

No. A08-1883

State of Minnesota
In Supreme Court

Imperial Developers, Inc.,

Plaintiff,

vs.

Calhoun Development, LLC,

Defendant,

Regal Custom Homes, Inc., et al.,

Defendants,

Lind Homes, Inc.,

Defendant,

Thompson Plumbing Corp.,

Defendant,

Great Northern I, Inc.,

Defendant,

Southview Design & Construction, Inc.,

Respondent,

BankFirst,

Appellant,

and

The Woodshop of Avon, Inc.,

Additional Defendant

and

Scherer Bros. Lumber Co., intervening defendant and third party plaintiff,

Respondent.

vs.

Mathew Lind, et al,

Third Party Defendants,

and

Simonson Lumber of Ham Lake, Inc.,

Third Party Plaintiff,

vs.

Contractors Capital Corporation, et al.,

Third Party Defendants.

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TABLE OF CONTENTS

TABLE OF AUTHORITIES.....ii

STATEMENT OF ISSUES.....2

STATEMENT OF FACTS.....2

ARGUMENT3

I. LENDERS MUST HAVE CLEAR AND DEFINITE RULES FOR DETERMINING THE PRIORITY OF MECHANICS’ LIENS IN RELATION TO THEIR MORTGAGES ON TORRENS PROPERTY AND TO HAVE CONFIDENCE IN THOSE RULES..3

II. IF PRIORITY DATES FROM THE REGISTRATION ON THE CERTIFICATE OF TITLE, THE CONSTRUCTION LENDING INDUSTRY WILL BE SIGNIFICANTLY HARMED.....6

CONCLUSION9

TABLE OF AUTHORITIES

Cases

Blue Earth County Pork Producers, Inc. v. County of Blue Earth, 558 N.W.2d 25,
30 (Minn. Ct. App. 1997)2

Cummings v. Koehnen, 568 N.W.2d 418, 424 (Minn. 1997).....2

Dolder v. Griffin, 323 N.W.2d 773, 780 (Minn. 1982).....3

Statutes

Minn. Stat. § 514.052, 3

Regulations

Truth in Lending, 73 Fed. Reg. 44,522 (July 30, 2008) (to be codified at 12 C.F.R.
pt. 226)8

Truth in Lending, 74 Fed. Reg. 41,193 (August 14, 2009) (to be codified at 12
C.F.R. pt. 226).....8

INTRODUCTION AND PRELIMINARY STATEMENT

The Minnesota Bankers Association (MBA) is please to provide this Amicus Curiae Brief in support of the Appellant, BankFirst.¹ The MBA is filing this Brief pursuant to its previously filed Notice and Request for Leave to Participate as Amicus Curiae, and the Court's order, dated February 16, 2010, granting that request.

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

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

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

property, and the potential negative impact on banks and their customers if mortgages only have priority from the date of registration.²

STATEMENT OF ISSUES

Is a Mortgage on Torrens Property “Of Record” for Priority Purposes within the Meaning of Minn. Stat. § 514.05, Subd. 1, when it is Filed with the County Registrar of Titles or Only After it is Subsequently Memorialized on the Certificate of Title?

STATEMENT OF FACTS

The MBA respectfully incorporates by reference the Statement of Facts set forth by the Appellant BankFirst’s Brief.

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

ARGUMENT

- I. LENDERS MUST HAVE CLEAR AND DEFINITE RULES FOR DETERMINING THE PRIORITY OF MECHANICS' LIENS IN RELATION TO THEIR MORTGAGES ON TORRENS PROPERTY AND TO HAVE CONFIDENCE IN THOSE RULES.

Minnesota banks must have a workable and reliable method for determining their priority status when filing a mortgage. Lenders have relied on Minnesota law to provide a clear and definite procedure for determining the priority of mechanics' liens in relation to their mortgages. When a bank takes a mortgage of real estate as security for a loan, there are a variety of interests that may make the property less valuable to the bank and must be considered to ensure the loan is fully collateralized. Most important of these interests to construction lenders are mechanics' liens.

Because mechanics' liens are statutory creations, lenders look directly to Minn. Stat. § 514.05 in determining the priority status of their mortgages. *See Dolder v. Griffin*, 323 N.W.2d 773, 780 (Minn. 1982) ("mechanics' liens exist only by virtue of the statute creating them"). Minn. Stat. § 514.05, subd. 1, provides that mechanics' lienholders have priority over mortgagees if the mortgagee had recorded or actual notice of the lienholder's interest at the time the mortgage is recorded.

Currently, lenders ensure statutory priority over mechanics' liens by recording their mortgage before the first visible improvement to the land. Lenders must be prepared to prove that no visible improvements were in place at the time of recording. Typically, lenders will take a picture of the property immediately after the mortgage has been recorded to demonstrate that no work had been commenced before that time.

Prior to making a disbursement, the lender and the title company normally receive waivers of mechanics' lien rights from the contractors and subcontractors who have worked on the project. These waivers may be collected either against payment for the work to which the waiver relates or on a "one free draw" basis. In the former case, prior to receiving payment for the work that it has done to date, the contractor presents a waiver of its lien rights with respect to all of that work. In the latter case, the lien waivers are one draw behind the loan disbursement; that is, the lender or title company collecting the lien waivers receives, with each draw, waivers with respect to all work paid for through the previous draw.

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

The ability to determine priority absent doubt or uncertainty is essential for lenders to make sound lending decisions. In today's economic environment, careful, prudent lending has never been more important. Banks must make sound

lending decisions to survive. Conversely, politicians are demanding that banks increase lending to stimulate the economy. Sound lending requires certainty in priority. Any uncertainty in priority will lead to decreased lending. Lenders will be far less willing to, or even able to, make loans that contain too much uncertainty.

Confidence in priority benefits not only the lender, but also the borrower. Every angle of the transaction needs to be fully evaluated and accounted for within the loan documents. Once a lender is able to gain a complete picture of the transaction, the borrower is better served. It allows the lender to match the borrower with the best loan product for their needs. It also benefits contractors, subcontractors and suppliers, because without lending, most projects would never get off the ground. Finally, it benefits the economy by creating work.

II. IF PRIORITY DATES FROM REGISTRATION ON THE CERTIFICATE OF TITLE, THE CONSTRUCTION LENDING INDUSTRY WILL BE SIGNIFICANTLY HARMED.

The potential negative effects of dating priority from registration on the certificate of title are significant. The direct impact will be felt by lenders, borrowers, and lienholders. The ripple effect will reach contractors, construction crews, material suppliers, and countless others. It will affect everyone's bottom line.

Lenders will have to spend additional time, manpower, and money to ascertain when their security interest becomes effective. This could be a time consuming and costly endeavor and may involve repeated trips to the county recorder to determine when the security interest has been memorialized. The pictures taken to prove that no work has been done on the property will have to be taken on the date the mortgage is memorialized, which cannot be predicted or controlled. They will also need to somehow control the construction site to prevent any work from commencing.

Once a lender develops its procedures to protect its priority position, all lenders and loan processors will need to be trained, which is another drain on time and resources. Even if procedures are in place and followed to the letter, the risk of intervening mechanic's liens cannot be eliminated. If the lender does everything right and makes sure no work is commenced until the mortgage is memorialized on the certificate of title, he will still not be certain of his priority,

because the date and time will not be recorded on the certificate of title. The lack of information about when a mortgage was actually recorded will put lenders in the difficult position of proving that the mortgage was memorialized before any work commenced. This untenable situation may result in the need for legislation requiring that the time of memorialization also be recorded on the certificate of title.

Even upon completion, lenders will never be completely confident that no stone has been left unturned. Because of this risk, funding of construction loans will likely be delayed until the county has entered the bank's security interest on the certificate of title. This could delay constructions projects for weeks.

Banks are a business. And like any other business that experiences an increased production cost, it can only absorb so much before it has to pass those costs on to the borrower. The additional monetary and time costs of avoiding intervening liens can only be partially absorbed by the bank. Owners of Torrens property wishing to build or renovate a home or commercial property will experience significant additional costs as well as delays. Some costs may be passed on to all bank customers indirectly in the form of increased fees.

Not all of the potential negative impacts can be summarized in dollars and cents. The increased uncertainty of priority will lead banks to reevaluate their lending practices. A borrower that may have been a desirable customer under the existing priority scheme suddenly becomes undesirable because the lender is unable to confidently determine their priority. This will result in a tightening of

available credit. When borrowers are unable to obtain loans, the ripple effect is immense. One needs only to pick up a newspaper today to see the impact on the economy. Lack of funding leads to slowed construction, which leads to reduced demand for resources and supplies, which leads to reduction in jobs, which leads to increased demand on already struggling government resources. The tightening of credit by reputable and regulated lenders opens the door for unscrupulous lenders and fraud. The total impact is difficult to completely predict, but impossible to ignore.

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

The same thing has happened with the implementation of the Higher Education Opportunity Act. *See Truth in Lending*, 74 Fed. Reg. 41,193 (Aug. 14, 2009) (to be codified at 12 C.F.R. pt. 226). The regulatory burden for offering

higher education loans was too great for some lenders, and they stopped offering the product. This same fate could await construction loans to owners of Torrens property.

CONCLUSION

The MBA respectfully urges the Minnesota Supreme Court to overturn the decision of the Court of Appeals in this case. To avoid significant disruption and added cost to the construction lending industry, mortgages must be considered effective from the time of filing, not from the date of memorialization on the certificate of title.

Respectfully submitted,

Dated this 25th day of March, 2010.

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FORM AND LENGTH CERTIFICATION

This brief was drafted using Word 2007. The font is Times New Roman, proportional 13-point font, which includes serifs. The word count of this brief is 2,107.

Dated: March 25, 2010


