1978

First of Denver Mortgage Investors and Citibank, N. A. v. C. N. Zundel and Associates et al : Brief of Plaintiffs-Appellants

Utah Supreme Court

IN THE SUPREME COURT OF THE STATE OF UTAH

FIRST OF DENVER MORTGAGE INVESTORS; and CITIBANK, N.A.,

Plaintiffs and Appellants,

vs.

C. N. ZUNDEL AND ASSOCIATES, a limited partnership; MOUNTAIN SPRINGS CONSTRUCTION COMPANY OF UTAH, a Utah corporation; MOUNTAIN SPRINGS CONSTRUCTION COMPANY, a California corporation; F. D. ASHDOWN and ALFRETTA B. ASHDOWN, Trustees; FMA LEASING COMPANY; DUNCAN ELECTRIC SUPPLY, INC., HOLT-WITMER INTERIORS, et al.,

Defendants and Respondents.

Case No. 15696

BRIEF OF PLAINTIFFS-APPELLANTS

Appeal from the Second Judicial District Court
of Davis County, State of Utah
The Honorable J. Duffy Palmer, District Judge

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NATURE OF THE CASE

This case involves a mortgage foreclosure action by the plaintiffs against a subdivision which originally comprised 44 acres in east Bountiful, Utah, known as the Lakeview Terrace Subdivision. Plaintiffs appeal from the judgment of the District Court of Davis County (Hon. J. Duffy Palmer) which awarded eight lien claimants a first priority of an aggregate $44,732.86, prior to plaintiffs' Trust Deed.

DISPOSITION IN LOWER COURT

The Court authorized a Sheriff's Sale to be conducted on January 19, 1978, based on a Judgment and Decree of Foreclosure dated December 20, 1977, which reserved the issue of priority of liens. Motions for Summary Judgment were heard on January 12, 1978, but the Court reserved its ruling until January 24, 1978. The plaintiffs bid $1,900,000 for the property on January 19, 1978. The Court awarded the lien claimants first priority on January 24, 1978, amounting to $44,732.86.

Plaintiffs-appellants seek a reversal of the Court's Order Granting Summary Judgment dated February 1, 1978, awarding $44,732.86 worth of liens, priority over the Trust Deed.

MATERIAL FACTS OF THE CASE

The plaintiff First of Denver Mortgage Investors (herein called "FDMI") first made a loan of $450,000 to C. N. Zundel and Associates, a limited partnership (herein called "Zundel") (R. 11). This first Trust

Deed was recorded August 1, 1973, against the property. On February 19, 1974, the loan was refinanced, and FDMI advanced the sum of $1,500,000 to Zundel, secured by Trust Deed recorded February 19, 1974. The limited partners of Zundel were John H. Kelly, Albert E. Mann, Fred F. Auerbach and George Witter, Jr. Mr. C. N. Zundel was the general partner. These individuals were personal guarantors on the loan. The prior Trust Deed for $450,000 was released and reconveyed on March 19, 1974. The Trust Deed was a blanket lien on the 44 acre subdivision which included approximately 50 single family residential lots on Lakeview Drive, Barton Creek Lane, 1300 East and 1500 East, plus the land later platted as Lakeview Terrace, Phase One and Phase Two, for condominiums, clubhouse, and an undeveloped 20 acres (plus or minus) in Lot 62. See the map of Lakeview Terrace attached as an Addendum to this Brief, which has been furnished for illustrative purposes, and is a composite of two maps received in evidence. The Promissory Note for $1,500,000 was due and payable on January 15, 1976. It was a construction loan due 23 months after inception, and plainly required refinancing, or other long term amortization. Zundel failed to pay the monthly interest charges, and by September 1, 1975, the delinquent interest amounted to $145,458.56, and FDMI filed its first Complaint for foreclosure on September 8, 1975 (R. 1).

On August 8, 1975, Zundel conveyed the property to Mountain Springs Construction Company of Utah, a Utah corporation (herein called "Mountain Springs"). The stockholders of Mountain Springs were the same individuals (with the exception of C. N. Zundel) as the limited partners, but Claude G. (Pat) Sinclair was the new president and executive officer.

On November 4, 1975, FDMI concluded a Supplemental Construction Loan Agreement with Mountain Springs (R. 143) and all of the guarantors except C. N. Zundel (R. 150). This Agreement provided, among other provisions, that Mountain Springs would provide $120,000 to pay for the cost of completion of the first ten townhouse units on Lakeview Terrace, Phase One (R. 144) (see map), and FDMI would lend an additional $112,500 to Mountain Springs for completion of the clubhouse and swimming pool on Lakeview Terrace, Phase Two (R. 147). The Borrower was to make the townhouse units salable and qualify for a certificate of occupancy by January 15, 1976. The construction loan of $1,500,000 was to be modified so as to be repaid in installments of $600,000 by July 1, 1976, $450,000 by October 1, 1976, $450,000 by July 1, 1977, and the final balance plus interest on December 1, 1977 (R. 148). Lot release prices were set forth for the sale of the single family sites and townhouse sites. Provided Borrower timely paid all installments on the loan, interest was to be recomputed from 4% per annum over the prime rate of Bank of America to 8% per annum from December 1, 1974, on the outstanding balance.

Mountain Springs failed to pay the $600,000 installment on July 1, 1976. FDMI had partially assigned the Note and Trust Deed to Citibank, N.A. (R. 96), which Assignment was recorded on July 30, 1976, and these two plaintiffs filed an Amended Complaint on August 2, 1976, foreclosing the $1,500,000 Trust Deed (recorded February 19, 1974) (R. 95). The defendant Mountain Springs filed an Answer and a Counterclaim for $1,325,000 damages (R. 233). Jury trial was originally scheduled for July 11, 1977 (R. 300), but Mountain Springs filed a Chapter XI Proceedings for an Arrangement on

July 8, 1977 (R. 360), and trial was delayed five months until December 12, 1977 (R. 386). The parties met in Court in an informal pre-trial on December 8 1977, at which time it was generally agreed and stipulated that: (1) there was going to be an issue as to the priority of liens; (2) that the plaintiffs' total debt including interest was $2,358,000, but they would only bid a net $1,900,000 for the property and take no deficiency judgment against the individual guarantors in consideration of Mountain Springs dismissing its Counterclaim with prejudice (T. 3-5). Due to these stipulations, there was only a short one-hour trial on December 12, 1977, wherein plaintiffs offered, and the Court received in evidence the Promissory Note for $1,500,000 (Ex. A), the Trust Deed (Ex. B), a letter and title report from Security Title Company of Farmington (Ex. C and D), the loan ledger (Ex. E), Computation of Interest (Ex. F), and the Lis Pendens recorded July 27, 1976.

The Minute Entry of the Court for December 12, 1977, recites that the plaintiffs will foreclose on the property for One Million Nine Hundred Thousand Dollars and will take no deficiency, and that a Decree of Foreclosure may issue except as to lots belonging to the defendants Ashdown, and certain lots already sold. Motions for Summary Judgment were set for January 12, 1978, and non-jury trial was set February 1, 1978 (R. 453). The Court (Hon. J. Duffy Palmer) signed Findings of Fact, Conclusions of Law and Judgment and Decree of Foreclosure on December 20, 1977 (R. 481-489). The Judgment was for $2,358,396. The Judgment recited that plaintiffs would bid the sum of $1,900,000 for the property and that, "The priority of the mechanic's and materialmen's liens is reserved for future determination and shall be set forth in a supplemental Judgment and Decree of Foreclosure to

be entered prior to Sheriff's Sale." (R. 489) Due to the fact that counsel for Mountain Springs withdrew from the case on October 24, 1977 (R. 394) and thereafter attorney Stanley M. Smedley did not enter his appearance in behalf of Albert E. Mann, one of the guarantors, until February 3, 1978 (R. 621), counsel for the plaintiffs prepared the Affidavit of John Kelly (President of Mountain Springs) which set forth the admitted amount owing by Mountain Springs to the various lien claimants, including interest and attorneys' fees of 20%. These amounts and the date the first work was performed are as follows:

Lien Claimant	First Work Performed For	Date First Work Performed	Amount including Interest and Attorneys' Fees
Child Brothers	C. N. Zundel	11/15/73	$13,450.52
Duncan Electric	Mountain Springs	1/22/75	4,310.70
Robert J. Wardrop	Mountain Springs	12/1/75	2,367.37
Countertop Shop, Inc.	Mountain Springs	3/9/76	790.43
Max D. Scheel	Mountain Springs	4/19/76	728.53
Ronald Graham Tile Co.	Mountain Springs	3/23/76	3,460.40
Bland Brothers	Mountain Springs	3/8/76	12,289.47
Holt-Witmer	C. N. Zundel	1/1/75	7,335.44
			$44,732.86

All liens were for work performed by the lien claimants for Mountain Springs who took over the project in 1975, except Child Brothers, Inc., who first did work laying water line and sewer pipe for Zundel on November 15, 1973, and Holt-Witmer who furnished furniture and furnishings

(non-lienable) plus wallpaper and linoleum (lienable) under a contract with Zundel. All of the lien claimants except Child Brothers performed labor or furnished materials on the various condominium units contained in Lakeview Terrace, Phase One (also called townhouse units in Supplemental Construction Loan Agreement). See the plat of Lakeview Terrace attached as an Addendum to this Brief. This separate portion of the Lakeview Terrace Subdivision was platted on January 23, 1975. Lakeview Terrace, Phase Two, was platted on February 11, 1976, and is the location of the clubhouse and swimming pool for the townhouse units.

On or about June 17, 1976, Child Brothers, Inc. was paid the sum of $13,210.40 and executed a Release of All Liens and Claims (R. 462). Mountain Springs (Pat Sinclair, president) also gave Child Brothers, Inc. a Warranty Deed to Lots 59 and 60 in the Lakeview Terrace Subdivision, "subject to . . . encumbrances of record." The Warranty Deed to the two lots, and the release of all claims of lien were recorded on June 22, 1976 (R. 462 and 464). On November 30, 1976, Child Brothers, Inc. filed another Notice of Lien alleging that the sum of $10,390.28 was owed to it and that the first work was performed on November 15, 1973, and the last work was performed on October 1, 1976. This Notice of Lien was filed three years after the first work was done by Child Brothers, Inc. for Zundel and nearly four months after plaintiffs had recorded their Lis Pendens, giving notice of the action to foreclose the Trust Deeds upon plaintiffs' Amended Complaint. Eugene Child, President of Child Brothers, Inc., testified on deposition that he did strictly pipeline work (Child deposition, page 5). He laid the sewer and water line for the subdivision and did some modification on

the Weber pressure water system and also some storm drain work (Child deposition, page 5). The invoices and ledgers of Child Brothers, Inc. show that he billed Zundel and Associates for all work done and interest accrued through July 31, 1975. On June 17, 1976, Child Brothers received payment of $13,210.40 and credited this sum to its account with Zundel (Exhibit 1 to the Child Brothers deposition). On June 17, 1976, Child Brothers, Inc. executed the Release of All Liens and Claims, and obtained the Warranty Deed to Lots 59 and 60 (Exhibits 3 and 4 to the Child deposition). Child Brothers opened up a new account with Mountain Springs commencing February 10, 1976 (Exhibit 2 to Child deposition). The first charge to this account was $97.80 worth of work to raise and adjust a valve box (Invoice No. 09442). The last work performed from September 22 to October 1, 1976, was for "Lake View Terrace, c/o Don Milligan" (Invoice No. 09776). This work was for laying a storm drain, 200 to 300 feet, across the intersection of Lakeview Drive and Barton Creek Road (Child deposition, page 31). It was bid by Eugene Child to Mountain Springs through Don Milligan, the engineer on the job (Child deposition, page 31).

ARGUMENT

POINT I. THE LIENS FOR MATERIALS FURNISHED ON THE TOWNHOUSE UNITS IN LAKEVIEW TERRACE, PHASE ONE, COULD NOT RELATE BACK TO THE OFF-SITE IMPROVEMENT WORK DONE BY CHILD BROTHERS, INC.

It is undisputed in this case:

1. That all of the lien claimants, except Child Brothers, Inc., first performed work on Lakeview Terrace, Phase One, after plaintiffs'

Trust Deed for $1,500,000 was recorded on February 19, 1974.

2. That the lien claimant Child Brothers, Inc. laid water line and sewer pipe for the subdivision, commencing its first work on November 15, 1973.

3. That Child Brothers, Inc., in consideration of payment of $13,210.40, released all claim to lien for work performed prior to June 17, 1976.

Under this state of facts, the trial court erred in ordering that lien claimants totalling $44,733.86 were entitled to priority ahead of the plaintiffs' blanket trust deed. The pertinent statute on the priority of liens provides as follows:

> 38-1-5. Priority--Over other encumbrances.--The liens herein provided for shall relate back to, and take effect as of, the time of the commencement to do work or furnish materials on the ground for the structure or improvement, and shall have priority over any lien, mortgage or other encumbrance which may have attached subsequently to the time when the building, improvement or structure was commenced, work begun, or first material furnished on the ground; also over any lien, mortgage or other encumbrance of which the lien holder had no notice and which was unrecorded at the time the building, structure or improvement was commenced, work begun, or first material furnished on the ground. (Emphasis added; 38-1-5, U.C.A. 1953)

In the case of Western Mortgage Loan Corporation v. Cottonwood Construction Company, 18 Utah 2d 409, 424 P.2d 437, this Court said:

> We are inclined to the view that the legislature intended the language "commencement to do work or furnish materials on the ground" to be limited to relate to the home or other structure which was being or about to be built upon the land. To tack the liens for labor or materials

> that went into the construction of the house to the liens that may have arisen for labor and materials furnished in off-site improvements in connection with the laying out and construction of facilities used in connection with the subdivision as a whole would be going beyond the intent of the statute.

Child Brothers, Inc. released all its right, title and interest in the lien it had against Zundel. The release was executed June 17, 1976, and was recorded June 22, 1976. The liens of all other lien claimants for work performed on the townhouse units cannot tie to or relate back to the off-site improvements performed for Zundel. Mountain Springs, a corporation, is not the same entity as Zundel, a limited partnership, the prior owner. It is undisputed that the work done in October, 1976, by Child Brothers, Inc. for Mountain Springs was done "as per bid." This work cannot be considered as under the same contract which Child Brothers, Inc. performed in 1973 for Zundel.

The defendant Child Brothers, by and through its attorney of record, recognized that the work done in 1973 was not under the same contract as the work done in 1976; that the original lien from November 15, 1973, to June 17, 1976, had been released, and that Child Brothers, Inc. had not brought an action to enforce its lien within twelve months after the completion of its original contract, as required by 38-1-11, U.C.A. 1953. For these reasons, Child Brothers, Inc. stipulated that its lien for $13,450.52, including the sum of $8,809.38 owing by Zundel (Exhibit 1 to Child Brothers deposition), was "junior and subordinate to plaintiffs' Trust Deed" (T. 574). In spite of this Stipulation, the trial court awarded Child Brothers, Inc. first priority and concluded that all other lien claimants could relate

back and tie to the date that water lines were first commenced to be laid in the subdivision. The property, Lakeview Terrace, Phase One, where all other lien claimants performed their work or supplied materials, was not even platted until January 23, 1976. The Memorandum Decision of the Trial Court dated January 24, 1978 (R. 614) gave the lien claimants a prior lien to 38 entirely separate single family lots bordering Lakeview Drive and Barton Creek Circle plus 20 undeveloped acres in Lot 62 of the original Lakeview Terrace Subdivision. See the map attached as an addendum hereto of Lakeview Terrace Subdivision and Lakeview Terrace, Phase One, and Lakeview Terrace, Phase Two, a planned unit development. Thus, the lien claimants were awarded first priority to the blanket property description on a 44 acre tract of ground including undeveloped property and 38 separate single family lots, upon which they performed no work whatsoever, and which was not included in the legal description contained in their Notice of Lien. These lien claimants performed their work in 1975 or 1976. The plaintiffs' Trust Deed was recorded February 19, 1974.

The Utah lien statute is clear that the lien claimant only has a ". . . lien upon the property upon or concerning which they have rendered service, performed labor or furnished materials . . ." (38-1-3). "The liens granted by this chapter shall extend to and cover so much of the land whereon such building, structure or improvement shall be made as may be necessary for the convenient use and occupation thereof . . ." (38-1-4). "The liens herein provided for shall relate back to, and take effect as of, the time of the commencement to do work or furnish materials on the ground for the structure or improvement and shall have priority over any lien,

mortgage or other encumbrance which may have attached subsequently to the time when the building improvement or structure was commenced, work begun or first material furnished on the ground . . ." (38-1-5). (Emphasis added.) It is obvious that the statute only contemplates liens to date back to the time each individual structure was commenced. There is great need to follow and preserve the principle announced in Western Mortgage Loan that liens on the individual buildings cannot tie to the off-site improvement work in the subdivision.

A 1977 Nevada Supreme Court case which re-affirms the doctrine and relies on Western Mortgage Loan Corporation v. Cottonwood Construction Company is Aladdin Heating v. Trustees of Central States, 563 P.2d 82. There, the court construed a statute whose language is substantially identical to that of Utah (38-1-5 U.C.A. 1953) and stated:

> (1, 2) It is clear that the "work done" provision of NRS 108.225 only prefers "liens for work or labor, which work or labor was begun prior to the filing of a mortgage (or recording of a deed of trust), but begun after the commencement of the erection of the building . . ." (Emphasis added). Pacific States Savings, Loan & Building Co. v. Dubois, 11 Idaho 319, 83 P. 513, 514 (1905); see also McClain v. Hutton, 131 Cal. 132, 61 P. 273 (1900); Home Savings & Loan Ass'n v. Burton, 20 Wash. 688, 56 P. 940 (1899). Here, actual on-site construction had not yet started and the architectural, soil testing, and survey work appellants rely on for their priority is insufficient to constitute the commencement of a building or improvement; something more is required. D-K Investment Corporation v. Sutter, 19 Cal. App. 3d 537, 96 Cal. Rptr. 830 (1971); Walker v. Lytton Savings and Loan Ass'n of No. Cal., 2 Cal. 3d 152, 84 Cal. Rptr. 521. 465 P.2d 497 (1970); Mortgage Associates, Inc. v. Monona Shores, Inc., 47 Wis. 171, 177 N.W. 2d 340 (1970); M. E. Kraft Excavating & Grading Co. v. Barac Const. Co., 279 Minn. 278, 156 N.W. 2d 748 (1968); H. B. Deal Const. Co. v. Labor Discount Center, Inc., 418 S.W. 2d 940 (Mo. 1967).

Where we to hold otherwise and permit mechanics' liens to accrue based on this work done prior to the commencement of construction, mechanics' liens could relate back to a time long before there were any visible signs of construction to inform prospective lenders inspecting the premises that liens had attached. Under such circumstances, no prudent businessman would be willing to lend construction money. See: Walker v. Lytton Savings and Loan Ass'n of No. Cal., cited above; M. E. Kraft Excavating & Grading Co. v. Barac Const. Co., cited above; Western Mortgage L. Corp. v. Cottonwood Const. Co., 18 Utah 409, 424 P.2d 437 (1967).

SUMMARY

As stated to this Court on the argument May 15, 1978, concerning respondents' Motion to Dismiss Appeal, plaintiff is attempting to obtain payment by redemption from several prospective buyers for $1,900,000 net to it, but is not willing to sell for less than $1,944,732.86 principal. The additional $44,732.86 will be paid to the junior lien claimants. If a developer-investor pays this amount during the period of redemption, the appeal will become moot. If the redemption period expires, plaintiffs are entitled to the property without obligation to pay the liens which should be determined to be junior and subordinate to the first Trust Deed.

Respectfully submitted,

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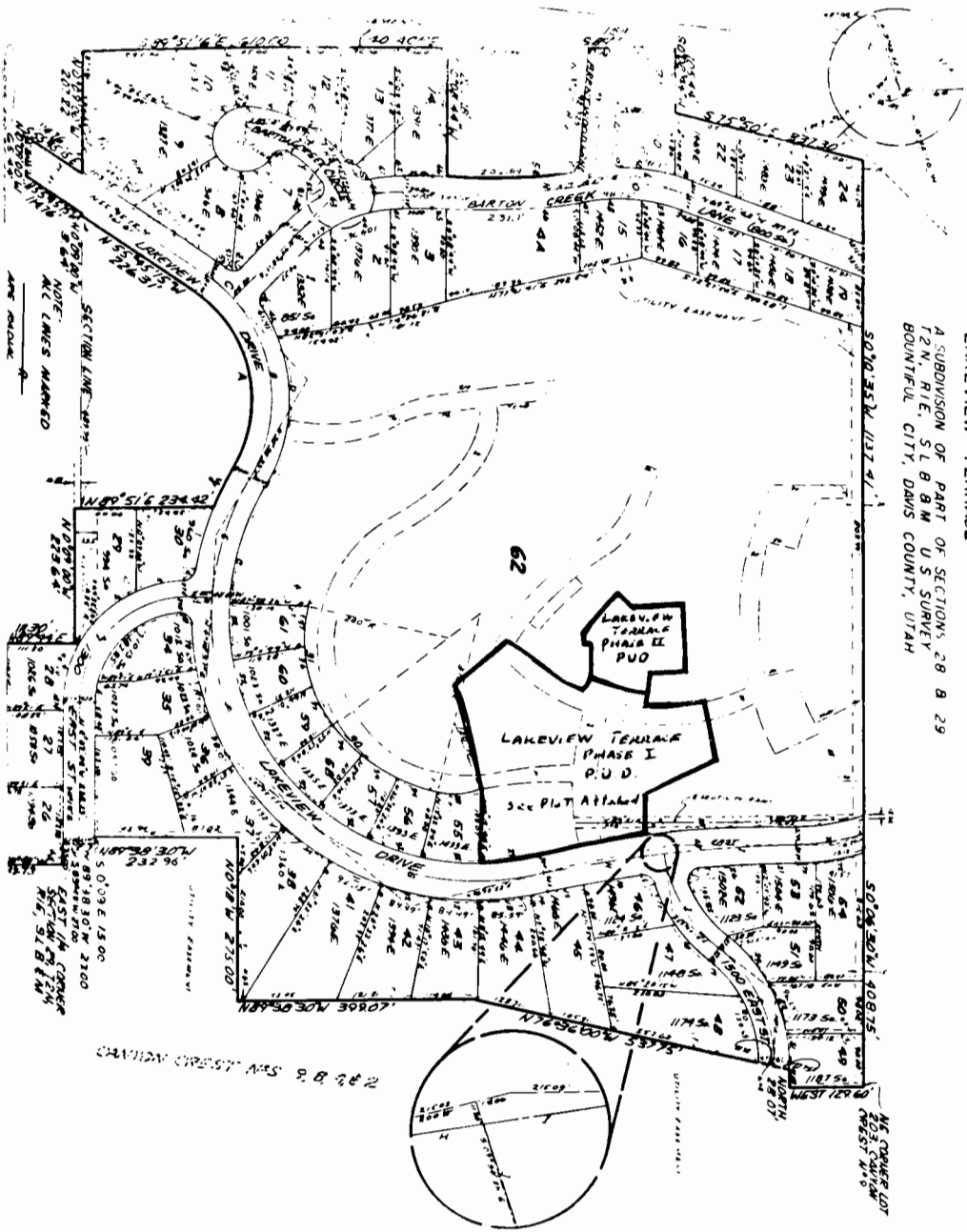


Security Title Company

LAKEVIEW TERRACE

A SUBDIVISION OF PART OF SECTIONS 28 & 29, T2N, R1E, SLB&M U.S. SURVEY

BOUNTIFUL CITY, DAVIS COUNTY, UTAH

LAKEVIEW TERRACE PHASE ONE

A PLANNED UNIT DEVELOPMENT

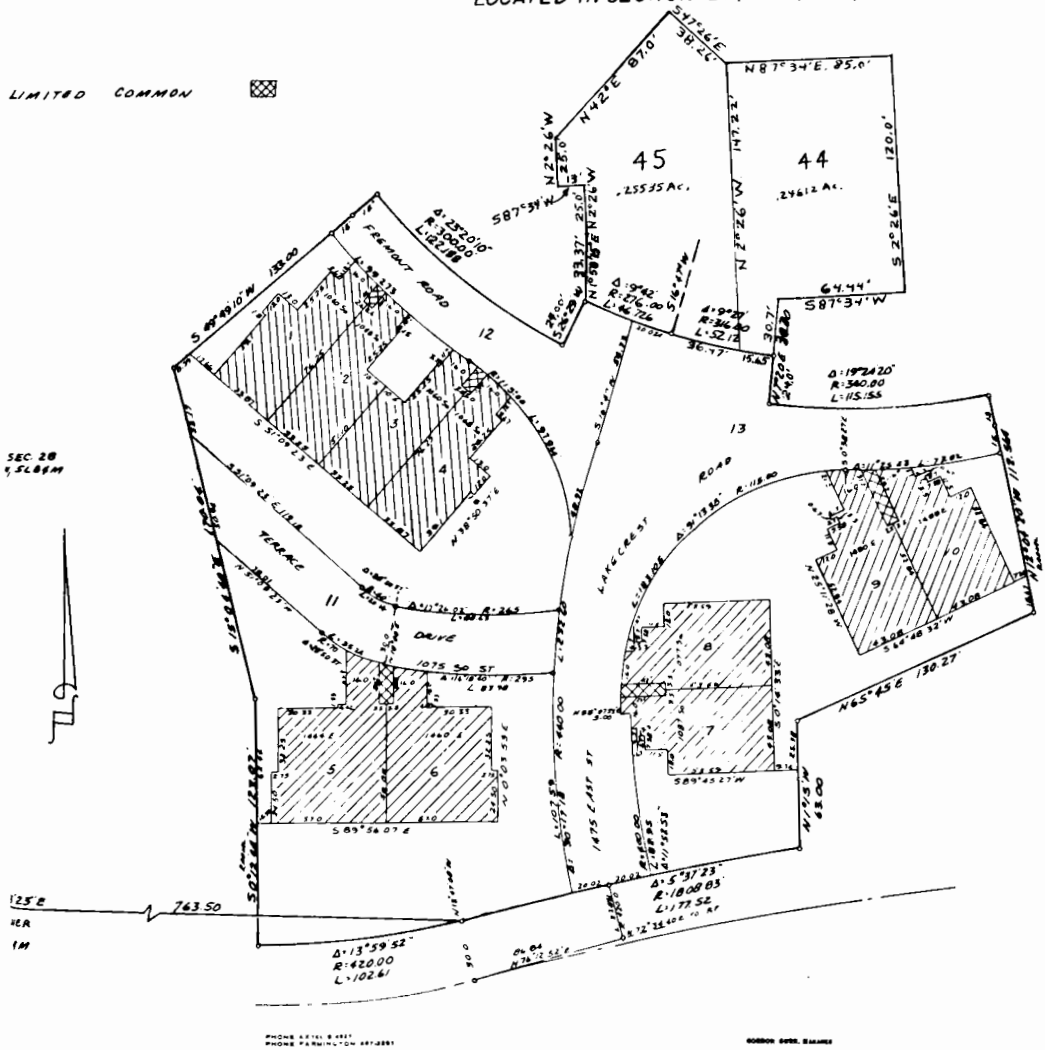
LOCATED IN SECTION 28, T2N, R1E, SL.B&M.

ALL CROSS HATCHED AREAS ARE LOTS TO BE INDIVIDUALLY OWNED. ALL OTHER AREAS ARE COMMON AREAS AND ARE ULTIMATELY TO BE OWNED BY LAKEVIEW TERRACE HOME OWNERS ASSOCIATION, A UTAH NON PROFIT CORPORATION

LAKEVIEW TERRACE PHASE TWO

A PLANNED UNIT DEVELOPMENT

LOCATED IN SECTION 28, T2N, R1E, S.L.B&M.



SECURITY TITLE COMPANY

FARMINGTON, UTAH