for the purpose of developing a housing project known as River View Homes ("Project"). Trial Stip. ¶ 1, AA-16; Amended Findings at ¶¶ 7, 9, AA-36; Supplemental Affidavit of Gerald Workinger in Support of KKE's Motion to Compel Discovery Against Riverview Muir Doran, Ex. V (Private Placement Memorandum). JADT planned a multi-phase development of Parcels I, II, and III. *See* Private Placement Mem. Phase II involved the construction of condominium units on Parcel I. *Id.* The improvements to Parcel I are the focus of this legal action.

B. KKE Furnished Services for the Improvement of Parcel I and Is Not Paid For Such Services

JADT hired KKE to provide architectural services in connection with the Project, including improvements to Parcel I. Trial Stipulation ¶ 3, AA-17; Amended Findings ¶ 10, AA-36. Between January 2003 and September 2006, KKE furnished services related to the Phase II improvement of Parcel I. Trial Stip. 6-7, AA-17; Affidavit of Robert C. Mayeron ("Mayeron Aff.") ¶ 13, AA-69; Amended Findings at ¶¶ 11-12, AA-36. During these six years, fifty-nine of KKE's employees spent approximately 8,500 hours working on Phase II of the Project. Mayeron Aff. Ex. A. KKE performed \$346,122.45 worth of

services related to the improvement of Parcel I for which it was not paid. Mayeron Aff. at ¶ 12, AA-69; Trial Stip. ¶ 5, AA-17.

KKE performed four categories of architectural services for JADT related to Parcel I: conceptual design, city approvals, design development and construction documents (“DD/CD”), and bidding and negotiation/construction administration. Affidavit of Ryan R. Dreyer in Support of Motion for Partial Summary Judgment (“Dreyer Aff.”), Ex. 7 (August 14, 2001 letter), Ex. 8 (April 8, 2003 letter), Ex. 9 (June 14, 2006 letter). KKE detailed the four categories of services and provided a budget for those services in various letters from KKE to JADT. *Id.* Design development and construction document services were the most expensive services of the Project. *See Id.*

KKE performed work for JADT related to the Project without any formal written contract. Deposition of Robert C. Mayeron (“Mayeron Depo.”) at 16, attached to Appellant’s Addendum, at ADD-33; Mayeron Aff. at ¶ 5, AA-67. JADT was billed at KKE’s standard rates on an open or running account. Mayeron Aff. at ¶ 5, AA-67. On a monthly basis, KKE billed JADT for KKE’s services. *Id.* Some of KKE’s invoices consisted of itemized bills for the time of individual KKE employees. Affidavit of Beverly Olson (“Olson Aff.”) Ex. A. Others consisted of bills itemized according to the four categories of work. *Id.* These bills included (1) a description of KKE’s work (by category), (2) the contract amount for such work (based on KKE’s letter proposals to JADT), (3) the percentage of the contract work completed to date, (4) the amount billed, (5) the amount previously billed, and (6) the amount billed in this invoice. *Id.*

JADT never objected to the amount billed by KKE. Mayeron Depo. at 16, ADD-33; Mayeron Aff. at ¶ 5, AA-67.

C. JADT Gave Mortgages to Mortgagees Against Parcel I and Other Parcels

On March 22, 2005, than two years after KKE had begun its work for JADT, JADT gave Mortgagees separate mortgages against Parcels I, II, and III worth a total of \$20,358,550. Trial Stip. ¶¶ 12-17, AA-18; Dreyer Aff. Exs. 1-2; Amended Findings at ¶¶ 17-22, AA-37-38. JADT obtained the loans to refinance the purchase of Parcel I, to purchase Parcels II and III, and to make improvements to the parcels. Private Placement Mem. at 008. The mortgages were closed on March 22, 2005 and recorded on March 23, 2005. Trial Stipulation, ¶¶ 14, 17, AA-18; Amended Findings at ¶¶ 17-22, 25, AA-37-38; Original Findings at ¶ 20, AA-27.

D. Before Closing and Recording, Mortgagees Received Documents Identifying KKE and Its Ongoing Services to the Project

Before the closing, Mortgagees, their attorneys, and their closer and title insurer, Chicago Title Insurance Company (“Chicago Title”), received documents from one of JADT’s owner’s Tim Baylor in preparation for the closing. Olson Aff. at ¶¶ 3 & Ex. A; Amended Findings at ¶ 38, AA-39; Affidavit of Gerald Workinger in Support of KKE’s Motion to Compel Discovery Against First Choice Bank, Ex. 19 (Responses to Request Nos. 36-41); Supplemental Affidavit of Gerald Workinger in Support of KKE’s Motion to Compel Discovery Against First Choice Bank, Exs. 26-28, 31 (Responses to Request Nos. 3-4, 7-8, 11-12, 19-20, 23-26); Supplemental Affidavit of Gerald Workinger In Support of KKE’s Motion to Compel Discovery Against Riverview Muir Doran, Exs. V,

W, Z (Responses to Request Nos. 13-16, 34-35). These documents not only identify KKE and the services it had provided to the Project, they also indicated that KKE was providing ongoing services to the Project and that it had not completed all of the work under its agreement with JADT.

1. The Invoices.

Before or at closing, JADT gave Chicago Title 27 invoices from KKE to JADT that were issued between June 30, 2003 and January 31, 2005. Olson Aff. ¶¶ 3-4 & Ex. A. KKE's work on the Project occurred between January 17, 2003 and September 1, 2006. The closing took place several months after the date of the last invoice. The invoices indicated that as of January 31, 2005, JADT owed KKE \$97,139.33. *Id.*

Some of the invoices identified the percentage of the work that KKE had completed under the contract. *Id.* (CTIC 0145-0147, 0149, 0158, 0160, 0162, 0167, 0170). These invoices indicated that KKE had not completed its work under the contract as of the date of the invoices. Based on these invoices, one could track KKE's progress in completing the work under the agreement with JADT for the June 30, 2003 through January 31, 2005 time period. The most recent invoice that Chicago Title had was dated January 31, 2005. *Id.* (CTIC 0170), attached to Appellant's Addendum, ADD-25. That invoice stated that KKE had performed 100 percent of the conceptual design work and 100 percent of the city approval work under the contract, but that KKE had only performed 48.31 percent of the DD/CD (design development and construction documents) work and 4 percent of the bidding/negotiation (construction administration) work. *Id.* Accordingly, based on this invoice, Chicago Title had information that KKE

had provided services but had not performed all of the work under its agreement with JADT.

2. The Private Placement Memorandum

At the time of closing, Mortgagees and Chicago Title had a Private Placement Memorandum in their possession. Amended Findings at ¶ 38, AA-39; Affidavit of Gerald Workinger in Support of KKE's Motion to Compel Discovery Against First Choice Bank, Ex. 19 (Responses to Request Nos. 36-41); Supplemental Affidavit of Gerald Workinger in Support of KKE's Motion to Compel Discovery Against First Choice Bank, Exs. 26-28, 31 (Responses to Request Nos. 3-4, 7-8, 11-12, 19-20, 23-26); Supplemental Affidavit of Gerald Workinger In Support of KKE's Motion to Compel Discovery Against Riverview Muir Doran, Exs. V, W, Z (Responses to Request Nos. 13-16, 34-35).

JADT's agent prepared this Memorandum in November 2004 in connection with JADT's efforts to obtain a loan to finance the purchase of a parcel of land and the related construction costs for the Project. Private Placement Mem. at 008. This Memorandum identified KKE and KKE's role as architect of the Project and inspecting architect. *Id.* at 012, 032. It contained KKE's design and floor plans for Parcel I. It also contained a cash flow analysis, which indicated that development of Phase II of the Project was expected to occur between April 2004 and November 2006 and that there were expected construction and architectural costs for this same time period. *Id.* at 037-038. All of this information indicated that KKE's work on the project was ongoing and had not

concluded as of January 31, 2005, the date of the last invoice in the possession of Chicago Title.

3. Other documents referencing KKE

At the time of closing, Mortgagees and their attorneys had other documents in their possession which referred to KKE and its services. First Choice Bank had an appraisal, preliminary plans, a first draw summary, and settlement statement. Workinger Aff. in Support of Motion to Compel Against First Choice Bank, Ex. 19; Supplemental Workinger Aff. in Support of Motion to Compel Against First Choice Bank, Exs. 26, 27, 28, 31. Riverview had the settlement statement. Suppl. Workinger Aff. in Support of Motion to Compel Discovery Against Riverview, Exs. V, W, Z. The appraisal referred to KKE and includes KKE's site, floor and other plans for Parcel I. Suppl. Workinger Aff. Ex. 27. The first draw summary indicated that the sum of \$97,139.33 was due and owing to KKE. The settlement statement indicated that KKE would be paid the sum of \$97,139.33.

E. Mortgagees and Their Insurer Made No Inquiry Concerning KKE and Its Services Before Closing

Despite having received documents referencing KKE and their architectural services related to the improvement of Parcel I, Mortgagees and Chicago Title did not communicate with KKE to determine the amount of JADT's outstanding debt to KKE before closing. Amended Findings at ¶ 29, AA-38; Mayeron Aff. at ¶ 19, AA-70. Nor did it make any inquiry concerning the extent of KKE's lien. Amended Findings at ¶ 30, AA-38. KKE did not communicate with Mortgagees or Chicago Title because it was

unaware that JADT had sought loans from Mortgagees and did not learn the identity of JADT's lenders before it commenced its action to foreclose its mechanic's lien. Amended Findings at ¶¶ 29, 31, AA-38-39; Mayeron Aff. at ¶ 21, AA-70.

F. Chicago Title Sent a Check and a Partial Lien Waiver to KKE on the Date of Closing

The mortgages were closed on March 22, 2005. Trial Stip. ¶¶ 14, 17, AA-18; Original Findings at ¶ 20, AA-27. Chicago Title's Beverly Olson ("Olson") added up the 27 invoices and determined that JADT owed KKE \$97,139.33 for the services covered by those invoices. Olson Aff. ¶¶ 4-5. Chicago Title used some of the loan proceeds to pay KKE for its work. Settlement Statement, Suppl. Workinger Aff. in Support of KKE's Motion to Compel Discovery Against Riverview Muir Doran, Ex. W.

Olson also drafted a partial lien waiver form. Olson Aff. ¶ 5. The form, attached to Appellant's Addendum at ADD-24, expressly provided that the payment of the \$97,139.33 constituted partial payment for KKE's work. Trial Stip. ¶ 22, AA-19. Chicago Title mailed a check to KKE dated March 23, 2005 in the amount of \$97,139.33 and also mailed KKE a partial lien waiver form. Trial Stip. ¶ 21, AA-19; Amended Findings at ¶¶ 24-25, AA-38; Olson Aff. Ex. B (check). Neither the check nor the partial lien waiver was accompanied by a letter or instructions. Amended Findings at ¶ 26, AA-38; Trial Stip. ¶ 22, AA-19.

Receipts and waivers of mechanics' lien rights are common industry forms. The Minnesota Department of Commerce provides model Minnesota Uniform Conveyancing Blanks at its website:

<http://www.state.mn.us/portal/mn/jsp/content.do?subchannel=-536881740&programid=536914031&id=-536881351&agency=Commerce&sp2=y>

Form 40.5.1 is a model receipt and waiver. The model form is designed for use either for partial payments, in which case the waiver is only for the amount paid, or for full and final payment for all labor, skill, or material furnished or to be furnished, in which case the waiver could be for the entire lien. Provision is also allowed for information about payments to subcontractors. This approach is consistent with Minn. Stat. §§ 514.02, 514.03, and 514.07, which, among other things, call for lienors who receive payment to pay their subcontractors and which would allow owners to withhold from payments amounts needed if a lienor's subcontractors are not paid.

The form drafted by Chicago Title is very similar to the model form, and KKE understood its intent and effect to be a partial waiver, not a full release of the entire lien. Mayeron Depo. at 54-56; 34-35, ADD-34, 37. The form expressly provided that payment was partial. ADD-24; Amended Findings at ¶ 25, AA-38. Lines 2-4 of the form state:

The undersigned hereby acknowledges receipt of the sum of \$97,139.33 as
 X PARTIAL PAYMENT for material, labor or service
 FULL AND FINAL PAYMENT for material, labor or
service

ADD-24. Nothing in the form indicated that any waiver was to be given for full and final payment. Chicago Title placed "\$97,139.33" on line 2 based on the total of the 27 invoices that JADT's Baylor provided to Olson. Olson Aff. at ¶¶ 5, 8. This is the payment and waiver amount for the partial release. Chicago Title had the option of indicating whether the payment of \$97,139.33 constituted partial or full payment for

KKE's work. Chicago Title drafted the form indicating that payment of \$97,139.33 constituted partial payment for KKE's work and placed an "X" on line 3, indicating that if KKE executed the form, KKE was acknowledging receipt of the sum of \$97,139.33 as "PARTIAL PAYMENT for material, labor or service" rather than "FULL AND FINAL PAYMENT for material, labor or service." ADD-24. In fact, the amount Chicago Title paid to KKE was less than the amount JADT owed to KKE. Amended Findings at ¶ 27, AA-38; Mayeron Aff. ¶ 18, AA-70.

The last line of the partial lien form stated:

The undersigned affirms that all materials and labor furnished on behalf of the undersigned have been paid in full, EXCEPT: _____

ADD-24. This line asked the lienholder to indicate whether it had paid in full its own subcontractors for the materials and labor furnished on its behalf or whether there are any exceptions to such payments. ADD-24. KKE noted no exceptions, thereby affirming that it had paid its subcontractors, if any. ADD-24.

G. KKE Executed the Partial Lien Waiver and Cashes the Check

On or about April 4, 2005, KKE cashed the check and Mayeron signed the partial lien waiver form on behalf of KKE, acknowledging that the check constituted partial payment for its services to JADT. Trial Stip. ¶ 23, AA-19. He mailed it to Chicago Title. *Id.*; Mayeron Depo. at 52-53, ADD-36-37; Mayeron Aff. at ¶¶ 14-16, AA-69; Amended Findings at ¶ 28, AA-38.

Mayeron understood that a partial lien waiver form is "a document that we sign as we get paid" and "memorializes a progress payment." Mayeron Depo. at 34-35, ADD-

34. Mayeron executed the partial lien waiver form because he understood that the partial lien waiver form was marked “PARTIAL PAYMENT,” he understood that KKE had just received a check from Chicago Title that constituted partial payment for KKE’s services, and he understood that JADT had outstanding debts to KKE. *Id.* at 54-56; 34-35, ADD-34, 37. Mayeron would not execute a full and final lien waiver form unless KKE “had received the last payment for the last invoice on a project” and there was no more work to be done on a project. *Id.* at 58, ADD-38.

Mayeron did not indicate on the partial lien waiver form that JADT had outstanding debt for labor KKE had performed because the partial lien waiver form did not request such information. *Id.* at 59, ADD-38. Mayeron explained: “It’s my understanding that that is for us to list payments to subs that we haven’t made or other payments.” *Id.* at 36, ADD-34. Mayeron affirmed that if he had any subcontractors that KKE had hired and KKE had not made payments to them, he would have put that information on the last two lines of the form. *Id.* at 37, ADD-35.

Mayeron did not believe that by signing this form, he was waiving KKE’s claim of priority because “it [the partial lien waiver] doesn’t say that anywhere.” *Id.* at 54, ADD-37. “[W]hen we sign a partial lien waiver, we are agreeing that to the extent that we have been paid, we are giving up our lien rights.” *Id.* at 34, ADD-34. In executing the partial waiver form, Mayeron understood he was agreeing that KKE’s total lien on the property was reduced by the amount of the partial payment. *Id.*

H. KKE Served its Mechanic's Lien Statement and Amended Statement

On November 27, 2006, KKE served JADT with its mechanic's lien statement in the amount of \$235,996.34. Trial Stip., ¶¶ 8-11, AA-17; Amended Findings at ¶¶ 13-16, AA-36-37. That same day, KKE recorded this first statement. *Id.* On December 29, 2006, KKE served and recorded the amended mechanic's lien statement in the amount of \$358,028.34. *Id.*

I. Ground Was Never Broken for Construction and JADT Defaults on Mortgages

Although KKE provided services for Phase II, ground was never broken for construction of the planned condominiums. Trial Stip. ¶ 24, AA-19; Amended Findings, ¶ 39, AA-39. All work apparently ceased when JADT defaulted on the mortgages.

J. KKE Sought to Foreclose its Mechanic's Lien and Mortgagees Sought to Foreclose Their Mortgages

Mortgagees commenced separate actions to foreclose their mortgages. KKE sought to foreclose its mechanic's lien and learned the identity of Mortgagees at this time. Amended Findings at ¶ 31, AA-39. The district court consolidated the three cases.

K. The District Court Decision

In response to Respondent First Choice Bank's motion for summary judgment, the district court ruled that KKE's mechanics' lien was prior and superior to Mortgagees' mortgages and entered judgment for KKE. Original and Amended Findings at AA-30-31, AA-42-44. The district court concluded that Mortgagees had actual notice of KKE's prior mechanic's lien against Parcel I before recording. Original Findings at 13, AA-30. The court reasoned that Mortgagees had actual notice because Mortgagees had received

documents that referred to KKE and the architectural services furnished by KKE in the improvement to Parcel I before closing but had made no inquiry concerning the extent of KKE's mechanic's lien against Parcel I. Original Findings at 14, 16, AA-30. The district court found that Mortgagees and Chicago Title made no inquiry concerning the extent of KKE's mechanic's lien against Parcel I. Amended Findings at ¶ 30, AA-38. At the time of closing, there was no actual and visible beginning of the improvement on the ground of Parcel I. *Id.* at ¶ 39, AA-39.

Because they had made no inquiry, Mortgagees erroneously believed that KKE had been fully paid for design services already performed. Original Findings at 15, AA-30. For all these reasons, the court determined that KKE's lien was prior and superior to Mortgagees' mortgages and ordered that Parcel I be sold to satisfy KKE's lien. Amended Findings at 3, 5, AA-42.

L. The Decision of the Court of Appeals

The Court of Appeals reversed. Decision dated September 15, 2009, AA-58. The court decided that actual notice required, not merely actual notice of prior professional design services but also actual notice of unpaid debt for those services. *Id.* The court concluded that Mortgagees did not have notice that JADT owed money to KKE before they closed and recorded their mortgages. *Id.* The court implied that KKE should have informed Mortgagees that JADT owed KKE money. *Id.*, AA-57. The court stated that KKE had the opportunity to identify JADT's outstanding debt on the partial lien waiver form in an area of the form that asked the lienholder (KKE) to identify all of the

subcontractors KKE had not paid. *Id.* The court declined to address the burden of a mortgagee with actual notice of prior services to inquire as to such obligation.

The Supreme Court granted KKE's petition for review.

SUMMARY OF LEGAL ARGUMENT

In *Kirkwold Construction Company v. M.G.A. Construction, Inc.*, 513 N.W.2d 241, 245 (Minn. 1994), this Court employed a plain-meaning interpretation of Minn. Stat. § 514.05, subdivision 1, as amended, to hold that if a mortgagee has actual notice of prior lienable work by a professional, its interest is subordinated to the professional's lien. The court of appeals erroneously decided that Mortgagees did not have actual notice of KKE's services within the meaning of Minn. Stat. § 514.05, subd. 1, even though they had notice of the architect's prior design services, for the invalid reason that they did not have notice of a debt owed for the work. This decision should be reversed because the court applied the incorrect legal standard. Moreover, even under the court of appeals' incorrect legal standard, the factual record demonstrates that Mortgagees had actual notice of the services provided and notice of a debt owed for the work.

The legal standard articulated by the court of appeals should be rejected because it is inconsistent with the mechanic's lien statutes and this Court's decisions interpreting those statutes, including the landmark decision *Kirkwold*. The *Kirkwold* approach fairly subordinates subsequent mortgagees' interests to prior liens where they take their interests with actual notice of those prior liens. The court of appeals' conclusion that KKE's lien should be subordinated to Mortgagees' interests is inconsistent with the plain

wording of the controlling statute and is, as well, inconsistent with the remedial nature and essential purpose of the mechanic's lien statute.

The court of appeals failed to address the legal underpinnings necessary for a mortgagee to claim the status of a bona fide mortgagee without actual notice. Without any statutory basis, the court articulated a standard that would condition actual notice on more information than is required even for record notice. The court ignored factual findings by the district court that were sufficient to put the Mortgagees on notice. Also, the court failed to address, and plainly misunderstood, the burden of inquiry and burden of proof associated with a mortgagee's claim of bona fide encumbrancer without actual notice. Likewise, the court erred in giving a *partial* lien waiver the effect that should have been limited to a full and final lien waiver or a subordination agreement, neither of which did Mortgagees request or obtain.

For all these reasons, KKE asks this Court to reverse the court of appeals' decision and affirm the continued vitality of the actual notice standard as articulated in *Kirkwold*. In doing so, this Court would promote the remedial purpose of the mechanic's lien statute and preserve the congruence of the core components of the statutory scheme.

LEGAL ARGUMENT

I. STANDARD OF REVIEW

Statutory construction is a question of law which this Court reviews de novo. *Morton Bldgs., Inc. v. Comm'r of Revenue*, 488 N.W.2d 254, 257 (Minn. 1992). "When the district court grants summary judgment based on the application of a statute to

undisputed facts, the result is a legal conclusion, reviewed de novo.” *Lefto v. Hoggsbreath Enters., Inc.*, 581 N.W.2d 855, 856 (Minn. 1998).

The mechanic’s lien laws should be construed in a manner that promotes the remedial nature of the laws and in favor of sustaining a mechanic’s lien. *Armco Steel Corp. v. Chi. & N.W. Ry. Co.*, 276 Minn. 133, 137-38, 149 N.W.2d 23, 26 (1967). Although mechanic’s lien laws are strictly construed when determining whether a lien attaches, they are liberally construed once the lien has been created. *Dolder v. Griffin*, 323 N.W.2d 773, 779-80 (Minn. 1982). “Mechanics lien laws are remedial in nature, and we have consistently held over the years that they should be liberally construed so as to protect the rights of workmen and materialmen who furnish labor and material in the improvement of real estate.” *Armco Steel Corp.*, 276 Minn. at 137-38, 149 N.W.2d at 26.

This Court has stated:

[W]e are of the opinion that no narrow or limited construction of our mechanic’s lien law should be indulged in by the courts, and that the labor and industry of the country should not be hampered by technicalities or harsh interpretations of what was evidently intended to be a just law for the benefit of our industrial pursuits, which tends so materially to the building of cities and towns, and is the embodiment of so much natural justice. He whose property is enhanced in value by the labor and toil of others should be made to respond in some way by payment and full satisfaction for what he has secured. To accomplish this result is the intent of the lien law.

Emery v. Hertig, 60 Minn. 54, 57, 61 N.W. 830, 831(1895).

II. KIRKWOLD'S PLAIN-MEANING INTERPRETATION OF MINN. STAT. § 514.05, SUBD. 1, DECLARES THAT ACTUAL NOTICE OF LIENABLE WORK BY A DESIGN PROFESSIONAL IS SUFFICIENT TO SUBORDINATE THE MORTGAGE TO THE PROFESSIONAL'S LIEN

In *Kirkwold*, this Court, based on the plain meaning of Minn. Stat. § 514.05, subd. 1, as amended in 1987, held that “if a bona fide purchaser or mortgagee has *notice of lienable work* performed by engineers or surveyors, its interest is subordinated to these liens for the work completed by the engineers and surveyors up to the time of the actual and visible improvement on the ground.” 513 N.W.2d at 245. The Court reasoned that “[t]here is no language in the amendments which subordinates the lien of the engineer or surveyor to the interest of persons with *prior actual notice of the services provided by these professionals.*” *Id.* (emphasis added). Although the mortgagees argued that the Court should follow precedents predating the 1987 amendments, and expressed concerns about the split priority system that would follow, the Court rejected arguments that the designers’ liens could not attach prior to the date of actual and visible improvement on the ground. The Court held that mortgagees with actual notice of prior professional services could not claim priority over liens for those services.

Following *Kirkwold*, the legislature did not further amend Minn. Stat. § 514.05. Thus, the split priority system¹ described in *Kirkwold* has endured for the past 15 years

¹ Following *Kirkwold*, if a professional has a valid lien that predates an actual and visible improvement to real property, and is entitled to priority over a mortgagee’s lien on that property by virtue of actual notice to the mortgagee, other lienholders are not entitled to tack their liens onto the professional’s lien. Thus, for one property, there may be a split in the priority of liens, with one lien for a design professional and a later lien tied to the date of the first visible improvement. All other liens may tack onto the date of the first visible improvement, but not onto the date of the professional’s lien. However, in this

without any indication that the system has proven unworkable or in need of further revision.

The question presented here is what constitutes actual notice for purposes of Minn. Stat. § 514.05. In addressing this issue before the district court and the court of appeals, the parties essentially agreed that *Kirkwold's* interpretation of Minn. Stat. § 514.05 controlled the disposition of this case, but disagreed about the nature of the holding in *Kirkwold*. The district court ruled, and KKE argues here, that the undisputed actual notice of KKE's design services constituted notice of lienable work in accordance with the *Kirkwold* analysis, establishing priority for KKE's lien. Mortgagees argued, and the court of appeals agreed, that *Kirkwold's* interpretation of the "actual notice" provision of the pertinent statutory language requires not only notice of services provided but also notice of a debt owed for the work.

The court of appeals' ruling that "actual notice" requires both actual notice of services provided *and* actual notice of a debt owed for the work is directly contrary to this Court's holding that actual knowledge of prior professional design services constitutes actual notice that the professional has performed lienable services. *Kirkwold* 513 N.W.2d at 245. The court of appeals' interpretation of the mechanics' lien statute undermines, rather than promotes, the remedial nature of the statute. The *Kirkwold* holding, as expressed in the concluding paragraph of the opinion, ties the operative test

case, the record contains no indication of any other liens beside the one architectural lien of KKE.

for actual notice to “lienable work.”² This phrase refers to the type of work that is lienable under Minn. Stat. § 541.01. KKE discusses the application of the term “lienable work” with respect to architectural services in Section V below. For purposes of the immediate discussion, however, it needs to be emphasized that *Kirkwold’s* holding did not specify the necessity of notice of unpaid work.

Mortgagees and the court of appeals focused on the observation in *Kirkwold* that the “trial court found that [Mortgagees] knew that [lienors] had performed lienable work, and knew or should have known that they had not been paid. Under these circumstances, [Mortgagees] had actual knowledge and, therefore, ‘actual notice’ of the possibility that a mechanics lien would attach.” 513 N.W.2d at 244. From this statement, Mortgagees argued and the court concluded that *Kirkwold* requires actual notice, not only of prior lienable services, but also that a then-existing debt was actually owed for the work. The court went on, erroneously, based upon this understanding, to reject KKE’s lien priority despite the trial court’s findings, supported by the record, that Mortgagees knew or should have known that KKE had not been paid in full for its work.

The court of appeals misconstrued and failed to honor the holding in the *Kirkwold* opinion. *Kirkwold’s* holding explicitly ties the priority of a mortgage, relative to a mechanics’ lien, to the question of the mortgagee’s actual notice of the lienor’s professional services, not to actual knowledge of an unpaid amount for services. Moreover, *Kirkwold* followed district court’s findings that the Mortgagees in that case

² Indeed, it can be observed that the court of appeals had noted in the *Kirkwold* case that “Although both [mortgagees] knew of [the lienors’] work, neither knew the two companies had not been paid.”

either knew *or should have known* about unpaid services. Clearly, such a reference was not limited to actual knowledge of a debt, but encompassed what should have been known.

Another problem with what the court of appeals did is that the court of appeals ignored the district court's findings of fact and law, all of which were based upon the record. Specifically, the district court found that KKE had performed lienable work prior to the mortgages, that KKE's bills were unpaid prior to the closing on the mortgages, that payment made to KKE out of loan proceeds represented only partial payment, and that the payment made to KKE did not constitute payment in full to KKE at the time of payment. Amended Findings, ¶¶ 11-12, 25, 27, 35, 38, AA-36, 39-40. The court of appeals disregarded these findings and did not explain the error in them. These findings are, in fact, correct. If there are factual disputes about these points, the proper disposition would be remand for further findings or trial, not outright reversal and judgment in favor of Mortgagees.

The court of appeals gave passing, and erroneous, attention to whether professional lienholders or subsequent mortgagees should bear the duty of inquiry about the matter of payment status. The court of appeals stated that § 514.05, subdivision 1 "does not require a bona fide mortgagee to inquire as to the extent of any lien, but rather requires that the mortgagee must have had actual notice of the lien prior to recording the mortgage for the lien to take priority." *Riverview Muir Doran, LLC v. JADT Dev. Group, LLC*, No. A09-0312, 2009 WL 2928770, at *5 (Minn. Ct. App. Sep. 15, 2009), AA-58. This statement begs the question of what is necessary for a mortgagee to claim the status

of “bona fide” mortgagee, which the court of appeals did not address. Moreover, this statement flies in the face of the holding of *Kirkwold* which, based upon a finding that the mortgagee had actual notice of “lienable work,” explained that the mortgagee was charged with either actual knowledge of unpaid work or what the mortgagee should have known.

III. MORTGAGEES DID NOT SATISFY THEIR BURDEN OF PROOF TO ESTABLISH THEMSELVES AS “BONA FIDE” MORTGAGEES WITHOUT ACTUAL NOTICE

Based on the actual notice requirement articulated in *Kirkwold*, the district court correctly determined that Mortgagees “had actual notice of KKE’s prior mechanic’s lien,” but “made no inquiry concerning the extent of KKE’s mechanic’s lien.” Amended Findings ¶¶ 30, 37, AA-38-39. The court reasoned that, “before the closing, Mortgagees and their attorneys received documents that referred to KKE and the architectural services furnished by KKE.” Amended Findings ¶ 38, AA-39. The court noted that the payment made to KKE out of closing proceeds “expressly provided that payment was partial.” Amended Findings ¶ 25, AA-38. When KKE received the check, “the amount paid was less than the amount due to KKE.” Amended Findings ¶ 27, AA-38. Beyond these findings, the record demonstrates unequivocally that KKE’s work was ongoing, was not yet complete and there was absolutely no basis to conclude that KKE had received full and final payment for all work both done and to be done. Olson Aff. Ex. A (invoices); ADD-25 (January 31, 2005 invoice); ADD-24 (Partial Lien Waiver), Private Placement Mem. The court charged Mortgagees with facts that they knew or should have

known. This was proper given the Mortgagees' actual knowledge of KKE's lienable work.

Kirkwold's reference to what the Mortgagees in that case knew or should have known about the status of payment is consistent with the express statutory condition in the second sentence of Minn. Stat. § 541.05 that a mortgagee must be a “*bona fide* purchaser, mortgagee, or encumbrancer without actual or record notice.” In other contexts, this Court has rejected the argument that a mortgagee who acquired the mortgage with actual knowledge of a prior interest could claim to qualify as a bona fide purchaser if the mortgagee reasonably understood the prior conveyance to be subordinate to his own.

The court of appeals seems to have concluded that KKE failed to carry some unspecified burden of proof about what the Mortgagees should have known. Given the Mortgagees' actual knowledge of the prior services, the court improperly reversed the burden of proof on the question of bona fide status. In *Goette v. Howe*, 232 Minn. 168, 173-74, 44 N.W.2d 734, 738 (1950), this Court held that

[i]t is well settled in this jurisdiction that if defendant . . . wishes to avail himself of the protection of the rule in favor of a bona fide purchaser . . . he must also bear the affirmative burden of proving the concurrence and coexistence of all the following elements: (1) Payment of a valuable consideration; (2) good faith, without purpose to take an unfair advantage of third persons; and (3) absence of notice, actual or constructive, of the outstanding rights of others.

Goette plainly deemed “bona fide” status to be an affirmative defense with the burden to be borne by the mortgagees. *Id.* See also, *Lloyd v Simons*, 90 Minn. 237, 240-

241, 95 N.W. 903, 904-905 (1906). Thus, Mortgagees may not rely upon their lack of information about the nature or extent of KKE's lien in the absence of inquiry.

Similarly, this Court has addressed similar understandings in other cases. For example, in *Republic National Life Insurance Co. v. Marquette Bank and Trust Co. of Rochester*, 312 Minn. 162, 165, 251 N.W.2d 120, 122 (1977), the court recited the same "prerequisites to bona fide purchaser status under the recording statute" as were outlined in *Goette*, citing *Bergstrom v. Johnson*, 111 Minn. 247, 250, 126 N.W. 899, 900 (1910). Likewise, in *Bergstrom*, this Court held that verbal notice of an outstanding permit was actual notice of a prior sale of timber, sufficient to impose a legal obligation to investigate and inquiry which, if not performed, meant that the purchaser could not claim to be a purchaser in good faith. 111 Minn. at 252, 126 N.W. at 901.

The court of appeals refused to consider arguments about the meaning of the term "bona fide" as applicable to purchasers or mortgagees for the ostensible reason that cases referring to section 507.34 of the recording act are not in pari material with section 514.05. This misses the point. The term "bona fide" as it appears in § 541.05 must mean something. Although this Court has not explicitly explained the meaning of the term "bona fide" as it appears in the second sentence of § 541.05, the term should mean the same thing in this statute as it means in other statutes and the cases cited above. *Kirkwold* indicates that a mortgagee with actual knowledge of lienable services is charged with what it knew or should have known about the status of payment is consistent with a proper interpretation of that term. By adopting an interpretation of the term "bona fide" in a manner that contradicts this Court's precedents and the meaning of

the term in other statutes, the court of appeals undermined the congruence of the statutory scheme.

Once the statutory term “bona fide” is given its plain meaning, under the facts as they were found by the district court in this case, the Mortgagees have no legitimate claim that they are “bona fide” mortgagees.³ Absent a showing of “bona fide” status, Mortgagees cannot claim priority over KKE’s lien under the second sentence of § 541.05.

IV. UNDER MINN. STAT. § 514.05, SUBDIVISION 1, THE SAME INFORMATION SHOULD BE REQUIRED FOR “ACTUAL NOTICE” AS FOR “RECORD NOTICE”

Under Minn. Stat. § 514.05, subdivision 1, either actual or record notice is sufficient to defeat the priority of a mortgage relative to a mechanics’ lien. The statute specifies that all that is necessary for record notice is “a brief statement of the nature of the contract.” “Record” notice does require any statement about any bills, paid or unpaid.

Plainly, under Minn. Stat. § 514.05, subdivision 1, had KKE provided “record” notice in the form of a brief statement of the nature of the contract, without any statement about the interim amounts due at any given point in time, the Mortgagees would have no possible claim that their 2006 mortgage has priority over KKE’s 2003 lien for design work.

Neither Mortgagees nor the court of appeals have identified any reason why more information is needed for actual notice than for record notice. There is no reason in the statutory language to suggest that “actual” notice requires any more or different

³ Neither of the Mortgagees expressly pleaded the status of good faith in their answers to KKE’s complaint.

information than for “record” notice. “Actual” notice has the same effect as “record” notice and no different information requirements are suggested in the statute for the two types of notice. Moreover, there is nothing in the statutory language to suggest that “actual” notice can exist only if there is also notice of one or more unpaid bills.

Here, without question, the Mortgagees had actual notice of “the nature of” KKE’s contract and work. So, Mortgagees were in exactly the same situation that they would have been had they been given record notice sufficient to satisfy the statute. Since, in fact, the Mortgagees had actual knowledge of KKE’s work, there is no difference to them in terms of notice than if they had seen the permissible, but not required, filing on record.

V. KKE’S ARCHITECTURAL WORK WAS “LIENABLE WORK” WITHIN THE MEANING OF MINN. STAT. §§ 514.01 AND 514.05

Although there is no question that architectural services are entitled to the lien protections of Minnesota’s mechanics’ lien statutes, and no party has argued otherwise, it is important to explain why this is the case under the statutory scheme and the Court’s case law. The architectural services performed by KKE are improvements within the meaning of Minn. Stat § 514.01. As such, architectural services are “lienable work” within the meaning of §§ 514.01 and 514.05, as interpreted by *Kirkwold*. As to this point, Minn. Stat. § 514.01 provides:

Whoever performs engineering or land surveying services with respect to real estate, or contributes to the improvement of real estate by performing labor, or furnishing skill, material or machinery for any purpose hereinafter stated . . . shall have a lien upon the improvement, and upon the land on which it is situated (emphasis added).

Minnesota cases have long held that architects are protected by Minn. Stat. § 514.01. *Gardner v. Leck*, 52 Minn. 522, 54 N.W. 746, 750 (Minn. 1893) (architectural services are “labor” and “skill” within the meaning of what has become Minn. Stat. § 514.01); *Knight v. Norris*, 13 Minn. 473, 13 Gil. 438, 439 (Minn. 1868) (“We can conceive of no sound reason why [an architect] should not receive the same protection as the carpenter, the mason, the lumber dealer, or the hardware merchant . . .”). An architect is entitled to a mechanic’s lien even though the architectural services are not actually used in the construction of an improvement to the property. The architect has constructively contributed to the improvement of the property. *Lamoreaux v. Andersch*, 128 Minn. 261, 150 N.W. 908, 911 (Minn. 1915); *Jandrich v. Svabeck*, 170 Minn. 24, 211 N.W. 957, 958 (Minn. 1927). Architectural services are “contributions to the improvement of real property” within the meaning of Minn. Stat. § 514.01, even if those services do not result in visible, physical alterations in the property or increase its capital value. *Korsunsky Krank Erickson Architects, Inc. v. Walsh*, 370 N.W.2d 29, 32 (Minn. 1985).

While *Kirkwold* formally dealt with surveyors and engineers, and noted historical changes made in 1974 to explicitly list the work of surveyors and engineers as lienable work, the court’s interpretation of Minn. Stat. § 514.05, as amended in 1987, applies to the work of all professionals. The amendments to add the work of surveyors as lienable work merely put surveyors on the same status as architects had been under the lien statutes for the past century. In this regard, at page 243 of the *Kirkwold* opinion, the statement is made that “[p]rior to 1974, surveyors and engineers were not entitled to mechanics’ liens in Minnesota.” The court cited to two opinions in support of that

statement. That statement was correct with respect to surveyors. See *Anderson v. Breezy Point Estates*, 168 N.W.2d 693, 697 (Minn. 1969).⁴ However, that statement was incorrect with respect to engineers. The *Kirkwold* opinion referred to *Dunham Associates, Inc. v. Group Investments, Inc.*, 310 Minn. 108, 119, 223 N.W.2d 376, 383 (1974). *Dunham*, which was decided on the basis of the lien statutes as they stood prior to 1974, specifically concluded that there is “no rational distinction between the services of an architect who prepares plans and specifications for a building and the services of an engineer who prepares structural, mechanical, and electrical plans for a building. If one is entitled to a lien, it would seem that the other is also.” *Id.* at 380. *Dunham* went on to hold that, however, on the particular record at issue there, the engineer’s inability to demonstrate the interest in the property of the party with whom it had its contract, plus the inability to identify a one-acre parcel as necessary to meet the size limitation of the lien as the statute was then written defeated the engineer’s lien. *Id.* at 384. Thus, *Dunham* actually stands for the proposition that engineers could obtain a lien prior to 1974, just as architects could.

In any event, the point remains that design work by architects has been recognized as “lienable work” for virtually the entire history of Minnesota’s statehood. The fact that the 1974 amendments merely put engineers and surveyors on the same status as architects, and that architects could obtain liens for work even if there was no actual and visible improvement to real property (as established in *Lamoreaux*) was pointed out to

⁴ Of course, as acknowledged in *Kirkwold*, the legislature amended the statute in 1974 to expressly allow surveyors, along with engineers, to claim a lien for their work.

the court in the briefing for *Kirkwold*. Thus, the holding of *Kirkwold*, which refers to the lienability of professional services, applies with equal force to architects.

VI. THE AMOUNT OF KKE'S LIEN IS NOT DEFINED BY THE AMOUNT REFLECTED IN A LIMITED SET OF INTERIM INVOICES

Among the problems with the court of appeals' treatment of the topic of the payment status with respect to KKE is that it has no statutory basis. The court erroneously implied that KKE's lien did not exist if a partial payment was made for that lien. The court did not explain, however, how such a ruling would make sense in relation to KKE's lien amount. It does not make sense. To understand this point, consider what Minnesota's statutes say about the amount of a lien.

Under Minn. Stat. § 514.03, subdivision 1, the amount of a valid lien is the full amount under its contract or, if there is a no contract, the full amount of the reasonable value of its services. Section 514.03, subdivision 1, provides that the lien amount shall be either the "sum agreed upon" or, if there is no such contract for an agreed price, then "for the reasonable value of the work done, and of the skill, material, and machinery furnished." Under the facts of this case, the architect's work was not governed by a fixed, agreed fee. Rather, KKE billed for its services as they were performed.

It is important to consider the application of Minn. Stat. § 514.03 in examining the question of the significance of the partial payment made to KKE out of the mortgage proceeds. There is nothing in the mechanics lien statutes to suggest that KKE or any other lienholder has a series of liens for its work, each to be tied to separate billings. Rather, under Minn. Stat. § 514.03, it is established that the lien for lienable work is for

the one total value, either for an agreed sum or for the total reasonable value of the services.

The court of appeals seemed to suggest that there is some “on and off” nature to liens, depending on whether, at any particular moment, there happens to be an amount owing under the contractual arrangements. Such an approach cannot be reconciled with the import of Minn. Stat. § 514.03 or any other aspect of Minnesota’s lien statute. Neither Mortgagees nor the court cited any case law precedent to suggest that the periodic happenstance of interim or periodic partial payments, whether timely made or not, cause a lien to blink “on and off.”

It is often, indeed usually, the case that an improvement to real property is performed over time. It is often the case that contractors or designers (or other mechanics’ lienholders) are entitled to partial or periodic payments along the way. This does not mean that there are multiple liens tied to each respective incremental payment along the way. To the contrary, there is a single lien measured by the entirety of the contractual improvement or service. It would be a shocking incongruity, and impossible to reconcile with the governing lien statutes, to adopt a rule that suggests that lien claimants suffer an obligation to start a new lien each time a partial payment is made. To the contrary, the governing statutes and law plainly provide that a lien exists from its inception for the full amount of the contract sum or reasonable value.

As will be discussed below, if interim payments are made along the way, such partial payments are limited in their effect to a partial reduction of the overall obligation,

in accordance with Minn. Stat. 514.07. Only final payments made in full. There was no payment in full in this case.

VII. KKE'S LIEN ATTACHED WHEN KKE STARTED ARCHITECTURAL DESIGN WORK

Under the first clause of the first sentence of Minn. Stat. § 514.05, subdivision 1, “all liens . . . shall attach and take effect from the time the first item of material or labor is furnished upon the premises for the beginning of the improvement.” This first clause explicitly applies “as against the owner of the land,” but this rule is not limited in effect to owners, as will be discussed shortly.

Under Minnesota cases this statute has been construed to mean, for architects (and engineers) who prepare design plans, and where the owner abandons and does not build the structure, that the lien attaches when the designer begins work. *Lamoreaux v. Andersch*, 128 Minn. 261, 263-268, 150 N.W. 908, 909-911 (1915). *See also Dunham Associates, Inc. v. Group Investments, Inc.*, 310 Minn. 108, 119, 223 N.W.2d 376, 383 (1974); *Korsunsky Krank Erickson Architects, Inc. v. Walsh*, 370 N.W.2d 29, 32 (Minn. 1985).

While it has often been stated that this rule for the attachment of the architect's lien applies with respect to the owner of the property, the plain statutory language does not limit the attachment rule to the owner. To the contrary, the lien “shall be preferred to any mortgage or other encumbrance not then of record, unless the lienholder had actual notice thereof.” Minn. Stat. § 514.05, subd. 1. In other words, KKE's lien shall be

preferred to any mortgage put on record after the date that KKE started work, *unless* KKE had actual notice of the mortgage at the time it started work.

The facts plainly show that the mortgages in question were not taken or filed until March 2005, long after KKE had started work. There is no suggestion that KKE had notice of such mortgages back in 2003 at the time it started work for this Project. Therefore, under the literal and plain language of the first sentence of Minn. Stat. § 514.05, subd. 1, KKE's lien attached and "shall be preferred" to the subsequent mortgage.

The second sentence of Minn. Stat. § 514.05, subd. 1, imposes an exception to the first sentence, but the exception depends upon certain qualifications. By necessary implication, if the qualifications are not established, then the exception does not come into play. Thus, while the statute provides that, as against a "bona fide purchaser, mortgagee, or encumbrancer without actual or record notice," no lien shall attach prior to the actual and visible beginning of the improvement on the ground, this exception to the rule of the first sentence only comes into play for a "bona fide" purchaser, mortgagee or encumbrancer, and only for one who takes "without actual or record notice." Accordingly, before one can arrive at the question of what is necessary for one to be a "bona fide ... mortgagee" and one "without actual or record notice," it is important to note, simply, that if a mortgagee cannot meet these conditions, the relative priority as between the lien and the mortgage is governed by the first sentence of the same statute. Thus, for a mortgage that does not meet the conditions, the lien "shall be preferred" to the mortgage.

VIII. THE PLAIN MEANING INTERPRETATION OF THE PHRASE “BONA FIDE PURCHASER, MORTGAGEE, OR ENCUMBRANCER WITHOUT ACTUAL OR RECORD NOTICE” SHOULD BE FOLLOWED

Rather than to follow the plain meaning interpretation of the statute laid out in *Kirkwold*, the court of appeals cited and relied upon *M.E. Kraft Excavating and Grading Co. v. Barac Constr. Co.*, 279 Minn. 278, 156 N.W.2d 748 (1968), a case that predates the changes to the pertinent lien statutes that were interpreted in *Kirkwold*. The parties to the *Kirkwold* appeal all debated the import of *Kraft* in light of the 1987 amendment. Although *Kirkwold* did not cite or refer to *Kraft*, it is clear that the *Kirkwold* court did not consider that *Kraft* dictated the proper interpretation of the statute as amended. The court of appeals erred by invoking *Kraft* rather than to follow *Kirkwold*.

Kraft is distinguishable from this case for several reasons. First, most importantly, *Kraft* predates the 1987 amendments to Minn. Stat. § 514.05 that substantially influenced the court’s interpretation of the statute in *Kirkwold*. Second, in *Kraft*, construction on the property had been commenced and was proceeding when the contractor ran out of money and stopped making progress payments to the lien claimants. 279 Minn. at 282, 156 N.W.2d at 751. Here, construction never started. Third, in *Kraft*, the court determined that the mortgagee placed its mortgage at a time during which it “had no knowledge that the architect had not been paid for his services.” 279 Minn. at 281, 156 N.W.2d at 750. Here, of course, the Mortgagees actually did have knowledge that KKE had not been paid for its services because, among other things, they used some of the mortgage proceeds to make payment in exchange for a partial lien waiver. In *Kraft*, the architect’s work had

only been preliminary prior to the mortgages and the working drawings were started after the mortgage had issued.

While *Kraft* stated that the mortgagee in that case did not know, at the time of the mortgage, that the architect had not been paid, this observation does not seem to have been pivotal, however, to the *Kraft* court. *Kraft* relied primarily upon the holding of *Erickson v. Ireland*, 134 Minn. 156, 158 N.W.2d 918 (1916) to the effect that even an architect's lien does not attach prior to the actual and visible beginning of the improvement on the ground, which is a ruling that applies in cases in which there has been such an improvement. *Kraft* essentially distinguished, and did not disturb, the rule of *Lamoreaux*, which applies in instances where there was no improvement on the ground. In any event, *Kirkwold* expressly rejected the mortgagees' arguments that a professional lien could not attach prior to the visible improvement, and knowingly adopted the split priority system entailed by its interpretation of the amended statute. 513 N.W.2d at 244.

Aspects of the statements in *Kraft* are inconsistent, and impossible to reconcile, with this Court's later decision in *Kirkwold*. In *Kirkwold*, the Court stated that "the plain language of the statute indicates that only a bona fide purchaser or mortgagee *without actual notice* shall be given priority over mechanics liens. It would be stretching this phrase far beyond its common meaning to hold that *actual knowledge* did not qualify as "actual notice." *Id.* The *Kirkwold* opinion explicitly rejected the argument that "'actual notice' refers to notice of an existing lien which may arise only with the beginning of the visible improvement on the ground." *Id.* The *Kirkwold* opinion explained: "This

interpretation would render the phrase meaningless. A mortgagee with actual notice of an existing lien arising out of the visible improvement would already be subject to a lien because all liens would have attached with the visible improvement.” *Id.*

In *Kraft*, in contrast, the court had stated that “[i]t is clear from the statutory language as interpreted by our decisions that whether one has the status of a bona fide mortgagee without notice depends upon whether or not there was an actual and visible beginning of the improvement on [sic] the ground prior to the recording of the mortgage.” 279 Minn. at 284, 156 N.W.2d at 752. Thus, *Kraft* was preoccupied with the risks that other lien claimants might tack on to a professional’s lien.⁵ It may be observed that *Kraft* solved this concern by focusing on the reference to the first visible improvement phrasing, while giving short shrift to the meaning of the “bona fide” language, the necessity for absence of notice as to a professional’s lien, and the burden of proof as to any duty of inquiry as it pertained to the professional’s lien. In a situation such as this case, in which there has been no construction start, concerns about additional liens are inapplicable and the only lien in question is that of the architect. In any event, on the basis of the 1987 amendments, the *Kirkwold* Court recognized that the tacking problem had been resolved by the legislature, allowing a plain language interpretation of the relative priority as between lienors and mortgagees.

Because the statute was revised, *Kirkwold* could and did take a different approach that more appropriately reconciled the balance of the interests between a professional

⁵ Similar concerns were identified in other cases, such as *Reuben E. Johnson Co. v. Phelps*, 279 Minn. 107, 156 N.W.2d 247 (1968) leading to similar reasoning. Such other cases that predate the 1987 amendments similarly are inapplicable after *Kirkwold*.

lienholder as against “persons with prior actual notice of the services provided by these professionals.” The *Kirkwold* Court protected the prior professional lienholders while confirming that the statute as amended left no room for other lien claimants to tack onto the professional’s lien attachment. Thus, Mortgagees would have priority as against liens of which they had not been aware, but would not have priority as against liens of which they were aware. This approach gives full meaning to the statutory language and provides an approach that conveys fairness tied to actual notice. While *Kirkwold* did not refer to *Kraft*, it seems abundantly clear that the reasoning of *Kirkwold* leaves little room for *Kraft*’s application to architect’s liens governed by the statute as amended in 1987.

Thus, the court of appeals failed to give effect to the rule that has been in place since *Lamoreaux* that, where there has been no construction start, an architect’s lien attaches from the commencement of the professional services. The court failed to give effect to the statutory interpretation laid out in *Kirkwold* that makes it clear that a mortgagee who takes a mortgage with actual knowledge that the architect has engaged in prior services, the architect’s lien is not subordinated to that mortgage. The court’s reliance upon an interpretation of the statute that predated the 1987 amendments, as reflected in *Kraft*, to the extent that it conflicted with *Kirkwold*, is erroneous.

IX. THE PARTIAL LIEN WAIVER DID NOT DEFEAT OR SUBORDINATE KKE’S LIEN

The court of appeals misinterpreted the Partial Lien Waiver to mean that it was intended to give KKE an opportunity to notify the Mortgagees of additional outstanding debts. The court’s misinterpretation turns the Partial Lien Waiver on its head. The

Partial Lien Waiver was nothing more than an acknowledgment of partial payment, in accordance with the statutory framework in Minnesota's lien statutes. The blank to which the court pointed had nothing to do with additional obligations of the owner to KKE, but rather had to do exclusively with the obligations of KKE to pay its subcontractors, if any, for their respective contributions to the design work.

On its face, the document form has alternative blanks allowing the form to be used either for "PARTIAL PAYMENT for material, labor or service" or for "FULL AND FINAL PAYMENT for material, labor or service." In this instance, for this case, the form was used only for a partial payment, not for a full and final payment. There can be no doubt about this because "X" is plainly marked on the partial payment line, not the full payment line. This salient fact needs to be kept in mind and read together with the acknowledgment typed into the form stating that the undersigned "for value received hereby waives any and all rights to file a mechanic's lien against said property for material, labor or service furnished to said property." This is not a waiver of all liens. Only if that language had been used in conjunction with an "X" on the *full* payment line, could one reasonably construe the document as an intentional waiver of all lien rights. The only line checked was the partial payment line. Accordingly, the only reasonable interpretation of the document is as a *partial* lien waiver, constituting a waiver only to the extent of the partial payment made at that time. The district court recognized this interpretation and there is no error in the district court's findings.

The court of appeals did not explicitly conclude that the Partial Lien Waiver should be interpreted as a waiver of KKE's lien altogether, but the court of appeals did

interpret the document as an opportunity “to state outstanding debt.” The court erred by construing the last sentence of the form as any kind of statement about the status of payments or obligations owed by the developer to KKE for other services provided by KKE. When viewed in light of pertinent statutes, the statement merely constituted an affirmation by KKE that KKE had paid in full its own subcontractors for the materials and labor furnished on behalf of KKE.⁶ The statement included an opportunity for KKE to note any exceptions to such payments but no exceptions needed to be made because KKE indeed had paid its own subcontractors.

This portion of the waiver form relates to the statutory framework set out in Minn. Stat. §§ 514.02, 514.03 and 514.07. Section 514.02 provides that payments received by a person contributing to an improvement to real estate shall be held in trust by that person for the benefit of those persons who furnished the labor, skill, material, or machinery contributing to the improvement. The statute makes it a crime to fail to pay subcontractors and others who furnish the labor and skill.

Section 514.03, subd. 1, provides that the lien amount shall be either the “sum agreed upon” or, if there is no such contract for an agreed price, then “for the reasonable value of the work done, and of the skill, material, and machinery furnished.” Section 514.03, subd. 2(c)(ii) notes that the sum total of liens is reduced by payments made to discharge any lien claims as authorized by Section 514.07. While subdivision 2 formally

⁶ The specific statement is “The undersigned affirms that all materials and labor furnished on behalf of the undersigned have been paid in full, EXCEPT:_____”

applies only to situations in which notice is required by § 514.011, the same principle rationally applies for any payments made, in accordance with section 514.07.

In turn, § 514.07 provides, in part:

The owner may withhold from the owner's contractor as much of the contract price as may be necessary to meet the demands of all persons, other than the contractor, having a lien upon the premises for labor, skill, or material furnished for the improvement, and for which the contractor is liable. The owner may pay and discharge all these liens and deduct the cost of them from the contract price.

Thus, if an owner determines that a lienholder has not paid its subcontractors, the owner is entitled to withhold what is necessary to meet the demands that might be made by those subcontracts. *Cf. Clark v. Anderson*, 88 Minn. 200, 201-02, 92 N.W. 964, 964-65 (1903) (construing a forerunner version of the mechanics' lien statute in effect at that time, and explaining the right of the owner to demand and receive a statement concerning such subcontractors in order to make direct payment).

The last sentence of the Partial Lien Waiver form was plainly drafted with these various statutory provisions in mind. In other words, the last sentence of the form is intended to elicit information from the lienholder to be given to the owner concerning any appropriate deductions from the payment to be made. If the lienholder indicates that it has not properly paid its subcontractors, then the owner can ascertain the amount to be appropriately deducted from the payment. This is true either for partial payments, as applicable here, or for final payments, as would be applicable at the end of a project. This interpretation of the form fairly protects the payor against any obligation to make multiple payments for the given service, while properly preserving and protecting the

priority of the architect's lien in the event of non-payment for other services on the same project by the same designer.

With the foregoing in mind, it becomes clear that the court of appeals misread the partial lien waiver. The last sentence of that document served merely to confirm that KKE was representing to the owner that there were no unpaid subcontractors who might have a lien for which KKE was liable. Thus, the only significance to the fact that the last sentence was presented without any exception merely meant that the owner had no cause to withhold any portion of the indicated payment to meet potential demands of KKE's subcontractors. The last sentence of the form was never intended, and cannot reasonably be construed, as a contradiction of the indication earlier on the same document that the payment made by the owner represented only a partial payment to KKE for KKE's materials, labor or service.⁷

The Partial Lien Waiver provides no basis for changing the attachment date of KKE's lien or for subordinating KKE's lien to a mortgage obtained after that date with actual knowledge of KKE's services. At most, the document is an ambiguous document that cannot be used to undercut the remedial protection of the architect's lien. Purchasers and Mortgagees who are on notice of prior lienable work know how to protect themselves by obtaining subordination agreements from designers or others. Here, there is no such subordination agreement. The district court ruled that there were no discussions about

⁷ If there is ambiguity in the form, this would not support a ruling for the Mortgagees. Ambiguities should be construed against the drafter. *Untiedt v. Grand Labs., Inc.*, 552 N.W.2d 571, 574 (Minn. Ct. App. 1996). If there are factual questions about the form, the proper result would be remand.

subordination of KKE's lien. Amended Findings § 29, AA-38. The plain wording of the partial lien waiver document, in a form of a type routinely used in the construction industry, rules out any suggestion that the partial lien waiver was equivalent to a subordination agreement. The Mortgagees had not even gone so far as to suggest that the document was a subordination agreement.

The suggestion by the court of appeals that the partial lien waiver imposed a duty upon KKE to notify others of outstanding debts flies in the face of common understanding and the facts of this case. To the contrary, the document explicitly noted that the receipt was only "partial payment" and KKE's representative Mr. Mayeron so understood the document. There is no basis for imposing meaning that was outside the ken of the parties at the time. Waiver requires knowing and intentional. Waiver is a voluntary and intentional relinquishment or abandonment of a known right. *Montgomery Ward & Co. v. County of Hennepin*, 450 N.W.2d 299, 304 (Minn. 1990); *Har-Mar, Inc. v. Thorsen & Thorshov, Inc.*, 300 Minn. 149, 156-57, 218 N.W.2d 751, 756 (1974). In theory, a person may waive any legal right, whether contractual, statutory or constitutional. See e.g., *State ex rel Johnson v. Independent School Dist. No. 810*, 260 Minn. 237, 246, 109 N.W.2d 596, 602 (1961). However, both knowledge and intent are essential elements of waiver. *Albrecht v. Sell*, 260 Minn. 566, 569, 110 N.W.2d 895, 897 (1961). Waiver must be based on a full knowledge of the facts. *Cohler v. Smith*, 280 Minn. 181, 189, 158 N.W.2d 574, 579 (1968). There was no basis to conclude that KKE was asked to or agreed to waive its lien rights, except for the limited waiver customarily given in exchange for receipt of partial payment. That does not change the attachment

date of the lien and does not change the gross amount of the lien. It merely serves to ensure that KKE could not seek double payment where partial payment had already been made.

X. THE FACTS SUPPORT PRESERVATION OF THE PRIORITY OF KKE'S LIEN EVEN UNDER THE INCORRECT ACTUAL NOTICE STANDARD ADOPTED BY THE COURT OF APPEALS

Even with the improper legal standard propounded by the court of appeals, the result is still erroneous. The unequivocal facts show that Mortgagees and their agent Chicago Title had actual knowledge that KKE had performed design services for the property, that KKE's work was unfinished, that KKE was owed payment for invoices that had been submitted and had not been paid prior to the closing, and that additional work had been or would be ongoing. Olson Aff. Ex. A (invoices); ADD-25 (January 31, 2005 invoice); ADD-24 (Partial Lien Waiver); Private Placement Mem. The Mortgagees and Chicago Title knew that the payment to KKE would not represent payment in full for the design services, but rather would be partial payment. The very fact that Mortgagees and Chicago Title arranged for a payment to be made to KKE for services rendered as of the date of the package of billings submitted by the borrower shows that the Mortgagees knew there were unpaid services. Olson Aff. §§ 3-9; Settlement Statement. The invoices themselves showed that the design work was less than 50% completed as of the date of the last billing. See ADD-25. The title company sent the payment to KKE with a "Partial Lien Waiver" that, on its face, expressly referred to the fact that the payment was only a partial payment, not payment in full. ADD-24. The district court found that the payment made to KKE was not even payment of the amounts due at the time of payment.

Amended Findings § 27, AA-38. The court of appeals inexplicably ignored the findings of the district court and concluded on its own, without factual citations, that the Mortgagees had not known that KKE was owed money. The court of appeals did not even address what Mortgagees might have learned had they inquired. The point here is, for the moment, that even if the legal standard did require actual notice that KKE was not paid in full, that is exactly what the district court found, quite properly, based upon the evidence in the record.

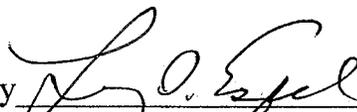
CONCLUSION

Based upon the points and authorities addressed herein, the court of appeals decision should be reversed. The judgment ordered by the district court should be reinstated.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

This brief complies with the word limitations of Minn. R. Civ. App. P. 132.01, subd. 3(a). The brief was prepared using Microsoft Word 2007 (using the Word 97-2003 file format), which reports that the brief contains 12,423 words.