

Case No. A11-2220

STATE OF MINNESOTA
IN SUPREME COURT

J. DesMarais Construction, Inc. and
Big Lake Lumber, Inc.,

Appellants

vs.

Security Property Investments, Inc.; Christopher
Schonning; Wright Lumber & Millwork, Inc.,
Pearson Plumbing Corp.,

Respondents.

**APPELLANT J. DESMARAIS CONSTRUCTION, INC.'S
BRIEF, ADDENDUM AND APPENDIX**

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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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ISSUE PRESENTED

Does the Court of Appeals' "newly integrated analysis" impermissibly discard existing mechanic's lien law by eliminating the duty of a purchaser or mortgagee to inspect the premises and by discarding the long-established standard of review recognized by this Court?

I. STATEMENT OF THE CASE

This case involves a home construction project built by Mark Hilde's home construction company, MLH Construction, on a lot owned by Mark Hilde's cabinet and remodeling company, M&L Cabinets and Countertops, LLC. Lien claimant Big Lake Lumber designed the home for MLH and supplied MLH with lumber and building supplies. J. DesMarais Construction, Inc. initially served as the framing subcontractor for MLH, but then at mortgage lender, 21st Century Bank's request, replaced MLH and completed construction of the home.

The trial of this case arises from a remand for trial by the Court of Appeals in Big Lake Lumber v. 21st Century Bank, Civil No. A09-2129 (Minn. App. 2010), to determine whether the first visible beginning of the home constructed occurred prior to the recordation of the mortgage. The first appellate decision held that neither party was entitled to summary judgment, because determination of the first visible beginning of the improvement was, under the circumstances presented, a question of fact. The Court made it clear that the factual dispute had to be resolved by trial, and that the facts presented were closely contested such that neither was entitled to prevail as a matter of law:

...Here, the parties primarily dispute whether the work performed by Wruck prior to appellant's mortgage is part of the same continuous improvement as the work performed by respondents after appellant's mortgage. According to our caselaw, this is a factual determination. Big Lake Lumber, Inc., Respondent, vs. Security Property Investments, Inc., A09-2129 (Minn. App. 2009) (unpublished).

On remand, the District Court made extensive findings that the improvement work that was done in August 2006 was the first visible improvement on the ground and that the home that was ultimately built was the same home that was contemplated by Hilde in 2006 when the first work was done. Appendix A-12 - A-28.

On appeal from this decision, the Court of Appeals reversed, applying a "newly integrated analysis" which attempted to harmonize and integrate past judicial decisions regarding separate improvement, abandonment and mortgage priority. The central thrust of the integrated analysis adopted by the Court of Appeals was to attempt to review abandonment and separate improvement decisions arising from two separate statutes, section 514.05 --involving priority disputes between mortgage and mechanics liens (E.g., Kloster-Madsen, Inc. v. Tafi's, Inc., 226 N.W.2d 603 (Minn. 1975), and section 514.08-- involving disputes over whether a lien claimant has filed a lien within 120 days of the last item of work --(E.g., Kahle v. McClary, 255 Minn. 239, 241, 96 N.W.2d 243, 245 (1959)). The Court of Appeals reasoned that the District Court's failure to apply the newly integrated analysis constituted an error of law and therefore the District Court's factual findings were not entitled to appellate deference. Rather than remanding for trial under the newly fashioned legal standard, the Court of Appeals substituted its own new

factual findings and decided the case based on those findings.

II. STATEMENT OF FACTS

This mechanics lien dispute arises from the construction of a home on a single lot located in Zimmerman, Minnesota and purchased by Mark Hilde's corporation, M&L Cabinets and Countertops ("M&L Cabinets"). In 2005, Hilde and his two corporations, M&L Cabinets, and MLH Construction, were in the business of developing, constructing and remodeling homes. Many of the homes that Hilde constructed were spec homes – homes built without an identified purchaser. Tr. 33- 38 (Hilde Testimony), 125 (Wruck Testimony). On occasion, if Hilde could not sell a spec home immediately, Hilde would place his current home on the market and move into the new one until it too could be sold¹. When M&L Cabinets purchased the lot on 168080 - 141st Street NW, Zimmerman, it was a heavily wooded, 2 ½ acre unimproved residentially zoned lot, the last undeveloped lot in the "Fox Hollow" neighborhood. Tr. 27-28. Hilde acquired the Fox Hollow lot because he considered it a "premium lot" for development. Tr. 28. He acquired the lot in the name of M & L Cabinets, a Limited Liability Company, upon advice of his banker and accountant "for business reasons." Tr. 28-29. The Fox Hollow property remained in the name of M & L Cabinets until the closing of the mortgage in October of 2006.

¹ As Hilde explained: "it was pretty common for me and my wife to build a house, live in it, sell it and go on to the next one." (Tr. 35, line 23-24).

Wruck Excavation Clears and Grades Fox Hollow Property. Hilde's

Construction company started work on the Fox Hollow home in August of 2005 by hiring its regular excavation subcontractor, Wruck, and sending him to the Fox Hollow lot to begin preliminary work on the home Hilde intended to build. At the time, Hilde told Wruck that he was going to construct a spec home on the site. Tr. 125. There was conflicting testimony in the trial court as to whether the excavator's pre-closing work (clearing, grading and leveling) was accomplished entirely in August 2005, or whether some of the excavator's work was accomplished in July of 2006, just before the property was staked. The second Court of Appeals' opinion contains contradictory statements as to whether the clearing was accomplished in two phases. In one sentence of the opinion, the Court says that all of the clearing occurred in August of 2005.² Shortly thereafter, however, the Court quotes and credits testimony that additional clearing was accomplished just before the staking, in July of 2006. See Tr. 40-44; Slip Opinion, page 3. We discuss the Court of Appeals resolution of this timing controversy below at page 10.

Despite the controversy over when the clearing work was actually completed, it is undisputed, and the District Court correctly found that the totality of Wruck's pre-recordation work visibly transformed the lot from a densely wooded forest to a lot made

² "Hilde..... had Wruck clear a path on the property on August 13-14, 2005. Hilde paid Wruck for the work, and Wruck performed no further work on the property until after October 27, 2006." Slip opinion, page 3.

ready for construction of a home designed by Big Lake Lumber. The lot was heavily forested, and the clearing project required removal of those trees. Before-and-after aerial photographs show that the lot was significantly changed by Wruck's work. See Trial Exhibit 3A (aerial photo of wooded lot). District Court Findings, ¶¶ 3-5, A-13. In addition to clearing the woods from the construction site, Hilde cleared a "driveable driveway" on the location of the future driveway to access the lot from the road, Tr. 43, and hauled in dirt so that one could drive into the construction site. Finding of Fact ¶ 4, A-13. Wruck also leveled and prepared a pad site on which the home itself could be built, and the pad that was leveled was the pad that was required by Big Lake Lumbers plans for the house that was actually built. The District Court found that this work performed by Wruck before recordation of 21st Century Bank's mortgage resulted in an open, obvious, and noticeable clearing upon which a driveway and residential home could be, and later were, built. Finding of Fact ¶ 5, A-14. A ditch separated the wooded lot from the construction site, and Wruck hauled in fill to allow construction equipment to drive into the cleared site. Tr. 34. The change in the lot was open and obvious to any person who inspected. Finding of Fact ¶ 5.

The work that was done before mortgage recordation was permanent and necessary for the completion of the ultimate construction project. Tr. 34-35. And the excavator who did the excavation work for the septic system was the same excavator who

continued working on the project after the mortgage was recorded.³ After the August clearing and grading, Wruck prepared a septic design, Trial Exhibit 1. This septic design included a layout, showing the location of the pad site that had been cleared for the home, a driveway entrance, the well and primary and alternative septic system. Wruck's septic design reported the results of soil borings and included a "trench and bed worksheet", describing the specifications for an onsite sewage treatment program. Finding of Fact, ¶ 3, A-13. This septic design represented the septic design for the home that was actually built. Finding of Fact ¶ 6, A-14.

Wruck's septic design documents were conveyed to Big Lake Lumber to prepare preliminary plans for the Fox Hollow home. In Spring of 2006, Hilde gave Big Lake Lumber's preliminary plans to J. DesMarais Construction, Inc. so that he could submit a preliminary framing estimate for work to be provided as framing subcontractor to Hilde's construction company. Tr. 91. Hilde wanted the estimate of the total construction cost so that he could begin to advertise the home for sale⁴. Tr. 52. The plans that Hilde provided DesMarais reflected the same home pad, septic system, and driveway location constructed

³ In the District Court, the Bank's counsel also "agree[d]" with the mechanic's lien claimants that "the house [built on the property] never changed from the plans" in place in 2005. 6/5/2008 Hearing Transcript p. 34.

⁴ DesMarais explained: "... I talked to Hilde and said it was prelim to figure out some numbers. So, at that point we did a quick bid and sent it over to him as prelim." Tr. 92.

by Wruck. DesMarais provided his preliminary estimate to Hilde in approximately April of 2006. Tr. 91-92.

Hilde Advertises Fox Hollow Project for Sale as Spec Home. Using Big Lake Lumber's preliminary plans and DesMarais' estimate, Hilde contacted his realtor, Dynamics Real Estate, and the two prepared a construction estimate, to begin advertising the proposed home for sale. (Tr. 35-36). Hilde also asked Big Lake Lumber to turn the preliminary plans into final plan documents which Big Lake Lumber produced at least by June of 2006,⁵ Trial Exhibit 8. In the meantime, Hilde's realtor, Dynamics, began to advertise the lot and the spec home designed by Big Lake lumber at the price determined with the assistance of DesMarais's preliminary estimate. Tr. 35-36.

Hilde provided Big Lake Lumber's final plans to DesMarais in June of 2006 and asked him to provide a firm written framing subcontracting bid to Hilde's contracting company MLH Construction. Tr. 92. These final plans were used for actual construction of the new home, by the engineer and its survey crew for staking, by the general contractor in the actual home construction (Hilde's company MLM), and by MLM's subcontractors, including DesMarais (Tr.87-88).

DesMarais Inspects Site and Prepares Final Bid to MLH. With Trial Exhibit 8 in hand, DesMarais visited the lot to prepare his estimate. Nothing he saw suggested that this project had been abandoned. He saw that the driveway had been cleared so that

⁵ As explained below, the date of DesMarais final framing bid is established by the invoice number on the bid itself. Tr. 94.

construction equipment could access the pad area in the interior of the lot. He saw that an excavator had already been out to the site to clear a pad site. See also Tr. 46. Trees and stumps had been removed. DesMarais testified:

As a subcontractor, at this point, I would consider it a lot. It was something that we were able to drive into. There wasn't tons and tons of room, but enough to get the equipment up there, and a contour pad. When I say contour, level, you know, had been turned soil more or less for an opening of some kind of some kind of structure.....The access in my mind would be a first code[sic] of a driveway. Pretty rough for the reason being that there's a lot of equipment coming in and going to get rutted up. Just kind of something quick to get us as subcontractors into the property.....You could tell either a bobcat or a dozer or something had turned the soil more or less to make the pad bigger, you know, on the knoll or kind of the hillside where this house was located. Tr. 93-94.

The clearing, contoured pad and driveway all conformed to the final plans, Exhibit 8 and to the septic design, Exhibit 1 prepared in 2005. After inspecting the site and the plans, on about July 6, of 2006, DesMarais submitted his framing proposal to MLH Construction.⁶ Tr. 94. Any suggestion that DesMarais built a different home than the home that MLH was advancing in the spring of 2006 is completely contradicted by the evidence. Tr. 87. Everybody – from the lumber yard, to the excavator, to the engineer and his survey crew worked off of these plans throughout. Tr. 87-88.

Hilde Attempts Sale to Shackleton. During July, Hilde had dealings with persons by the name of Schonning, Shackleton and Glime all of whom have some relationship to a company called Security Property Investments, Tr. 37, 38, or Security

⁶ The invoice number 170506 indicates the date on which the framing proposal was submitted as a bid. Tr. 94.

Lending Group. Tr. 70. Although the Court makes extensive reference to the transactions with these persons, the fact is that DesMarais had no idea that they even existed. Tr. 97. During this time period, the property was titled in the name of the developer-contractor's limited liability company. There was nothing on the ground, or anywhere else for that matter, that warned any tradesman that Hilde was building a different home, and in fact he was not. No witness for the bank testified that the Bank or its title company even made a determination as to whether there was a visible beginning of the improvement, nor did anyone testify that such a determination was influenced by a belief that a different house was being constructed. The buyers filed no notification under section 514.06, disclaiming responsibility for the construction project.

On about July 6, 2006, Shackleton signed a purchase agreement for the Fox Hollow property, with a closing date for July 20, 2006, but that purchase agreement did not close. Also in July of 2006, Hilde's construction company retained the services of Bogart-Peterson, land surveyors and civil engineers, to stake the Fox Hollow home in accordance with the final plans prepared by Big Lake Lumber (Exhibit 8). On July 28, 2006, Bogart Pederson sent a two person field crew out to the Fox Hollow property and staked the perimeter of the pad created by Wruck. The staking conformed with Wruck's septic design, with the work already completed on the ground, and with Big Lake Lumber's final plans. A draftsman and land surveyor then prepared a House Staking Certificate for the Fox Hollow home and dated the staking certificate August 7, 2006.

The Staking Certificate corresponds to Wruck's septic plan (Exhibit 1) and the Big Lake Lumber's final plans (Exhibit 8), and the clearing and leveling work that Wruck had done. See Tr. 45-46, Exhibit 9 and 10.

Excavation Crew Returns and Performs Additional Clearing. As explained above, there was a conflict in the testimony as to whether further excavating and clearing work was conducted in 2006 just before the July 28, 2006 staking.⁷ Mr. Hilde, of MLH Construction, emphatically testified that an excavation crew returned to the lot before staking and performed additional clearing work. Tr. 42-44. In fact a portion of Hilde's testimony that clearing work occurred just before the July 2006 staking is quoted in the Court of Appeals decision at the bottom of slip opinion, page 3. This testimony created a problem for Twenty-First Century Bank, because it recognized that if the District Court were to find that additional clearing occurred before mortgage recordation in 2006, that would be fatal to the Bank's position that the first visible beginning of the improvement took place after the October 27, 2006 mortgage recordation. Since the Bank contended (incorrectly) that the July staking was part of a second and separate improvement, it was imperative for the Bank to prove that no visible improvement work occurred in that time

⁷ Big Lake Lumber's brief in this court at page 12 understandably adopts Hilde's testimony at Tr. 42-44 in its recitation of the facts, because as we explain here, the Court of Appeals implicitly adopted that testimony by quoting that testimony at the bottom of Slip Opinion page 3, and relying upon it in the opinion.

period⁸. The Bank understandably resisted vigorously any suggestion that any visible 2006 lienable work took place in 2006 before mortgage recordation, because that would establish that the alleged second improvement that Security Property Investments intended to buy, had its first visible beginning before the mortgage was recorded, even if there were two separate improvements.

The Court of Appeals, however, accepted Hilde's testimony that the clearing was accomplished partly in 2005 and partly just before staking, and that finding was used in the opinion to support the panel's contested finding that constructing the home for Schonning created a separate improvement. By excluding the inquiring lawyer's question from its quotation of Hilde's testimony, however, the opinion omits the important fact that Hilde was describing work that occurred before the July 2006 staking and this occurred before mortgage recordation. This point is not immediately obvious from a cursory reading of the appellate decision, because the quotation at the bottom of Slip Opinion, page 3, omits the question that Mr. Hilde was answering when he delivered that quotation. The question he was answering was whether someone from Wruck's crew did any further work before the closing. The testimony - - accepted by the Court of Appeals - - affirms that before the engineer staked the already existing construction site,

⁸ The District Court found that all of the clearing work was completed in August of 2005. Ordinarily, we would be accepting that finding under the clearly erroneous standard. Our quandary is that the Court of Appeals operates from its own rendition of the facts, and that version of the facts includes acceptance of Hilde's testimony that further clearing work occurred before the July staking.

further clearing was done on the site. Hilde's actual testimony is as follows, italicizing portions not included in the Court of Appeals opinion:

Q. And in order to make that lot buildable, did you have to perform any additional work prior to the closing?

*A. At that time there was in order to even consider a build on there, again, Tony had to be in there to clear some of the lot out so that people could get up in there. The lot had to be staked. The house that they were going to build or I was going to build out there had to be staked. Engineering had to be done.....This was work that had to be done again, because too much time passed from the original.
.Tr. 39.*

.....
Q And are you positive that Mr. Wruck performed that work after the 2005 work, but before the closing in – before the closing?

A Yes. Tr. 43

The Court of Appeals cites this testimony as confirmation that a new project was underway, one built for Schonning or Shackleton, but it completely ignores the fact this testimony, if true, establishes that this second visible clearing was performed before the staking, and hence would have been itself a first visible improvement (see Section 514.05) on the ground of the alleged second project⁹. See Tr. 38-40.

On August 28, 2006, Christopher Schonning signed a Contractor Agreement with Hilde's construction company, MLH Construction, to build the Fox Hollow Home

⁹ In addition to this clearing work, at some time prior to closing, Big Lake Lumber supplied construction materials to the site and fencing was installed. Tr. 42, 79, 86. Resolution of the dispute over the timing of the clearing work was immaterial to the logic of the District Court's factual findings, because the District Court found that all work prior to the closing was part of a single continuous project.

already designed by Big Lake Lumber for \$389,596¹⁰. Schonning did not testify. There was no evidence that Schonning had concluded that work Wruck performed was for a different improvement than the improvement he was buying. There is no evidence that Schonning believed that the work done on the Fox Hollow property was abandoned, nor is there any evidence that he engaged in any form of due diligence regarding the first beginning of improvements. On October 10, 2006, Mr. Schonning crossed out Shackleton's name on the unclosed July 6 purchase agreement, crossed out the closing date, changed the execution date, crossed out the old price and inserted new dates and a new price, leaving the realtor unchanged. The new purchase price was identical to the price listed on the August 28, 2006 construction agreement.

On October 27, Schonning finalized his purchase of the Fox Hollow property and the spec home, executed a mortgage, and authorized draws for Hilde's construction company and his subcontractors. 21st Century presented no testimony that the Bank or title company engaged in due diligence to determine what work had already been done¹¹.

¹⁰ The contract stated that "The Contractor shall furnish all of the materials and perform all of the work shown on the Drawings and/or described on the Specifications entitled Exhibit A as annexed hereto. (Contractor Agreement Article 1), which most certainly would have been Exhibit 8, Big Lake Lumber's final plans.

¹¹ In its Reply Brief in the Court of Appeals, 21st Century Bank asked the Court to strike that portion of our brief that asserted that there was no evidence of an inspection and due diligence to determine whether there was a first visible beginning., on the grounds that we failed to cite anything in the record that establishes a duty to inspect. The brief pages referenced in the Court of Appeals opinion contain 13 references to the transcript, several direct quotations from the transcript, as well as references to and quotations of the District Court's factual findings. The failure to support the duty to

There was no evidence that the Bank or Title Company made an attempt to determine whether there was a visible beginning of the improvement, nor did anyone testify that they relied upon a determination that the work done at the site had been abandoned. The Bank left the record completely silent on whether it even conducted an inspection of the premises. Moreover, there was no evidence that DesMarais or Big Lake Lumber had any idea that the Bank was asserting that the home construction project had been abandoned. The same subcontractors were working on the same plans, continuing to build on the same pad on the same lot.

J. DesMarais Construction then started its work on the premises as subcontractor of Hilde's construction company, MLH. From the lien claimants perspective, the home underway was the very same house for which the pre-closing work had been done. They were working for the same construction company that started the work and the same plans. They were constructing on the same clearing, using the same driveway, the same septic design and the same leveled construction pad. With framing underway, DesMarais ran into Schonning and Shackleton for the first time long after DesMarais' framing work had begun:

[A]ctually the first day, I remember this very well -- the first day that we start doing the roofing, the structure was up. There was numerous people

inspect with reference to the transcript arises, of course, from our belief that the duty stems from the statute itself. We stand foursquare behind our statement in the Court of Appeals brief that the Bank offered no evidence from an inspector or any other witness that demonstrates that an inspection was conducted or that a due diligence process of any kind led to the conclusion that the mortgage would be superior to lien claimants.

stopping by. I later come to find out that it was Security Investments, Chris Schonning, and Jason Shackleton, came in walking around the house and stuff. As a sub we ask that everybody stays out of the structure. It's unsafe. They had clearly stated to me that this was their house. And kind of lit a whole 'nother page on me, more or less, you know, what's going on? At this point, I was assuming or had thought I knew that this was Mark Hilde's property. Tr. 97.

DesMarais eventually substituted for Hilde as general contractor at the request of the Bank's representative, Randy Lee, when Hilde didn't make a timely payment of the draw.

The Bank provided reassurance that payment would be made. DesMarais testified:

Once the structure was up, normally the next step is, first of all, to get a payment, like a progress payment. And then at that point get the house weather-tight, which would include setting windows, getting roofing on, and getting some kind of building wrap on so that the house was secure for the weather. At that point we didn't receive any payment. So, I had found out who the banker was, had called them directly to find out what was going on. Tr. 96. . . .At that point I had called Century 21 Bank, Randy Lee, to find out what was going on. It was a concern of mine as a contractor that we get this house weathered up. We're in November coming into winter. I need to know are we going to get paid, number one, and number two, should we move forward to get this thing weather-tight. . . .He told me we would be getting a payment on the framing, and that there would be a payment as far as getting the roof and the siding done to proceed. Tr. 96-97.

The upshot was that the Bank decided that it wanted DesMarais to complete the home instead of Hilde. As DesMarais explained:

From that point, you know, they had kind of talked about Mark Hilde and whatnot, that they weren't very happy with what was going on, and that they were thinking about firing him. From that point, we got a call from Century 21 Bank asking me if I would be at all interested in contracting the project, being that we had already been in the project, already started the work, to their favor they would like us to see -- come in and finish contracting it. Tr. 98

DesMarais then agreed to accommodate the Bank's request, and he proceeded to take over construction. When the house was complete, however, the Bank refused to provide funds necessary to pay for the complete construction, leaving DesMarais on the hook for the work that the Bank had asked him to perform, and this mechanics' lien action ensued.

III. SUMMARY OF THE ARGUMENT

The Court of Appeals in its final decision remanded this case for trial, explicitly finding that resolution of the priority between the valid liens and 21st Century Bank's mortgage turned on a factual dispute to be resolved by the District Court upon a trial. After trial, the District Court found that work performed before mortgage recordation "was visible, and was performed for the undisputed purpose of clearing the Property to create a home site." The Court continued: "Gathering together Wruck's 2005 work with the work of Plaintiff Big Lake Lumber, Defendant J. DesMarais Construction, and the other subcontractors, it is clear the work forms the single improvement of constructing a home on the Property." District Court Conclusions of Law, page 11. In reversing, the Court of Appeals second decision departs from well established standards governing priority disputes of this kind, by failing to afford appellate deference to the factual findings of the trial court and by failing to recognize that priority decisions rest upon the reasonable conclusions drawn from an inspection of the improvement on the ground. Minn. Stat. § 514.05 subd. 1. Kloster-Madsen, Inc. v. Tafi's, Inc., 226 N.W.2d 603 (Minn. 1975). The principle that priority disputes between mortgage and lien turns on what an

inspection would disclose just prior to recordation is not a judicial invention, it rests on the clear language of section 514.05 subdivision 1, which states that these priority disputes are resolved by reference to the first visible beginning of the improvement “on the ground.”

We generally agree with the summary of the law provided in Big Lake Lumber’s brief. The difference in our emphasis here in this brief arises in three areas. First, in Section IV-A, we point out mechanics liens run with the land. 25 Minnesota Practice Series (Real Estate Law) § 5:18(d), p. 214. The reason for the lien is to make the land subject to the tradesman’s claim for unpaid services, even if the property is sold or otherwise transferred. Holding that an improvement becomes a separate improvement, upon a sale, is tantamount to a direct assault on the principle that once a lien attaches, the lien runs with the land. Then in Section IV-B, we argue that the Court of Appeals newly integrated analysis incorrectly disregards the central role played by the mortgagee’s inspection prior to recordation. The determination of whether work performed prior to mortgage recordation is the first visible beginning of the improvement is based upon what the parties find on the ground, and that determination is a factual dispute which must not be reversed unless clearly erroneous. E.g., Kloster-Madsen, Inc. v. Tafi's, Inc., 226 N.W.2d 603 (Minn. 1975) (“Whether the work done also constituted the actual and visible beginning of the improvement is, as we have long held, a question of fact”); Witcher Const. Co. v. Estes II Ltd. P'ship, 465 N.W.2d 404, 406 (Minn. App. 1991),

review denied (Minn. Mar. 15, 1991) (whether labor was performed as part of distinct improvements ...is a question of fact, and the reviewing court need only determine if the evidence reasonably supports the lower court's finding that the improvement was continuous); Poured Concrete Found., Inc. v. Andron Inc., 529 N.W.2d 506, 510 (Minn. App. 1995), review denied (Minn. May 31, 1995); R.B. Thompson, Jr. Lumber Co. v. Windsor Development Corp., 374 N.W.2d 493 (Minn. App. 1985); R.B. Thompson, Jr. Lumber Co. v. Windsor Development Corp., 383 N. W.2d 357 (Minn. App. 1986); Thompson Plumbing Co., Inc. v. McGlynn Cos., 486 N.W.2d 781 (Minn. App. 1992).

The Court of Appeals shift of the factual focus away from the objective conditions disclosed by an inspection on the ground towards the subjective and undisclosed intent of one of the parties is without precedent. For well over a century, our courts have made the first - beginning determination by looking at the whether the person performing the duty of examining the property is able in the exercise of reasonable diligence to see the improvement. E.g., Wentworth v. Tubbs, 53 Minn. 388, 55 N.W. 543 (Minn. 1893); Lampert Yards, Inc. v. Thompson-Wetterling Construction & Realty, Inc., 302 Minn. 83, 223 N.W.2d 418 (Minn. 1974); Kloster-Madsen, Inc. v. Tafi's, Inc., 226 N.W.2d 603 (Minn. 1975). This is what Section 514.05 requires. Until now, lien claimants and title companies could reliably depend upon the objective facts disclosed by an inspection of the property, and for this reason, the title insurance and construction mortgage industry both have adopted the practice of requiring an inspection of the property, often aided by

an inspector's checklist and then documented with a picture to determine whether construction has begun. See Jesco, Inc. v. Home Life Ins. Co., 357 N.W.2d 123 (Minn. Ct. App. 1984); Richard Knutson, Inc. v. Westchester, Inc., 374 N.W.2d 485, 487 (Minn. Ct. App. 1985). In case after case, we find appellate courts analyzing what the a title inspector found on the ground, or what he reasonably should have found. Hence, this Court's leading decision holds "the test is whether the person performing the duty of examining the premises to ascertain whether an improvement has begun is able in the exercise of reasonable diligence to see it." Kloster-Madsen, Inc. v. Tafi's, Inc., 226 N.W.2d at 607. In Section IV-C, we show that this doctrine is not altered by the leading Court of Appeals cases on separate improvement, which likewise look to the whether an inspection of the property discloses that a new improvement is underway, or that the existing improvement has actually been abandoned. See Superior Construction Services v. Latoria Belton, 749 N.W.2d 388 (Minn. App. 2008) (at the time of recordation of mortgage, home was occupied and construction work fully completed); Langford Tool & Drill Co. v. Phenix Biocomposites, LLC, 668 N.W.2d 438, 443 (Minn. App. 2003) (owner posted warning signs and barricaded site; attorneys assisted in assuring that an inspection would disclose abandonment).

The facts supporting the District Court's findings included the following: (A) The property on which the home was to be constructed was held in the name of a limited liability company owned by the developer, (B) the same general contractor, MLH,

conducted the work performed before the mortgage was recorded and after; (C) all work was performed using the same plans, the same septic system design and the same certificate of survey; (D) The District Court found that clearing, leveling, grading and tree removal cleared the site in August, 2005 for the home that was actually built, (E) throughout 2006 MLH was taking active steps to move the project forward, including the performance of lienable work during this time period; and (F) the Bank did not prove that it relied on objective facts on the ground to determine that there were two separate projects. The project was not barricaded or posted. No inspector, indeed no witness, testified that due diligence was performed and in fact, at summary judgment, the bank conceded that an inspection would have disclosed the existence of construction activities. (G) As found by the Court of Appeals, clearing work occurred in July of 2006, just before the staking, and hence, the first visible beginning preceded mortgage recordation, even if that work were regarded as a separate improvement.

IV. ARGUMENT

A. Once a Mechanics Lien Attaches, it Runs with the Land and is Enforceable Against Purchasers of the Land.

The Court of Appeals found that Hilde's decision to cause his Cabinet company to sell the Fox Hollow Road Property to Schonning turned the Fox Hollow home project into a separate improvement. For this reason, we begin our argument by pointing out that a mechanics lien is granted "upon the land," and it therefore runs with the property. Korsunsky Krank Erickson Architects, Inc. v. Walsh, 370 N.W.2d 29, 32 (Minn. 1985).

Minn. Stat. §514.01. When a first visible improvement to a construction project occurs before conveyance of the property is recorded, the purchaser takes the property subject to any rights of lienholders who did, or will do, work on that project. 25 Minnesota Practice Series (Real Estate Law) § 5:18(d), p. 214. “When improvements are made by one person upon the land of another, all persons interested therein otherwise than as bona fide prior encumbrancers or lienors shall be deemed to have authorized such improvements, insofar as to subject their interests to liens therefor”. Minn. Stat. §514.06. By the time that Schonning closed on his purchase of the Fox Hollow property, there already was a first visible beginning on the ground, including clearing of a dense woods, grubbing, grading, leveling, driveway construction, and staking around the construction pad. Schonning clearly knew that construction was to continue, because he signed a construction contract with MLH Construction to continue construction in accordance with the previously existing plans. The Bank granted a loan to Schonning, and it too had constructive knowledge of that first visible beginning.

This is not a case where Hilde’s construction company, MLH, cancelled its home construction project and sold the property to build a gas station, or shopping center. There has been only one set of house plans from beginning to end; only one septic system design, only one driveway, only one construction pad, and a single location upon which the home was to be built. The Court of Appeals reversed the District Court’s factual finding of single improvement, entirely on the grounds that the home was now going to

be completed for Schonning, instead of Hilde's Cabinet Company. That holding essentially leads to the ultimate conclusion that attachment of a lien can be destroyed by the transfer of the property to a person who wants to buy the very house that has already been begun. And, according to the Court of Appeals, the sale of a property with a lien already attached can free the property of liens, even when no effort is made to warn the tradespeople that the buyer and bank take the position that a new project is underway. In fact, in this case, the Bank itself actually induced DesMarais to take over the construction project. The home was not yet closed up, and winter weather was approaching. The Bank induced DesMarais to finish the house in order for the Bank to save its collateral, but seeks here to arrogate all of the value that DesMarais provided to itself. This is exactly the kind of unfairness that mechanics liens are designed to prevent! Section 514.06 contemplates that the buyer (and its mortgage company) can free themselves from liens only by providing a statutory notice or by obtaining a subordination agreement¹². The Court's opinion makes the statutory notice unnecessary, and creates a trap for unwary tradesmen, by holding that a change in intended purchaser, vacates attachment of the lien, without the required notice.

¹²Any person who has not authorized the same may protect that person's interest from such liens by serving upon the persons doing work or otherwise contributing to such improvement within five days after knowledge thereof, written notice that the improvement is not being made at that person's instance, or by posting like notice, and keeping the same posted, in a conspicuous place on the premises. Minn. Stat. § 514.06.

B. Section 514.05 Is a Constructive Notice Statute Which Requires on the Objective Facts on the Ground.

The Court of Appeals newly integrated analysis fails to recognize that priority disputes between mortgagee and lien claimant revolve around what a reasonably diligent inspection would disclose before mortgage recordation¹³. At this point, our argument proceeds according to the following organization. In Part B-1 we summarize the traditional approach to priority disputes, that the determination of first visible beginning is a question of fact, with the exception that the enumeration of visible improvements is governed precisely by the enumeration of lienable improvements listed in section 514.05 subdivision 1, subject to the exclusion in subdivision 2. In Part B-2, we show that section 514.05 has been construed to require the trial court to focus on the facts disclosed by an inspection of the property, because priority disputes are determined by the first visible improvement “on the ground.” In Part C, we discuss the major recent appellate cases that dispose of disputes where the mortgage lender claims that the first visible beginning proposed by the lien claimants are for a separate improvement. We show that none of these cases suggest that the facts presented here could be resolved in favor of the mortgage lender as a matter of law.

(1) Determining the First Visible Beginning is a Question of Fact.

Under section 514.05, all liens for work, whenever performed, attach as of “the

¹³ The Court's misunderstanding of this fundamental principle even led to the striking from DesMarais brief references to the duty to inspect, because there was no evidence in the record establishing the existence of that duty.

time the first item of material or labor is furnished upon the premises for the beginning of the improvement¹⁴.” However, subdivision 1 of section 514.05 further provides that as to 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.” Section 514.05 thus directs the district court to resolve priority disputes of the kind presented here by applying the phrase “actual and visible beginning of the improvement on the ground” to the facts presented at trial.

Except for the application of the legal definition of improvement (discussed below), this Court and the Court of Appeals have consistently held that whether the labor or materials furnished constitutes the actual and visible beginning of the improvement on the ground is a question of fact. Kloster-Madsen, Inc. v. Tafi's, Inc., 303 Minn. 59, 226 N.W.2d 603 (Minn. 1975); R.B. Thompson, Jr. Lumber Co. v. Windsor Development Corp., 374 N.W.2d 493 (Minn. App. 1985); R.B. Thompson, Jr. Lumber Co. v. Windsor Development Corp., 383 N. W.2d 357 (Minn. App. 1986); Thompson Plumbing Co., Inc. v. McGlynn Cos., 486 N.W.2d 781 (Minn. App. 1992). An improvement is a permanent addition to or betterment of real property that enhances its capital value and that involves the expenditure of labor or money and is designed to make the property more useful or valuable as distinguished from ordinary repairs. Kloster-Madsen, Inc. v. Tafi's, Inc., 303

¹⁴ All liens, as against the owner of the land, 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, and 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.

Minn. 59, 226 N.W.2d 603 (Minn. 1975); Carlson-Greffe Construction, Inc. v. Rosemount Condominium Group Partnership, 474 N.W.2d 405 (Minn. App. 1991). Whether the actual beginning of the improvement on the ground is actually visible, and whether it contributes value to the final product, is a question of fact. Kloster-Madsen, Inc v. Tafi's, 226 N.W.2d 603 (Minn. 1975); Suburban Exteriors, Inc. v. Emerald Homes, Inc., 508 N.W.2d 811 (Minn. App. 1993).

(2) Clearing, Grubbing is Within the Statutory Category of Improvements which Qualify as a First Visible Beginning as a Matter of Law.

The question whether a work that is visible on the ground is an improvement within the meaning of section 514.05 is a mixed question of law and fact.

Kloster-Madsen, Inc. v. Tafi's, Inc., 303 Minn. 59, 226 N.W.2d 603 (Minn. 1975);

Suburban Exteriors, Inc. v. Emerald Homes, Inc., 508 N.W.2d 811 (Minn. App. 1993).

The legal part of this mixed question is now governed by amendments to section 514.05 subdivision 2, and judicial decisions interpreting those amendments, that occurred in the mid-1980's. Prior to 1985, the category of improvements that would qualify as a first visible beginning was the subject of dispute, see National Lumber Co. v. Farmer & Son, Inc., 251 Minn. 100, 887 N.W.2d 32 (Minn. 1957), and liens were often challenged on the grounds that the work done, although lienable and visible, weren't sufficiently connected to the building itself to qualify as the first visible beginning. In 1984, a closely watched Bankruptcy Court decision interpreted amendments to Chapter 514 to establish that all

work listed in Section 514.01 qualifies as priority setting, unless it is expressly excepted by section 514.05. In re: ZACHMAN HOMES¹⁵, INC., 47 B.R. 496; 1984 Bankr. LEXIS 4519; R.B. Thompson, Jr. Lumber Co. v. Windsor Dev. Corp., 374 N.W.2d 493 (Minn. Ct. App. 1985)¹⁶ In the Zachman case, the federal bankruptcy court determined that amendments to Chapter 514 established that staking, clearing, grubbing, and grading of building sites reasonably placed construction mortgagees on notice that something was in the process of being constructed. In R.B. Thompson, Jr. Lumber Co., 374 N.W.2d 493 (Minn. App. 1985), the Minnesota Court of Appeals confirmed Zachman's reasoning. Both Courts found persuasive the fact that the legislature in 1974 had explicitly amended section 514.05 in a way that prevented the Courts from disqualifying any category of lienable improvements as visible beginnings, unless expressly excluded by the legislature. In R.B. Thompson, the Court of Appeals invited the legislature to consider changing the

¹⁵ Zachman is cited by: Phillips-Klein Cos. v. Tiffany Partnership, 1989 Minn. App. LEXIS 1284 (Minn. Ct. App. Dec. 12, 1989); R.B. Thompson, Jr. Lumber Co. v. Windsor Dev. Corp., 383 N.W.2d 362, 1986 Minn. App. LEXIS 4089 (Minn. Ct. App. 1986); R.B. Thompson, Jr. Lumber Co. v. Windsor Dev. Corp., 383 N.W.2d 357, 1986 Minn. App. LEXIS 4077 (Minn. Ct. App. 1986)

¹⁶ See also R.B. Thompson, Jr. Lumber Co. v. Windsor Dev. Corp., 383 N.W.2d 357 (Minn. Ct. App. 1986); R.B. Thompson, Jr. Lumber Co. v. Windsor Dev. Corp., 383 N.W.2d 362, 367 (Minn. Ct. App. 1986); Korsunsky Krank Erickson Architects, Inc. v. Walsh, 370 N.W.2d 29, 32 (Minn. 1985) (erecting a building, planting trees, or "grubbing" all describe improvements which run with the land.) Following the Zachman and R.B. Windsor decisions, the legislature was asked to clarify the list of eligible improvements and in Laws 1987 Chapter 95, the legislature effectively confirmed the Zachmann and Windsor decisions, but removed staking from the list of improvements that could be considered a first visible beginning.

list of excluded improvements, and the legislature then added staking to that list in Laws 1987 Chapter 95. (This principle is recognized as well in the Poured Concrete trilogy, discussed in the following section).

(3) Lien - Mortgage Priority Disputes are Resolved by Determining Whether a Reasonable Inspection would Disclose a First Visible Beginning.

The language of the statute focusing our attention on a first visible beginning is relatively simple and straightforward. The issue is whether there is an improvement “on the ground.” Nothing in the statute suggests the determination should hinge on factors not visible on the ground, such as discussions between the owner and his mortgage company, or the decision to sell the construction project to a finance company. For well over a century, our courts have made the first - beginning determination by looking at the whether the person performing the duty of examining the property is able in the exercise of reasonable diligence to see the improvement. E.g., Wentworth v. Tubbs, 53 Minn. 388, 55 N.W. 543 (Minn. 1893); Lampert Yards, Inc. v. Thompson-Wetterling Construction & Realty, Inc., 302 Minn. 83, 223 N.W.2d 418 (Minn. 1974); Kloster-Madsen, Inc. v. Tafi's, Inc., 303 Minn. 59, 226 N.W.2d 603 (Minn. 1975). This focus – on what can be seen by an inspection on the ground – provides stability and protection to both lien claimants, as well as to mortgage lenders and their title insurers, because everyone has equal access to the same information. Appellate courts have regularly explained that section 514.05 “imposes a duty on a purchaser or mortgagee to examine

the property for the beginning of any actual and visible improvements before a sale or mortgage transaction is completed.” Kloster-Madsen, Inc. v. Tafi's, Inc., 303 Minn. 59, 226 N.W.2d 603 (Minn. 1975). The leading case, explains:

Whether the work done also constituted the actual and visible beginning of the improvement is, as we have long held, a question of fact, for § 514.05 in effect imposes a duty on a purchaser or encumbrancer to examine the premises for the beginning of any actual and visible improvements before a sale or mortgage transaction is completed. The test for determining visibility is not, as Prudential argues, that the improvement, although "visible to the naked eye," must also be discernible to "the mind's eyes insofar as they tell one's mind that an improvement has been commenced. Rather, the test is whether the person performing the duty of examining the premises to ascertain whether an improvement has begun is able in the exercise of reasonable diligence to see it. Reuben E. Johnson Co. v. Phelps, 279 Minn. 107, 156 N.W. 2d 247 (1968); M.E. Kraft Excavating & Grading Co. v. Barac Const. Co. 279 Minn. 278, 156 N.W. 2d 748 (1968); Lampert Yards, Inc. v. Thompson-Wetterling Const. & Realty, Inc. 302 Minn. 83, 223 N.W. 2d 418 (1974) (emphasis added).

Kloster’s reference to “the person performing the duty of examining the premises” represented a reflection of the uniform practice of the mortgage lending and title insurance industry in Minnesota. Section 514.05 proclaims that a mortgagee cannot assert priority over lien claimants, if recordation occurs after the first visible beginning of improvements on the ground.

The duty referred to in Kloster-Madsen derives then from the statutory provisions that effectively give mortgagees constructive notice of the condition of the property just before mortgage recordation. Accordingly, the title insurance and construction mortgage industry both have adopted the practice of requiring an inspection, of the property (often

aided by an inspector's checklist and then documented with a picture) to determine whether construction has begun. See Jesco, Inc. v. Home Life Ins. Co., 357 N.W.2d 123 (Minn. Ct. App. 1984); Richard Knutson, Inc. v. Westchester, Inc., 374 N.W.2d 485, 487 (Minn. Ct. App. 1985). The articulation of the duty to inspect implements the concept that the "visible beginning" requirement affords constructive notice to the construction lender.

Under our cases, an inspector is charged not merely with what he actually saw, but what he would have seen if the inspection were conducted with reasonable diligence. Kloster-Madsen, Inc. v. Tafi's, Inc., 303 Minn. 59, 226 N.W.2d 603 (Minn. 1975) (District Court's finding for lien claimant affirmed); Lampert Yards, Inc. v. Thompson-Wetterling Constr. & Realty, Inc., 302 Minn. 83, 88 (Minn. 1974) (district court's finding that reasonable inspection would not have disclosed batter-boards left on a field affirmed); Reuben E. Johnson Co. v. Phelps, 279 Minn. 107, 118 (Minn. 1968) (survey stakes decision prior to statutory amendment: property line survey stakes located in the weeds not objectively visible); Jesco, Inc. v. Home Life Ins. Co., 357 N.W.2d 123 (Minn. Ct. App. 1984) (reasonable inspection should have revealed visible beginning; trial court's finding that mortgage has priority reversed).

In accord with the "actual and visible beginning of improvement on the ground" mortgage lenders or their title companies who claim priority typically present evidence to the District Court showing that their title inspection (or a reasonable title inspection)

reasonably concluded that the improvement had not yet begun. Thus, in Kloster-Madsen the District Court considered “the testimony by the person who examined the premises for Prudential after the mortgage was recorded was that he observed no improvements” before the mortgage was recorded. 226 N.W.2d at 607. In Jesco, the District Court carefully considered the testimony of Minnesota Title’s inspector and focused on whether that inspection reasonably should have disclosed the alleged first visible beginning¹⁷. 357 N.W.2d 123. In Reuben E. Johnson, supra, two officers of the lender testified that they visited the site and provided photographs of their observations¹⁸. In the case before this Court, the Bank presented no evidence that there ever was an inspection, or presented evidence that the Bank reasonably concluded that a separate improvement was under way.

¹⁷ “On about October 19, 1979, Mork mortgaged the two lots to Northland Mortgage Co. The mortgage was recorded that day. The next day, Saturday, October 20, 1979, John Yurecko inspected the property for Minnesota Title Insurance Company, Northland's agent, to determine whether any mechanic's liens had priority over its mortgage. During Yurecko's inspection he walked the perimeter of the two lots looking for signs of construction. At a number of locations he took pictures with a Polaroid camera. Due to heavy brush and some culverts Yurecko did not walk the western perimeter but instead took a zig zag course along that perimeter. He testified that during his one hour inspection he did not see the laths nor any other sign of construction. Six of those photos were introduced at trial none of which portray the entire two lots or show the laths . . . ” 357 N.W.2d at 124-125.

¹⁸ “On the day the mortgages were filed, two officers of Schumacher went to the building site to determine whether any work had been commenced thereon. They testified that the land was overgrown with tall grass, weeds, and shrubs, and that as they walked about the property they saw no stakes and no indication of construction or grading. Photographs which they took reveal no indication of construction or grading stakes.” 156 N.W.2d at 250.

C. An Integration of Existing Appellate Precedent Does not Support the Court of Appeals Decision.

Implicit in the Court of Appeals newly integrated analysis is the assertion that prior appellate decisions lead naturally to what the Court of Appeals has done here, but that is simply not correct. Inspection of the last decade of published Court of Appeals decisions shows that, actually, those decisions have been moving strongly in the direction of recognizing that priority disputes between mortgagee and lien claimants must be resolved by reference to objective conditions on the ground. None of the cases integrated by the Court of Appeals come close to suggesting that on the facts presented here, a ruling in favor of the mortgage lender is compelled.

In Witcher Construction Co. v. Estes II Ltd. Partnership, 465 N.W.2d 404, 407 (Minn. Ct. App. 1991), the Court of Appeals considered work done under two separate phases of construction and under two separate contracts. As the Court explained, Developer Estes II planned to renovate the International Harvester Building in St. Paul. Renovation work was contracted under two separate documents. The first contract was for renovation of the building's shell and the second contract was for renovation of tenant space. Respondent Witcher Construction was the construction manager for the base building work and the general contractor for the tenant improvement work. The Court of Appeals affirmed the District's findings that the two projects were not separate improvements. The Court of Appeals explained that the Courts have "consistently

held that separate construction phases of the same overall construction project constitute one continuous improvement." The Court continued by pointing out that "when determining whether a project was a single improvement, the type of contract is not dispositive; the question asked is whether the materials furnished or work performed were all pursuant to one job as a continuous undertaking 465 N.W.2d at 407.

Poured Concrete, involves a trilogy of cases, the first of which is unpublished.

The first visible beginning of the improvement in Poured Concrete was the clearing and leveling of a lot. In Poured Concrete Foundations, Inc., v Andron, Inc. 1992 Minn. App. LEXIS 652 (Poured Concrete- I), the Court of Appeals held that:

When the owner/contractor and the excavator have a unified plan, purpose, and contract that includes preparation for building a home on a lot, and when the first visible sign of improvement to the lot is the excavation, lien claimants who contributed labor and materials to the actual construction of the home may relate their liens back to the date of the original excavation when the first labor was furnished upon the premises. (Syllabus)

Poured Concrete I actually reverses a District Court summary judgment on behalf of the mortgage lender. Its holding, is foursquare in opposition to the Court of Appeals decision here. The facts in Poured Concrete I are that between November 1987 and June 1988, Andron, Inc. (Andron), a developer, purchased two residential parcels which became Interlachen Bluff subdivision in Edina. With approval from the City of Edina, Andron divided the subdivision into eight lots, and intended to build a model home on lot 7. Andron hired Kevitt Excavating, Inc. (Kevitt) to do grading work for the subdivision in May 1988. Kevitt's bid specifically included grading, clearing, cutting, filling, removing

stumps, and constructing building pads. The Poured Concrete Court focuses specifically on the mortgage lender's inspection of the premises:

“Prior to offering the mortgage, a CMI vice president inspected lot 7, and observed Kevitt's excavating work, including the building pad.”

At the close of plaintiff's case, the trial court granted CMI's motion for involuntary dismissal, concluding that Kevitt's original grading work was not an improvement to lot 7 and was separate and distinct from the lien claimants' work pertaining to the house construction itself. Following Windsor and Zachman, discussed Part II-B above, the Court of Appeals held, as a matter of law, that the District Court was compelled to recognize that grading was a first visible beginning, because grading is listed in section 514.01, “and does not fall within the specifically listed exceptions¹⁹.” In Poured Concrete II, the Court of Appeals ordered the District Court once again to hold a trial on the merits and reversed its attempt to rule in favor of the mortgage lender. On remand from Poured Concrete II, the District Court found that the lien claimant's grading work was a separate and distinct improvement from the subsequent home construction and once

¹⁹ The Court continued: Additionally, the work done by Kevitt significantly altered the property and is substantial enough to constitute an improvement under the statute. See Northwest Wholesale Lumber, Inc. v. Citadel Co., 457 N.W.2d 244, 250 (Minn. App. 1990) (tree excavation and removal constitutes visible improvement); R.B. Thompson, Jr. Lumber Co. v. Windsor Dev. Corp., 383 N.W.2d 357, 360 (Minn. App. 1986), pet. for rev. denied (Minn. May 22, 1986) (visible staking and grading constitutes visible improvement); R.B. Thompson, Jr. Lumber Co. v. Windsor Dev. Co., 383 N.W.2d 362, 365 (Minn. App. 1986), pet. for rev. denied (Minn. May 21, 1986) (staking, construction of building pad, and installation of water top box constitutes visible improvement).

again, found that the mortgage was superior to the lien, but the Court of Appeals reversed a third time.

The question in *Poured Concrete III*, then, was whether the District Court's findings were clearly erroneous, or as the Court of Appeals framed it, an abuse of discretion. *Poured Concrete Foundation, Inc. v. Andron, Inc.* 529 N.W.2d 506(Minn. App. 1995).

Langford Tool & Drill Co. v. Phenix Biocomposites, LLC, 668 N.W.2d 438, 443 (Minn. App. 2003) involved the construction of a Mankato manufacturing plant on behalf of Phenix Biocomposites in December 1996. *Langford* represents the beginning of increasing recognition by the Court of Appeals that section 514.05's emphasis on the improvement “on the ground” requires a focus of what an inspection of the premises would find. In the spring of 1997, Phenix ran into financial problems, and in April of 1997 the company halted construction. Phenix not only intended to stop construction, but it acted aggressively to make sure that any person visiting the site could tell from objective conditions at the site itself that construction was not underway. The construction site was intentionally barricaded, and there were no trespassing signs posted on the property.

Efforts to restart the construction project centered on a two-fold strategy. The first part was to assure that any unidentified tradesmen who observed the property prior to mortgage recordation would see that there was no construction underway. The new

lender's attorney surveyed the project site and concluded that the project had been abandoned before the deal for the loan was closed, and that the abandonment had been objectively manifested such that potential lien claimants would be on notice that the old project had ceased.

The second part of the strategy to prevent attachment of liens pre-dating the new Rabobank mortgage was to identify contractors and subcontractors through sworn construction statements²⁰ so that the mortgagee could identify all potential lien claimants and obtain subordinations to the mortgage. The contractor, Schwickert, was required to identify all subcontractors who had worked on the project and file a subordination statement recognizing that the new mortgage financing by Rabobank would be superior to mechanics liens²¹.

After new financing was issued, Phenix Biocomposites ran into a second round of financial difficulty. When one of general contractor Schwickert's subcontractors sued Schwickert and the owner, Phenix Biocomposites, for non-payment, the contractor, subcontractor and owner all concocted a device to circumvent Schwickert's subordination

²⁰ The lien enforcement action arose out of a settlement agreement between one of the subcontractors, Central Mechanical, and guarantors of the Phenix debt. Under the terms of the agreement, Central Mechanical in no way represented, warranted, or covenanted that the mechanic's liens would be enforceable. Consequently, the mechanics lien action represented an attempt by guarantors of the construction debt seeking to recover some of their loss out of the bank's security interest in the improvement.

²¹ The expressed purpose of the subordination agreement was to induce Rabobank to offer financing to restart new financing.

agreement²². On these facts, the District Court rejected motions for summary judgment and tried the case, ultimately finding that the facts established that Schwickert and Phenix had abandoned the first project and could not circumvent Schwickert's subordination agreement. A key factor was the action of lenders to use due diligence to determine that objective facts on the ground would support the abandonment conclusion.

The physical, visible condition, to be determined from an inspection of the premises, is an essential element as part of determining whether a project has been abandoned. . . .

Superior Construction Services v. Latoria Belton, 749 N.W.2d 388 (Minn. App. 2008), confirms this focus on objective facts available to tradesmen and mortgage company alike. In Superior Construction, homeowner Belton hired Superior Construction Services in May of 2002 to rehabilitate her home after a fire²³. Superior completed the repairs and Belton moved back into her home on January 2003. From all outward objective appearances, the project was completed and no further work was

²² The Court explained: "On February 18, 2000, Phenix entered into a forbearance agreement with Central Mechanical. The agreement provided that Central Mechanical would refrain from exercising its collection remedies against Phenix until June 30, 2000, in exchange for Phenix's promise to pay the judgment by that time. The agreement was secured by the personal guarantees of eleven individuals, each of whom had some personal stake in the success of the business of the Phenix Entities." 668 N.W.2d at 441.

²³ In a work-authorization document, the homeowner had agreed to remit her insurance proceeds to Superior within thirty days after receiving them. Superior completed the bulk of the contracted work over the next six months, and Belton was able to move back into the house in January 2003, but she diverted the insurance proceeds to another purpose.

performed for over two years. In January of 2005, Belton secured a consumer loan and the mortgage was duly recorded. A month later, Superior Construction contacted Belton and sought payment for the work done two years before. On March 2005, Superior came back to the Belton home and did 8 hours of miscellaneous work and filed its lien statement, asserting that the March 2005 work was part of the two-year old project.

Superior Construction presented two separate statutory issues. Superior Construction asserted a lien both on work done, but unpaid, in 2003 and the 8 hours of work done in March of 2005. As to the 2003 work, Superior Construction could not assert its lien, unless the District Court found that it had complied with section 514.08, which requires that a lien be filed within 120 days of the last item of work. The answer to this question required a determination of whether the contract (or undertaking) between the owner of the property, Belton, and the contractor, Superior Construction, contemplated the work done in 2005, and if so, whether the appearance of the property established an abandonment of the project. As to the lien for the 8 hours of work done in 2005, that work could only be subject to a lien if the work done in 2003 constituted the first visible beginning of the work done in 2005.

In addressing these inquiries, the Court recognized that the Langford decision had not fully confronted whether lien priority decisions should be based upon the subject intent of the parties (that is the contractor and the owner), or the objective manifestation of intent on the ground. By all appearances the property gave the objective impression

that construction was completed. The property owner had moved into the property and had been occupying it for two years. No construction equipment and no actual work of any kind had been performed on the premises during those two years. The Court wrote:

We did not explicitly address in Langford whether intent should be judged by an objective or subjective standard. Our analysis in that case suggests that intent is to be judged by the objective manifestations of the parties. See *Id.* at 444 (indicating that intent can be inferred from actions of parties).

The court continued:

On this record the district court did not err by determining that the facts compelled the conclusion that the project had been abandoned as a matter of law. The district court properly concluded that Superior's and Belton's objective manifestations of intent--the cessation of work for more than two years and a mutual failure to communicate for at least fifteen months--was sufficient to overcome any after-the-fact assertions by Superior of its subjective intent to continue the project.

Summary judgment for the mortgage company was granted, even though the owner of the property and the contractor both asserted that the work performed in 2005 was within the scope of their 2003 agreement. The Court of Appeals decision protected mortgage and title companies by allowing them to rely upon the objective conditions found on the ground.

D. Factors Identified by Bank and Court of Appeals Do Not Compel a Finding for the Mortgage Lender.

The Bank's argument, and Court of Appeals decision, suggests several factors which should compel a finding of separate improvements as a matter of law. These arguments amount to an invitation to disclaim the principle that the separate improvement

(or abandonment) issue is an issue of fact to be determined by the trial court. In this section, we respond briefly to the logic propounded by Bank and Court of Appeals.

It is argued, incorrectly, that Hilde's financing for the improvement changed. But actually, 21st Century Bank provided all of the financing for the improvement. Assuming the Bank conducted a title search, it would have discovered, in fact, that the construction that had already proceeded had not been separately financed. There simply were not two financings here, but only one. Thus, it was apparent to the Bank and Schonning that he was buying the property in its partially improved state, and consequently the purchase price that Schonning was paying was buying the lot and the improvements that had already occurred. The lack of a previous financing is, if anything, a sign to the mortgage company that the work in progress is part of the contemplated future improvement, not the reverse. The fact that Hilde was looking at other financial institutions in no way advances the separate improvement argument.

It is argued that because Hilde considered moving his family into the home, once it was constructed, that as a matter of law, the work done in the early phases constitutes the Hilde home, and the work done later constitutes the Schonning home. That would mean that if a developer starts a spec home and decides to move into it, because he can't find a buyer, the lien priority would be altered simply because his plans change on how he is going to dispose of the property. Or, if the developer begins to build a home for one purchaser, and the purchase transaction falls through, and a second purchaser buys the

home, that would mean that lien priority would be destroyed, simply because the first buyer didn't acquire the home.

It is also argued, incorrectly, that work on the original project ceased and that there was a lapse of over a year from the first work to the next during which no activity occurred. This argument is based upon a disregard of the facts and the District Court's finding. In the first place the legislature has not decreed that a home must be constructed in a year, or lien attachment is destroyed. Section 514.05 subdivision 1 says nothing of the sort. In any event, Big Lake Lumber prepared preliminary plans and then final plans during the time period when the Bank claims that the project had ceased. Hilde was working with DesMarais to arrange for the framing of the home that was to be built on site during this time. In July of 2006, two months before recordation, an engineer was out staking the home that Hilde had planned to build throughout 2006. The Bank ignores this staking, because staking cannot be the first visible improvement on the ground, but the District Court did not consider the staking as a first visible improvement. The engineering work, and the drawing of the plans, all were lienable work, that show that the home project was still underway.

Finally, it has been suggested that somehow the building of homes or the construction finance industry as whole will be impeded if liens can attach under these circumstances. The suggestion is that mortgage companies will only finance construction projects if they can be assured that they can somehow convince tradesmen

that they should work on projects where they don't get paid. Sound construction financing practice is not predicated upon the idea that construction lenders should be able to shift the risk of loss onto tradesmen. DesMarais and Big Lake Lumber were not managing construction advances, the Bank's title company was. DesMarais and Big Lake Lumber were not authorizing further work on the construction project without adequate funds in escrow, the Bank and title company were. The problem here arises because evidently the Bank authorize DesMarais to complete this construction project, even though the Bank lacked sufficient funding to pay for the work that it authorized. There is no public policy that favors inducing tradesmen to build homes without getting paid. In fact, the policies behind the mechanics lien statute is exactly the opposite.

If a mortgage lender conducts an inspection and discovers a visible beginning, that gives the mortgage lender constructive notice that if further work is done, the lien is superior to the mortgage. It must know that trades persons who supply work or materials to the site will be under the impression that there has been a visible beginning. Instead of rolling the dice and hoping for a finding of separate improvement, the proper procedure for the bank under these circumstances is to bar any construction unless the owner has provided sufficient funds to assure that tradespeople will get paid for authorized work. Or, if the mortgage lender wants to shift the risk of loss for construction financing mismanagement onto the tradesmen, it can order them to do no work unless they sign a subordination agreement.

V. CONCLUSION

The Court of Appeals decision should be reversed with instructions to affirm the decision of the District Court. If this Court believes that section 514.05 is insufficient to afford proper guidance to the courts on how to resolve priority disputes, it should invite the legislature to change the law. But it is inappropriate to fashion a new legal principle governing priority disputes, and then to apply those principles retroactively to a construction project that took place in 2006.

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Respectfully Submitted,

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