

Case No. A05-2018

State of Minnesota
Supreme Court

Mavco, Inc., d/b/a Maverick Construction,

Appellant/Petitioner,

vs.

*Rodney Eggink and Karla Eggink,
Wells Fargo Bank, N.A.,
Craig A. Moore and Nicole M. Moore,
and Great River Federal Credit Union,*

Respondents.

APPELLANT MAVCO, INC.'S, BRIEF AND APPENDIX

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ISSUES FOR REVIEW

- I. IS THE ONE YEAR STATUTE OF LIMITATIONS CONTAINED IN MINN. STAT. § 514.12, SUBD. 3, APPLICABLE TO A MORTGAGEE WHO HAD ISSUED ITS MORTGAGE WITH NOTICE OF A VALIDLY PERFECTED MECHANIC'S LIEN AND WHOSE INTEREST IN THE PROPERTY WAS NOT RECORDED AT THE TIME THE MECHANIC'S LIEN FORECLOSURE ACTION WAS COMMENCED?

THE COURT OF APPEALS HELD THAT IT WAS, AND AFFIRMED THE DISTRICT COURT'S ORDER GIVING THE MORTGAGE PRIORITY OVER THE MECHANIC'S LIEN.

- II. IRRESPECTIVE OF THE APPLICATION OF THE ONE YEAR LIMITATION, SHOULD THE APPELLANT'S MOTION TO FILE A SUPPLEMENTAL COMPLAINT THAT RELATED BACK TO THE COMMENCEMENT OF THE ACTION BEEN GRANTED?

THE COURT OF APPEALS HELD THAT IT SHOULD NOT HAVE AND AFFIRMED THE DISTRICT COURT'S DECISION DENYING THE APPELLANT'S MOTION.

STATEMENT OF THE CASE

The Appellant Mavco provided labor and materials for the repair of a home owned by Rodney and Karla Eggink. The home had been damaged by fire and significant renovation was necessary. The last work in regard to the repairs was done by Appellant Mavco on November 26, 2003. When the Egginks refused to pay a substantial portion of the bill, a mechanic's lien statement was recorded against the property on January 23, 2004. (See Appendix, p. A2-A6.) The bill remained unpaid and Appellant Mavco then commenced a mechanic's lien foreclosure action against the Egginks as well as against all other persons with an interest of record. This action was commenced on May 17, 2004. Pursuant to statute Appellant Mavco recorded a Notice of Lis Pendens on May 19, 2004, giving notice that the foreclosure action was proceeding. (See Appendix, p. A7-A9.)

Three days prior to the lien action being commenced, but about four months subsequent to the lien statement being recorded, the Egginks refinanced their property with the Respondent Wells Fargo. The mortgage reflecting that refinancing was dated May 14, 2004. The mortgage itself, however, was not recorded until July 28, 2004. (See Appendix, p. A10-A29.)

In their Answer to the foreclosure Complaint, the Egginks did allege that they had a mortgage with Respondent Wells Fargo. (See Appendix, p. A30-A32.) Inquiry of the Egginks' counsel, however, did not provide any explanation for the disparity between that allegation and the record title as it then existed. Written interrogatories were then served on the Egginks to try to clarify that discrepancy. (See Appendix, p. A33-A36.)

In November of 2004, shortly before the anniversary of the last day work was performed on the property, discovery responses were received by Appellant Mavco which for the first time revealed that the property had been refinanced and confirmed the existence of the Respondent Wells Fargo's mortgage. (See Appendix, p. A37-A45.) The district court's scheduling order

precluded bringing in additional parties at that point. (See Appendix, p. A46-A48.) In early January of 2005, a mediated settlement was worked out between the Appellant Mavco and the Egginks which provided that the Egginks would pay Appellant Mavco \$100,000 by March 1, 2005 to resolve the matter. The agreement further provided that if the amount was not paid, the lien could then be foreclosed for that amount including attorneys' fees. At the Egginks' request, a 30 day extension was given, and still no payment was made. At that point the Respondent Wells Fargo first contacted the Appellant Mavco and notified it that it was claiming that its mortgage had priority over the lien. Appellant Mavco then served a supplemental complaint on Respondent Wells Fargo and motions were made to the district court seeking a resolution of the priority issue. The district court, in a decision dated August 8, 2005, determined that the Respondent Wells Fargo mortgage had priority over the Appellant Mavco lien because Wells Fargo had not been named a party in the foreclosure action within one year from the last day of work. (See Appendix, p. A49-A55.) Based on that, the district court denied the Appellant's motion to file the supplemental complaint naming Wells Fargo and give that complaint relation back effect. The Appellant Mavco then appealed to the Court of Appeals. The Court of Appeals, in a published decision, affirmed the district court's order with Justice Minge filing a dissent. (See Appendix, p. A56-A63.)

ARGUMENT

- I. THE ONE YEAR STATUTE OF LIMITATIONS CONTAINED IN MINN. STAT. § 514.12, SUBD. 3, SHOULD APPLY ONLY TO THOSE PARTIES WHO HAD A RECORDED INTEREST AT THE TIME THE LIEN FORECLOSURE ACTION IS COMMENCED AND THE NOTICE OF LIS PENDENS RECORDED. PERSONS WITH AN UNRECORDED INTEREST IN THE PROPERTY THAT IS SUBJECT TO THE LIEN ARE NOT AND SHOULD NOT BE CONSIDERED NECESSARY PARTIES, AND THEY SHOULD BE BOUND BY THE JUDGMENT AGAINST THOSE WITH WHOM THEY ARE IN PRIVITY.

Pursuant to Minn. Stat. § 514.12, subd. 1, the Appellant Mavco did record a Notice of Lis Pendens on May 19, 2004. The effect of a Notice of Lis Pendens is set out in Minn. Stat. § 557.02. That statute reads as follows:

In all actions in which the title to, or any interest in or lien upon, real property is involved or affected, or is brought in question by either party, any party thereto, at the time of filing the complaint, or at any time thereafter during the pendency of such action, may file for record with the county recorder of each county in which any part of the premises lies a notice of the pendency of the action, containing the names of the parties, the object of the action, and a description of the real property in such county involved, affected or brought into question thereby. From the time of the filing of such notice, and from such time only, the pendency of the action shall be notice to purchasers and encumbrancers of the rights and equities of the party filing the same to the premises.

This Court has on a number of occasions dealt with the effect of a recording of a Notice of Lis Pendens on persons who have an unrecorded interest in the property prior to the date the notice was recorded. In the case of Bredeson v. Nickolay, 194 N.W. 460 (Minn. 1923), this Court held that a person with an unrecorded interest in the property, which was not placed of record until after a Notice of Lis Pendens was recorded, took subject to the results of the action which was reflected in the Notice of Lis Pendens. That case involved plaintiff who had purchased property from a defendant without knowledge of a prior transfer of a portion of the property to the defendant's sister. When a dispute developed between the plaintiff and the record owner about the purchase agreement, the plaintiff sued for specific performance and recorded a Notice of Lis Pendens. The notice was recorded before the sister placed on record her evidence of title. This Court held that since the Notice of Lis Pendens was recorded prior, the sister's interest was subject to the rights of the plaintiff as determined in the action and thus the sister, as well as the defendant who was her source of title, were bound by the judgment entered in favor of the plaintiff.

The case of Marr v. Bradley, 59 N.W.2d 331 (Minn. 1953), is also instructive. In that case, Bradley had entered into a contract for the sale of property before a Notice of Lis Pendens was recorded by Marr. Bradley then obtained a deed and recorded it after the Notice of Lis Pendens. The court determined that the contract as it existed prior to the recording of the Notice of Lis Pendens was unenforceable, and thus Bradley's interest was subject to the final disposition of the case reflected in the lis pendens notice. This was true whether or not they were actually a party to the action.

Similar is the holding of the Minnesota Court of Appeals in the case of Howard, McRoberts & Murray v. Starry, 382 N.W.2d 293 (Minn. Ct. App. 1986). In that case, a Notice of Lis Pendens involving title to the property was recorded prior to the foreclosure of an attorneys' lien. The Court held that in that case the attorneys' lien was subject to whatever judgment was ultimately entered in the action. As the Court of Appeals indicated, a party who records their interest subsequent to a recorded Notice of Lis Pendens, is not and cannot be a good faith purchaser for value and, as such, the subsequent encumbrancer's interest is a void as against the claims in the pending action.

Much the same reasoning was used by the Court of Appeals in the case of Fingerhut Corp. v. Suburban National Bank, 460 N.W.2d 63 (Minn. 1990). While it is true that that case dealt with registered property, the Court in that case did hold that a mortgage issued before but registered after a recorded Notice of Lis Pendens was subject to the outcome of that pending litigation, even though the mortgagee was never a party to the pending litigation. Again, the Court indicated a subsequent encumbrancer is subject to the final disposition of the pending action, even though it was not a party.

Finally, and perhaps most instructive, is this Court's holding in the case of Hokanson v. Gunderson, 56 N.W. 172 (Minn. 1893). This case, as old as it is, appears to be the only

Minnesota Supreme Court case that has dealt specifically with the effect of a Notice of Lis Pendens in a mechanic's lien action. While the Supreme Court in that case did hold that a Notice of Lis Pendens was not binding on a party with a subsequently acquired interest, it did so only because that party was not in privity with a party who had been named in the foreclosure action within one year after the last work on the property was completed.

The lien claimant in the Hokanson case foreclosed its lien and named only the record owner of the property. This notwithstanding the fact that there were two mortgagees with an interest of record at the time the lien action was commenced. One of the mortgagees during the pendency of the action foreclosed its mortgage and then sold its interest to a third party, Marvin. In the syllabus set forth by the Court, it phrased its primary holding as follows:

In an action to enforce a mechanic's lien, a notice of lis pendens filed is not binding upon a person claiming an interest in the premises affected by the lien, unless he is made a party to the action, or claims under one who was made a party within the life of the lien. (Emphasis added.)

Because Marvin's interest in the property flowed from the mortgagee who had foreclosed and who had not been made a party, the Court determined that Marvin was not in privity with a party to the action and because of that, Marvin's interest was not controlled by the disposition of the action reflected in the Notice of Lis Pendens.

In this case, there is absolutely no question that Wells Fargo's interest flows directly from the Egginks and, as such, its interest in the property as against the lien claim of the Appellant Mavco, is no better than the Egginks' interest. The concept of privity is very much applicable here. This Court on a number of occasions has held that a judicial determination of title is binding on one whose rights are derived from a party, as long as the party to be bound was in privity with the party in that litigation. Privity is defined in Black's Law Dictionary as

a “mutual or successive relationship to the same rights of property”. Based on this concept of privity, this Court has held that a judgment affecting the party’s title to real estate not only binds that party, but also his grantee. See Carl v. DeToffol, 25 N.W.2d 479 (Minn. 1946), Leader v. Joyce, 135 N.W.2d 34 (Minn. 1965), and Lowe v. Patterson, 135 N.W.2d 38 (Minn. 1965).

This Court, in the DeToffol case, specifically indicated that judgments are binding on parties and their privies, and that a judgment affecting a party’s title also binds that party’s grantees. As the Court indicated in the DeToffol case, a purchaser from a party to the action simply stands in that party’s shoes when it comes to title, and he takes only the title that his predecessor or source of title had.

While it is true that in this case Wells Fargo’s interest was acquired just shortly before the Notice of Lis Pendens was recorded, it is also true that the interest it acquired at that point was subject to a lien that had attached, was preserved, perfected, and most importantly was of record. Wells Fargo’s interest then was subject to the lien. Once the Notice of Lis Pendens was filed, it then knew that the lien that had been perfected was now being foreclosed. At that time, its interest was subject to the rights and equities of Appellant Mavco, the person recording the notice. Since its interest at that point was void and thus unenforceable as against Appellant Mavco, its rights were and continue to be subject to the result of the action reflected in the notice, and it should be bound by that result whether it was a party or not. Wells Fargo was and is in privity with the Egginks, its source for its interest in the property. As such, its rights to the property as against the lien claim should be no better.

This concept of privity is fully consistent with the Minnesota Recording Act. Minn. Stat. § 507.32 does indicate that the recording of a document provides legal notice to all subsequent encumbrancers of the rights reflected in that document whether there is actual notice of those rights or not. See Minnesota Central Railroad v. MCI, 595 N.W.2d 533 (Minn. Ct. App. 1999).

Thus when Respondent Wells Fargo issued its mortgage, it is deemed to have notice of the Appellant Mavco's lien rights. Minn. Stat. § 507.34 makes an unrecorded interest void as against the interests of a subsequent good faith purchaser of the property. While Minn. Stat. § 507.34 does not specifically reference mechanic's lien claimants, Minn. Stat. § 514.05 and 514.06 specifically define a lien claimant's rights as against mortgagees. Minn. Stat. § 514.05, subd. 1, specifically states that the lien "shall be preferred to any mortgage or other encumbrance not then of record, unless the lienholder had actual notice thereof." Minn. Stat. § 514.06 specifically states that all persons interested in the property other than as a bona fide prior encumbrancer "shall be deemed to have authorized such improvements, insofar as to subject their interests to the liens therefore." This legally induced consent not only reinforces the arguments about privity set forth above, but also makes it clear that in these circumstances where Wells Fargo cannot be considered as a bona fide encumbrancer, that its interest was and is void as against the Appellant's lien.

With that being said, it is true that Minn. Stat. § 514.12, subd. 3, does state, among other things, that "no person shall be bound by any judgment in such action unless made a party thereto within the year." The Court of Appeals, as well as the district court, looked at this provision in isolation and in a rather mechanical application held that it applied to Wells Fargo even though it had no interest of record at the time the foreclosure action was commenced. It is the Appellant's position that that provision cannot be construed in isolation, but must be viewed in the context of the entire lien statute. A person can and should only be made a party if their presence is known and necessary for the proper adjudication of the lien action. The lien statute itself does specifically deal with required parties to the action. Minn. Stat. § 514.11 reads as follows:

The action may be commenced by any lienholder who has filed a lien statement for record and served a copy thereof on the owner pursuant to section 514.08, and all other such lienholders shall be made defendants therein. (Emphasis added.)

Thus by statute, the only necessary parties to the lien action are the lien claimant who has filed a lien statement of record, as plaintiff, and all other such lienholders as defendants. The phrase “all other such lienholders” clearly refers to lienholders in a similar position as the plaintiff, namely, those who have filed a lien statement for record and thus have a recorded interest.

While it is true that this Court historically has recognized that mortgagees are proper parties to such an action since a determination of the amount and priority of their liens may be necessary to effectuate the proper foreclosure remedies, the rights of those parties which this Court has deemed necessary cannot and should not be greater than the rights of other lien claimants similarly situated. Just as a lienholder who has failed to record its lien statement could not be expected to be named as a defendant, so also a mortgagee who has issued a mortgage with knowledge of a recorded and perfected mechanic’s lien but who has not even bothered to record its interest.

The lien statute then goes on to deal with situations where a party has not been named as a defendant. Minn. Stat. § 514.12, subd. 2, states as follows:

One action for all. After such filing, no other action shall be commenced for the enforcement of any lien arising from the improvement described, but all such lienholders shall intervene in the original action by answer as provided in section 514.11. Any such lienholder not named as a defendant may answer the complaint and be admitted as a party.

When § 514.11 and § 514.12, subd. 2, are read together, it is apparent that the lienholder who commences an action must only name those with a recorded interest. Those whose interest arises or is placed of record after the commencement of the action have an obligation to intervene on their own.

Finally, Minn. Stat. § 514.12 has some very significant language following its reference to the one year limitation. The statute goes on to read as follows:

... and, as to a bona fide purchaser, mortgagee or encumbrancer without notice, the absence from the record of a notice of lis pendens of an action after the expiration of the year in which the lien could be so asserted shall be conclusive evidence that the lien may no longer be enforced.

Thus subd. 3 really does deal with two different classes of persons. The first are those, or should be those, with an interest of record at the time of the commencement of the action. The second class, as referenced above, deals with subsequent encumbrancers such as Wells Fargo is in this case. In regard to that second class of persons, those who acquire or record an interest that is subsequent to the lien, it is only those who have no notice of it who can take advantage of the lapse of one year. More importantly and by implication, the existence of the Notice of Lis Pendens within one year would clearly negate the presumption contained in the statute, and just as clearly, give notice to the subsequent encumbrancer of the action itself and put the onus on it to intervene, if it feels its presence is necessary to protect its interest. As a matter of statutory construction, there would simply be no reason for subd. 3 to include language protecting subsequent purchasers if the statute itself required that even subsequent mortgagees or encumbrancers be named if its interest came into effect and was recorded after the perfection of the lien and the commencement of the foreclosure action.

Thus in this case, Respondent Wells Fargo's rights should not be determined as if it was a party with an interest at the time the action was commenced. Its failure to record its interest precluded knowledge of that fact. Rather its interest should be analyzed as an interest of a subsequent purchaser or encumbrancer. If Wells Fargo had notice of the Appellant's lien, which it clearly did, and if the Notice of Lis Pendens was recorded within a year from the last day of

work, which it clearly was, then Wells Fargo's interest should be subject to that lien whether it was formally made a party or not.

Respondent Wells Fargo has and no doubt will continue to argue that the Appellant Mavco could have named Wells Fargo as a party before the one year statute of limitations ran. That is true. But the issue is not whether the Appellant could have. The issue is whether the Appellant Mavco should have. As set forth above, the statute itself requires as defendants only lien claimants similarly situated. That is those who recorded their interests. Case law has required that others with an interest of record be also named as defendants. No case, however, has been found that requires someone with an unrecorded interest to be named if their interest was not of record at the time the action was commenced. The district court, as well as the majority of the Court of Appeals, relied heavily on the case of Morrison County Lumber v. Duclos, 163 N.W. 734 (Minn. 1917). In that case, however, the mortgagee's interest was of record before the foreclosure action was commenced. Perhaps more importantly, the mortgagee in that case had issued its mortgage and recorded its interest without any actual notice of the mechanic's lien. The mechanic's lien statements in that case were filed subsequent to June of 1913. However, the mortgage was issued on June 11, 1913. Thus in that case the mortgagee took its interest without legal notice of the lien.

Here Wells Fargo had legal notice because the lien statement had been recorded. On May 19, 2004 it then had legal notice that the lien that had previously been perfected and preserved was being foreclosed. Wells Fargo had a right under the express language of the lien statute to intervene. It chose not to. While it is true that this Court in the past has indicated that the nature, extent and duration of the lien should be strictly construed by the terms of the statute, it is also true that this Court has held that equitable principles do apply to lien actions. See Northland Pine Co. v. Melin Bros., 161 N.W. 407 (Minn. 1917). In this case when Wells Fargo

issued its mortgage, it could have, and should have, required the lien to be taken care of or accept the consequences of being subject to a lien it had legal notice of. In this case, Wells Fargo, with legal notice of the pendency of the foreclosure action, could have and should have intervened if it had any claim that its interest was not subject to the lien.

In contrast, the Appellant Mavco had no actual notice and no legal notice of Respondent Wells Fargo's interest at the time the action was commenced. While the existence of the Wells Fargo mortgage was alleged in the Answer to the Complaint, inquiry of the Egginks' counsel provided no explanation for the disparity between that allegation and the record title as it existed in June of 2004. It was precisely because of that that written interrogatories were sent to try to clear up that disparity. Responses to that discovery were not received by the Appellant until November of 2004. While it did become clear at that point that Wells Fargo had refinanced and satisfied the prior mortgages as opposed to simply taking an assignment of prior mortgages, it was also clear at that point that Wells Fargo had issued its mortgage subject to the lien. The scheduling order in place at that point also precluded adding additional parties. While it may have been possible to amend the order and obtain service of Wells Fargo before the anniversary date, it should not have been necessary under these circumstances.

The Court of Appeals' decision giving the holder of an unrecorded interest in property that was taken with notice of the lien, priority over that lien, is problematic in more ways than one. Not only does it conflict with the clear priorities that are set forth in Minn. Stat. § 514.05 and 514.06, it also contradicts the language of Minn. Stat. § 514.11 limiting defendants to those who have a recorded interest. It also requires the prosecuting lien claimant, who may or may not receive timely responses to discovery, to continually update their search of the record to determine whether any new necessary parties have popped up while the action is pending. Such a requirement makes the requirement of the Notice of Lis Pendens an absurdity. The Notice of

Lis Pendens that is required by the lien statute is there for a purpose. It is there to give those whose interest was not of record notice that the lien is being foreclosed. If those with an unrecorded interest feel it necessary to protect their interest, they can and do have the absolute right to intervene. Simply put, the onus should be on one, who has taken subject to the lien, to intervene to protect its interest rather than it being on the lien claimant who has checked the record and named all parties with a recorded interest at the time the action is commenced.

II. IRRESPECTIVE OF THE APPLICABILITY OF THE ONE YEAR LIMITATION, THE DISTRICT COURT AND/OR THE COURT OF APPEALS SHOULD HAVE ALLOWED THE FILING OF A SUPPLEMENTAL COMPLAINT BY THE APPELLANT AND HAVE GIVEN IT RELATION BACK EFFECT.

M.R.C.P. 15.04 allows a supplemental complaint to cover occurrences or events which have happened since the initial pleading. That certainly applies here. Knowledge of Wells Fargo's interest such as it was clearly came after the commencement of the action and the initial Summons and Complaint. M.R.C.P. 15.03 provides the specific criteria for giving an amended or supplemental complaint relation back effect. In this case, those criteria were met. Wells Fargo has no defense on the merits in regard to the priority issue. It has no defense whatsoever in regard to this lien. It issued its mortgage with knowledge of the lien, and the Notice of Lis Pendens gave it legal notice that that lien, which had priority, was being foreclosed. As a sophisticated lender, it knew or certainly should have known that the only reason it wasn't named is because it had failed to record its interest.

In a similar situation, new defendants have been substituted in after the one year time limit, and the effect of that substitution or amendment has related back to the commencement of the action. In the case of R.B. Thompson, Jr. Lumber v. Windsor Development, 383 N.W.2d 357 (Minn. Ct. App. 1986), the Court of Appeals did recognize that allowing an amendment and

giving it relation back effect were appropriate in a mechanic's lien action. In that case as here, the right mortgagee had notice of the pendency of the action and knew that but for a mistake, it would have been named as the defendant mortgagee originally. The Court of Appeals in upholding the trial court's order allowing the amendment and giving it relation back effect cited with approval this language from the trial court, "substantive rights should not be decided on technical grounds, particularly if no harm results." In this case, the Court of Appeals, in upholding the trial court's denial of the motion, distinguished Windsor Development on the grounds that the named mortgagee here, Vermillion State Bank and Wells Fargo, were not related parties. The issue under the rules, however, is whether or not Wells Fargo knew or should have known that but for a mistake the action would have been brought against it. Because Wells Fargo is deemed to have legal notice not only of the lien but also of the Notice of Lis Pendens which was clearly recorded before its mortgage, it legally knew this action was pending. It also knew that it had not timely recorded its mortgage. It simply defies belief that a sophisticated lender such as Wells Fargo would not have known that it was omitted from the action originally because its identity was not known, a mistake it caused by not recording its interest on a timely basis. Because the criteria for relation back effect have been met, the motion should have been granted.

CONCLUSION

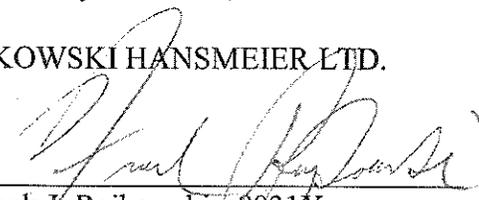
While the motion should have been granted, the overriding issue is, and continues to be, the priority of the Appellant's lien as against the Wells Fargo mortgage. On that issue, this Court should draw a bright line that establishes once and for all who is a required party to a lien foreclosure action. That bright line should be drawn at the time the action is commenced as it is only those with a recorded interest who are necessary parties. As such, this Court should hold that it is only those necessary parties who have the benefit of the one year limitation on the lien.

Those who take subsequent to the lien, as Wells Fargo did here, can protect their interest, if necessary, by intervening. If not, to the extent they are in privity with a named party, their rights will be adjudicated in the lien foreclosure action; and to the extent they are in privity, they should be bound by the result of that action whether they were a party or not. Such a holding will harmonize the lien statute with the recording act and the lis pendens statute. It will further avoid creating unnecessary and potentially impossible hurdles to the prosecution of a lien action. It will in fact put the burden of loss back where it belongs, on a sophisticated lender, one who took its mortgage subject to a duly recorded and perfected lien.

Dated this 14th day of December, 2006.

Respectfully submitted,

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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) (with amendments effective July 1, 2007).