

NO. A09-0312

State of Minnesota
In Supreme Court

Riverview Muir Doran, LLC,

vs.

JADT Development Group, LLC, et al.,

First Choice Bank,

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

and

First Choice Bank,

vs.

JADT Development Group, LLC, et al.,

Riverview Muir Doran, LLC,

Darg, Bolgrean, Menk, Inc.,

KKE Architects, Inc.,

and

KKE Architects, Inc.,

vs.

JADT Development Company, LLC,

First Choice Bank, et al.,

Darg, Bolgrean, Menk, Inc., et al

Respondent,

Respondents,

Respondent,

Defendants.

Respondent,

Respondents,

Respondent.

Defendant,

Appellant,

Appellant.

Respondent,

Respondents,

Defendants.

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INTRODUCTION AND PRELIMINARY STATEMENT

The Minnesota Bankers Association (MBA) is please to provide this Amicus Curiae Brief in support of the Respondent, First Choice Bank.¹ The MBA is filing this Brief pursuant to its previously filed Notice and Request for Leave to Participate as Amicus Curiae, and the Court's order, dated January 5, 2010, granting that request.

The MBA is a trade association representing the commercial banking industry in the State of Minnesota. The MBA was founded in 1889 and represents approximately 415 state and national banks located throughout the state. Its membership includes banks of all sizes, from independent community banks to large regional banks. As a practical matter, the issues presented by this case could potentially affect every financial institution in the State.

The primary purpose of this Brief is to convey to the Court that the legal issues raised by this case have broad implications for not just the banking industry in Minnesota, but the mortgage industry as a whole. The MBA is in full agreement with the analysis and conclusions in Respondent's Brief. The arguments in this Brief will focus on the practical perspective of banks as mortgagees when determining priority status, the need for a workable and reliable method for determining priority status when filing a mortgage, and the potential

¹ This brief was not authored, in whole or in part, by counsel for any party in this action. No party other than the amicus curiae and its members made a monetary contribution to the preparation or submission of this brief.

negative impact on banks and their customers if the scope of actual notice is extended to include inquiry or implied notice.²

STATEMENT OF ISSUES

In determining lien priority status under Minnesota Statute section 514.05, subd. 1, what constitutes actual notice?

STATEMENT OF FACTS

The MBA respectfully incorporates by reference the Statement of Facts set forth by the Respondent's Brief.

² Those issues outside the scope of the record are raised in the interests of fulfilling the role of Amicus Curiae by informing the Court "as to facts or situations which may have escaped consideration or to remind the court of legal matters which may have escaped its notice." Blue Earth County Pork Producers, Inc. v. County of Blue Earth, 558 N.W.2d 25, 30 (Minn. Ct. App. 1997), Cummings v. Koehnen, 568 N.W.2d 418, 424 (Minn. 1997).

ARGUMENT

- I. LENDERS MUST HAVE A CLEAR AND DEFINITE PROCEDURE FOR DETERMINING THE PRIORITY OF MECHANICS' LIENS IN RELATION TO THEIR MORTGAGES AND BE ABLE TO HAVE CONFIDENCE IN THOSE FINDINGS.

Minnesota banks must have a workable and reliable method for determining their priority status when filing a mortgage. Lenders have relied on Minnesota law to provide a clear and definite procedure for determining the priority of mechanics' liens in relation to their mortgages. Introducing new forms of notice will create confusion and uncertainty in addition to being overly burdensome. Banks and other lenders would never have complete confidence in their priority status.

When a bank takes a mortgage of real estate as security for a loan, there are a variety of interests that may make the property less valuable to the bank and must be considered to ensure the loan is fully collateralized. Included in these interests are mechanics' liens.

Because mechanics' liens are statutory creations, lenders look directly to Minn. Stat. § 514.05 in determining the priority status of their mortgages. *See Dolder v. Griffin*, 323 N.W.2d 773, 780 (Minn. 1982) (“mechanics’ liens exist only by virtue of the statute creating them”). Minn. Stat. § 514.05, subd. 1, provides that mechanics’ lienholders have priority over mortgagees if the

mortgagee had recorded or actual notice of the lienholder's interest at the time the mortgage is recorded.

Prudent lending practices, in addition to the statutory requirements, force lenders to look for both recorded and actual notice when determining priority. When searching for recorded notice, lenders look for any liens filed with the County Recorder in the county where the property is located and any brief statements indicating a contract for work on railways, telegraph lines, and similar projects filed with the Minnesota Secretary of State for contracts claimed under Minn. Stat. § 514.04.

Lenders look for actual notice by searching for actual and visible beginnings of improvements to the ground. Any visible improvements to the property made prior to the recording of the mortgage have priority over that mortgage. Minn. Stat. § 514.05, subd. 1. Consequently, lenders often inspect and photograph the property immediately after recording the mortgage to ensure being able to prove that no work had commenced and that their mortgage has priority over any mechanics' liens.

These are established procedures that lenders consistently rely on in determining the priority status of their mortgage. Outside of being specifically told by a lien claimant of their prior interest in the property, lenders are confident that by taking these steps, their findings are an accurate reflection of their priority status.

The ability to determine priority absent doubt or uncertainty is essential for a lender. It is vital for lenders to be able to make sound lending decisions. In the economic environment that exists today, that ability has never been more important. Public outcry and regulatory actions indicate the absolute imperativeness for sound lending procedures and decisions. At the same time, there continues to be a clamor for increased lending to stimulate the economy. Any uncertainty in priority on the part of the lender deviates from sound lending practices and will reduce lending. Lenders will be far less willing to, or even able to, make loans that contain this element of uncertainty.

Confidence in priority benefits not only the lender, but also the borrower. Every angle of the transaction needs to be fully evaluated and accounted for within the loan documents. Once a lender is able to gain a complete picture of the transaction, the borrower is better served. It allows the lender to match the borrower with the best loan product for their needs.

The discovery of a mechanic's lien through either recorded or actual notice requires additional protective steps to be taken by the lender. Most commonly, lenders protect themselves against mechanics' liens by obtaining a title insurance policy. While mechanic's lien coverage under a title insurance policy does not assure statutory priority, it does provide a solvent party to assume the defense of any mechanics' liens claims and someone against which the bank may recover if prior mechanics' liens must be satisfied in order for the bank to realize the full value of the property upon foreclosure and sale.

Lenders may also attempt to collect lien waivers upon discovering a mechanic's lien. A lien waiver by a mechanic's lienholder gives priority to the interest of the lender. In addition, it allows the lender to remove the value of the lien from the value of the property when evaluating the loan to ensure it is properly collateralized. Lenders rely on the plain language of the lien waiver. A partial waiver must specify what claim the mechanic's lienholder retains priority. A complete waiver of any potential claims is just that – a complete waiver. Any subsequent claims become secondary to the lender's mortgage.

Lenders also take steps to protect their borrowers. Borrowers are customers and banks work hard to ensure customer satisfaction. Upon learning of a mechanic's lien, the lender can clearly convey to the borrower the impact of the existing liens, how it will impact the collateral in relation to the mortgage, and what loan product would best fit their needs. Borrowers can then make educated decisions on how best to proceed. Borrowers are only able to gain a clear perspective of the transaction if lenders are able to provide a clear perspective of a transaction, and this is only possible if lenders are confident in their priority and the methods used to determine that priority.

II. THE ADDITION OF INQUIRY OR IMPLIED NOTICE TO ACTUAL NOTICE CREATES CONFUSION AND UNCERTAINTY, IS OVERLY BURDENSOME, AND MAKES IT VIRTUALLY IMPOSSIBLE FOR A LENDER TO ESTABLISH A PRACTICAL COURSE OF ACTION FOR DETERMINING PRIORITY.

The process of searching for recorded notice through a records search and actual notice through inspection of the property are clear and easily followed procedures. The addition of inquiry or implied notice creates several grey areas starting with the proper procedures and ending with complete uncertainty of priority status.

A search to discover a mechanic's lienholder would take on a whole new meaning. Lenders would never be completely confident that their chosen course of action was sufficient to discover anything that they "should have known" as is demanded by inquiry or implied notice. Because Minn. Stat. § 514.05, subd. 1 does not contemplate the addition of implied or inquiry notice, it does not outline the necessary steps to discover implied or inquiry notice, nor are there established practical steps similar to a record search for recorded notice. Lenders would be forced to determine their own course of action.

Forcing lenders to create their own methods in an attempt to include implied or inquiry notice would result in confusion and uncertainty. No two lenders, nor their legal counsel, would come to the same conclusion of what is the appropriate methodology. Mechanics' lienholders would surely disagree with any method utilized by the lender if it did not uncover an interest the lienholder claims

to be superior to the mortgage. Some may conclude that merely asking the borrower of the existence of other lienholders would be sufficient. Others may believe that independent research on the part of the lender is necessary. The extent of that independent research and how it would be completed would also differ greatly from lender to lender.

What implications are enough to constitute notice? Just how much inquiry is enough? These questions will be raised again and again as lenders struggle to determine their priority under an inclusion of implied or inquiry notice. The statutes do not provide answers. If actual notice was intended to include implied or inquiry notice for priority purposes, it would be specified in Minn. Stat. § 514.05, subd. 1 and the necessary procedures to accomplish this notice outlined. Mechanics' liens are creatures of statute, and are therefore limited to the language of the statute. *See Dolder v. Griffin*, 323 N.W.2d 773, 780 (Minn. 1982).

III. THE EXPANSION OF ACTUAL NOTICE TO INCLUDE IMPLIED OR INQUIRY NOTICE CREATES INNUMERABLE POTENTIAL NEGATIVE EFFECTS.

The potential negative effects of expanding the meaning of actual notice to include implied or inquiry notice are incalculable. The direct impact will be felt by lenders, borrowers, and lienholders. The ripple effect will reach contractors, construction crews, material suppliers, and countless others. It will affect everyone's bottom line.

Banks are a business. And like with any other business that experiences an increased production cost, it can only absorb so much before it has to pass those costs on to the consumer.

Lenders will have to spend time, manpower, and money to develop a method for addressing the addition of implied or inquiry notice. Lenders will have to consult with the attorneys and determine what they believe to be the best approach. Without guidance from the statutes, this will be a time consuming and costly endeavor. Once an approach has been developed, all lenders and loan processors will need to be trained, another drain on time and resources.

The actual research process will cost lenders time and money. It will be ongoing from the time of application until the moment the lender files its mortgage. Lenders will have to check and double check every resource to ensure that a new lienholder did not enter the picture in the interim. Even upon completion, lenders will never be completely confident that no stone has been left unturned.

The uncertainty that remains in the process may lead lenders to take excessive measures to protect their interest in the property as collateral. As mentioned earlier in this brief, many lenders avail themselves of the protection of title insurance upon discovering a mechanic's lien. It may become standard practice for lenders to obtain title insurance on every mortgage loan, regardless of whether a mechanic's lien was discovered prior to the mortgage filing. Many of these policies would likely be unnecessary. The costs of title insurance are passed

down to the borrower. Consequently, the addition of implied or actual notice could be very costly for the borrower.

Title insurance companies will also react to changing climates. Due to an increase in policy demand and an increased likelihood of claims, it is foreseeable that the cost of title insurance will increase. It is also foreseeable that title insurance companies may determine that the increased risk associated with construction loans is too great and stop offering policies for these loans altogether. A reduced number of title insurance companies offering construction loan coverage will only serve to drive the costs up even more.

Other costs will be passed on to all bank customers indirectly. The additional monetary and time costs of research can only be partially absorbed by the bank. These costs will be distributed to and born by all customers in the form of increased fees.

Not all of the potential negative impacts can be summarized in dollars and cents. The increased uncertainty of priority will lead banks to reevaluate their lending practices. A borrower that may have been a desirable customer under the existing priority scheme suddenly becomes undesirable because the lender is unable to determine their priority and the proper value to apply to the collateral. This will result in a tightening of available credit. When borrowers are unable to obtain loans, the ripple effect is immense. One needs only to pick up a newspaper today to see the impact on the economy. Lack of funding leads to a slow down of construction, which leads to a reduced demand for resources and supplies, which

leads to a reduction in jobs, which leads to an increased demand on already struggling government resources. The tightening of credit by reputable and regulated lenders opens the door for unscrupulous lenders and fraud. The total impact is difficult to completely predict, but impossible to ignore.

Another area of concern is existing mortgages. Lenders took these mortgages in reliance on the established methodology of determining priority by record searches and property inspections. Lenders may find themselves in the perilous position of being under-secured because additional steps were not taken to discover any potential inquiry or implied notice, steps that at the time of recording their mortgage were unknown to them. Many of these cases will likely end up before the court, clogging the already overly burdened system and eating away at court resources.

Looking forward, lenders may come to the decision that the increased uncertainty and increased costs are too high to continue offering construction loans to their customers. Lenders will stop offering products to customers if the burden is too great. We are already seeing this happening with the increased regulatory burden applied to some loan products. For example, the Board of Governors of the Federal Reserve introduced a new classification of real estate loan called a high price mortgage loan. *See Truth in Lending*, 73 Fed. Reg. 44,522 (July 30, 2008) (to be codified at 12 C.F.R. pt. 226). Along with this classification came numerous regulatory requirements. After considerable evaluation, some lenders determined the burden was too great and stopped offering products that

were considered high priced mortgage loans. The same thing has happened with the implementation of the Higher Education Opportunity Act. *See Truth in Lending*, 74 Fed. Reg. 41,193 (Aug. 14, 2009) (to be codified at 12 C.F.R. pt. 226). The regulatory burden for offering higher education loans was too great for some lenders, and they stopped offering the product. This same fate could await construction loans.

CONCLUSION

The MBA respectfully urges the Minnesota Supreme Court to uphold the decision of the Court of Appeals in this case. Mechanics' lienholders must provide recorded or actual notice as required by Minn. Stat. § 514.05, subd. 1, to claim priority over recorded mortgagees. Actual notice does not include inquiry or implied notice.

Respectfully submitted,

Dated this 23th day of February, 2010. **Minnesota Bankers Association**

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FORM AND LENGTH CERTIFICATION

This brief was drafted using Word 2007. The font is Times New Roman, proportional 13-point font, which includes serifs. The word count of this brief is 2,923.

Dated: February 23, 2010

A handwritten signature in cursive script, reading "Amanda Reges", written over a horizontal line.