

1966

Western Mortgage Loan Corporation v. Cottonwood Construction Company, a Corporation, et al. : Respondent's Brief

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IN THE SUPREME COURT
OF THE STATE OF UTAH

FILED

WESTERN MORTGAGE LOAN
CORPORATION, a corporation,

MAY 23 1966

Plaintiff-Respondent,

vs.

Clk. Supreme Court, Utah

COTTONWOOD CONSTRUCTION
COMPANY, a corporation, et al.,

Defendants,

Case No.

10516

* * * * *
OSCAR E. CHYTRAUS COMPANY,
INC., a corporation, GIBBONS & REED
CONCRETE PRODUCTS COMPANY,
a corporation, RICHARD P. GARRICK,
BOISE CASCADE CORPORATION,
a corporation,

Defendants-Appellants

RESPONDENT'S BRIEF

Intermediate Appeal from Interlocutory Pretrial Findings
of the 3rd District Court for Salt Lake County,
Honorable Aldon J. Anderson, Judge

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IN THE SUPREME COURT OF THE STATE OF UTAH

WESTERN MORTGAGE LOAN
CORPORATION, a corporation,
Plaintiff-Respondent,

vs.

COTTONWOOD CONSTRUCTION
COMPANY, a corporation, et al.,
Defendants,

* * * * *

OSCAR E. CHYTRAUS COMPANY,
INC., a corporation, GIBBONS &
REED CONCRETE PRODUCTS
COMPANY, a corporation, RICHARD
P. GARRICK, BOISE CASCADE
CORPORATION, d/b/a BESTWAY
BUILDING CENTER, a corporation,
Defendants-Appellants.

Case No.
10516

RESPONDENT'S BRIEF

STATEMENT OF FACTS

In order that the court might have a true picture of the facts in this case, Respondent submits herewith its statement of facts for the Court's scrutiny.

In November 1959, the owners of an unimproved tract of land situated in Salt Lake County, State of Utah,

entered into a real estate contract with Harrison and Moore, a partnership, for the sale and purchase of the tract of land for the sum of \$84,000.00. In said contract the buyers agreed to develop a subdivision on said land, the sellers to be under no obligation or expense in connection with the planning, approval and development of said subdivision. The Agreement further provided for a conveyance of lots in the subdivision on a lot release basis and in the event of buyers building houses on the lots, for subordination of buyers' obligation to the sellers to the lien of the construction mortgages. (R. 163-168)

Harrison and Moore, in turn, contracted with James A. Finnegan, Jr., and wife, under date of August 18, 1960. Finnegans later assigned their interest to Cottonwood Construction Company, a corporation. (R 169-177)

County approval for Lazy Bar Subdivision was obtained in the latter part of 1960.

From the latter part of 1959 to October of 1960, Charles D. King surveyed the land, platted it, placed visible stakes upon the ground, marking the lots, including Lot 10, thus defining the intended subdivision development. (R 69)

Lloyd Jackson and Rex L. Jackson then installed the roads, curb and gutter, sidewalks, water mains, sewer mains and sewer laterals. Installation of the sewer mains and laterals was completed about January 1, 1961 and the dirt removed from the trenches was replaced and rough graded. (Note that this took place 22 months before construction of the home started on Lot 10)

The other off-site improvements were made as stated in Appellants' Brief.

Application for construction financing on Lot 10 was made to Western Mortgage Loan Corporation and approved. The note and mortgage in the amount of \$15,750.00 were executed October 29, 1962 and the mortgage was recorded the same day.

Contrary to Appellants' contention that there was no commitment of funds to the account by Western, upon receiving the executed note and mortgage, Western immediately assigned both documents to the First Security Bank of Utah, N.A. hereafter referred to as First Security Bank, as security for a loan equal to 80% of the face amount of the note. First Security Bank then created a special non-interest bearing account in Western's favor, denominated as a Ban Control Account and credited the same with the sum of \$12,600.00, being 80% of the face amount of the note. A separate Ban Control Account was created for each lot. Western also maintained its general checking account with the same bank. After Western made each disbursement for Lot 10, First Security Bank would debit the particular Ban Control Account and credit Western's general checking account with the exact amount of the disbursement.

Before Cottonwood Construction Company could receive title to Lot 10 and execute a valid first mortgage, a lot release price of \$500.00 had to be paid to the fee title owners. Western advanced this sum as a short term loan, as well as monies for title insurance, hazard insurance and recording fees on Lot 10 and after the construction

loan was paid, charged said items against it as an expense. In addition, Western charged against the construction loan its service charge and interest charges as the same accumulated. Neither the lot release price, nor any of the other charges just mentioned were reimbursed from the Ban Control Account. The lot release price and said charges equaled at least 20% of the face amount of the note, so that Western, in fact, committed in advance all of the funds shown in the note and mortgage on Lot 10.

The discretion allowed Western in Schedule "A" relates only to the amounts and time thereof and not to the ultimate duty of Western to disburse funds equal to the face amount of the note.

In the Pre-construction Affidavit, Finnegan and an associate stated that no work has been started and no materials furnished for Lot 10.

The mortgage for Lot 10 was recorded prior to the furnishing of any labor or materials for the building of the house on said lot.

As shown by its ledger, Western attributed advances to Lot 10 at frequent intervals from October 31, 1962 to January 24, 1963. (R. 151, Exhibit M-84) At about this time Western learned that some of the money advanced to Cottonwood had not been paid to some of the material suppliers. Western then informed Cottonwood that no further funds would be advanced on the mortgage until Cottonwood furnished the balance of properly executed lien waivers covering all advances to date. This, Cottonwood failed to do.

Paragraph 10 of the loan agreement provided that upon default of the borrower, including work stoppage by the lender under the terms of the agreement, the lender could, at its option, (1) declare all indebtedness secured by the mortgage immediately due and payable and be released from all further obligation to the borrower or (2) take possession of the premises, finish improvements and pay the costs thereof out of the funds in the account. (R. 151, Exhibits W-2) These rights of the lender were cumulative and not to the prejudice of any other rights under its mortgage. Respondent wishes to call attention to the exact language of paragraph 10 of the loan agreement which Appellants chose to alter in their statement of facts. (Appellants' Brief. pp. 7 and 8)

When it became apparent that Cottonwood had misapplied funds advanced to it by Western, the lien claimants met with Western to determine what course of action should be taken. Western was urged by Jim Reed, one of the managers of Boise Cascade, the appellant, to allow the project to continue by making funds available. It was agreed by the lien claimants and Western that Cottonwood should convey title to the property to Security Title Company, as trustee for Western and the lien claimants, and that in order to mitigate the damages, Western should continue to advance the funds from the mortgage account to complete the houses which were in various stages of construction — exposed to the weather, untenable and subject to acts of vandalism — worthless in such condition to serve the purpose for which they were being constructed. On the strength of this agreement,

Cottonwood conveyed the property to Security Title Company, as Trustee for Western and the lien claimants. Arlen Fox, secretary of Cottonwood was hired to supervise the work required to finish the houses. The same lien claimants, suppliers and laborers were used as had been used from the beginning of the project and Western paid for all work and materials furnished from the date of the resumption of work. Negotiations involving the proposed agreement were protracted due to the number of lien claimants involved and the complexities of the situation. In the meantime, other creditors began to file actions against Cottonwood. It soon became apparent to Western that the only solution to the problem was to commence foreclosure of the construction mortgages so this action (and its companion cases) was filed. To further mitigate the damages occasioned by this involved situation the houses were rented as completed. The house on Lot 10 was rented in August 1964. It has been occupied by tenants ever since. The yard has been landscaped, the value of the house increased, rents have been collected and are being held by Western pending the disposition of this case.

ARGUMENT

POINT I

THE TRIAL COURT WAS CORRECT IN ACCORDING PRIORITY TO ADVANCES MADE UNDER THE CONSTRUCTION MORTGAGE OF WESTERN MORTGAGE LOAN CORPORATION IN LIGHT OF EXISTING STATUTORY AND CASE LAW.

(A) THE CONSTRUCTION LOAN AGREEMENT
CREATED THE OBLIGATION OF THE
MORTGAGEE AND ALL ADVANCES MADE
THEREUNDER TOOK PRIORITY AS OF
THE TIME OF RECORDATION OF THE
MORTGAGE.¹

The mortgage transaction in issue had for its purpose the securing of progress payments under a construction loan agreement. This arrangement contemplated the advancement of funds at various stages of development until the improvements were completed in accordance with settled plans and specifications.

In Utah as in other jurisdictions which favor prior recorded mortgages over later liens, disbursement of funds by the mortgagee as the terms of the loan agreement require has been deemed sufficient to confer priority for all such advancements as of the time of recordation of the mortgage.²

In *Culmer Paint and Glass Co. v. Gleason*, 42 U. 344, 130 Pac. 66 (1913) certain mortgages were "given for the express purpose of raising funds to construct (a) building" and the mortgagee was to

"... pay out the money as the building progressed"

1. Respondent will not depart from the usual and accepted terminology, viz.: "obligatory or optional" — in presenting its case concerning the nature of the advances made under its construction mortgage. Suffice it to say, that the terms employed by appellants, "volitional or non-volitional," are nowhere recognized by the case law or commentaries on this subject, and one can only speculate as to why appellants felt it desirable to by-pass the accepted terminology.

2. Utah Code Anno. 1953, 38-1-5. The prevailing view as to the nature of construction mortgage advances is noted throughout the discussion of Point I, but see particularly the authorities at p. 16-24.

The mortgages were held to take priority over a subsequently arising mechanic's lien to the extent that advances were actually made under the mortgage.

Again in *Utah Savings & Loan Assoc. v. Mecham*, 11 U. 2d 159, 366 P. 2d 598 (1961), mortgages regular in form which were given to secure funds for the development of a subdivision were accorded priority over the claims of materialmen who delivered supplies subsequent to recordation of the mortgages. This Court stated in response to the argument that no obligation existed to make the advances:

"A mortgagee who is loaning money to a mortgagor-borrower is obliged to pay out the money in accordance with the directions of the borrower. This is especially so where, as in the instant case, a sum certain is stated in the mortgage and no provisions are made for future advances."

The appellants do not assert that the *Culmer* and *Mecham* cases were decided erroneously, nor do they dispute the rationale upon which the construction mortgages in these cases were accorded priority.³ Ordinarily, therefore, it would seem the appellants could have no valid

3. The equitable basis for priority has frequently been noted, e.g., in *Kiene v. Hodge*, 57 N.W. 717, the court stated: "The lots, independent of the buildings, were not sufficient security for the loan . . . The equities are strong in favor of the (mortgagees). At the time defendants commenced to furnish the lumber for which their liens are claimed, the records indicated the lien of the (mortgagees), and they engaged in the transaction in the full light of the facts."

See also Scholl, *Priorities Between Mechanic's Liens and Construction Loan Mortgages in Alabama*, 23 Ala. Law. 398 (1963): "The theory behind the statutes in jurisdictions giving priority to the construction loan mortgagee . . . is that the . . . mortgagee has contributed as much or more to the improvement of the land as have the mechanic's lienors. This seems to be a perfectly realistic approach. . . ."

since the mortgage here was regular in form and clearly secured typical construction outlays.

However, the appellants would deny such priority solely on the basis of those provisions of the loan documents governing disbursement of funds. Basically, the contention is that no obligation existed on the part of the mortgagee to advance funds because of the right retained to exercise discretion in making the advancements.

In examining the merit of this contention, the doctrine of future advances as it relates to construction mortgages must necessarily be considered at the outset; thereafter the question of whether the disbursement procedure adopted here requires a different result will be considered.

NATURE OF CONSTRUCTION LOAN AGREEMENT

Appellants state the general rule that advances which the mortgagee is obligated to make will take priority over intervening liens while optional or voluntary take priority only as of the time each is made. However, appellants thereafter make no meaningful attempt to differentiate between the different types of security devices to which the principle is applicable, nor are they at all helpful on its specific application to construction mortgages.

It is important to note that there are a number of transactions in which a mortgage may secure future

advances.^{3a} One of the most frequently employed today is the so-called "optional advance" or "open-end" mortgage. Basically a standard mortgage taken on *existing* security, the open-end mortgage contains an additional clause permitting future advances to be made at the lender's option. Its usefulness in establishing a continuous line of credit to homeowners for needed repairs, additions to existing structures, etc. is well known.⁴ However, it is clearly distinguishable from the construction mortgage which is taken not on the security of land or on land and existing improvements but only on the security that improvements will be erected in accordance with predetermined plans.

The distinction is made quite clear in the very source appellants have urged the Court to accept as authority for their argument. Thus at p. 20 of appellants' brief, the following appears:

"In the third type, the mortgage will provide expressly for the making of future advances, but the making of these advancements is strictly within the discretion of the mortgagee. Such a device is termed a mortgage to secure 'optional future advances.'" Blackburn, *Mortgages to Secure Future Advances*, 21 Mo. L. Rev. 209 (1956).

This statement apparently is intended to be relevant to the security device, i.e., construction mortgage, now before the court.

3a. Osborne, for example, lists in addition to construction loans, "mortgages by way of indemnity for prospective indorsements; guarantees and accommodations of commercial paper to be issued by the mortgagor; fluctuating current balances under lines of credit, established with the mortgagee; and security for a bond issue or series of bond issues." Osborne, *Mortgages* §113.

4. 65 Harvard Law Review 478 (1952)

Actually, the author does not end his statement quite as indicated by the quote. Rather, the latter sentence in full reads this way:

“Such a device is termed a mortgage to secure ‘optional future advances,’ *but currently is becoming more familiarly known as an ‘open-end mortgage’.*” (emphasis supplied)

When the author turns to obligatory advance mortgages and construction financing, he states:

“A typical example of the obligatory form is found in commercial construction projects where the lender is contractually bound to make subsequent advances to cover the costs as the work progresses.” (p. 219)

This accurately reflects the view the courts have overwhelmingly adopted with regard to construction mortgages. That is, *the agreement to disburse as construction progresses creates the obligation* sufficient to protect the advances made pursuant thereto.

The *Culmer* and *Mecham* cases so held, and the following are but a few examples of cases in accord:

Boise Payette Lumber Co. v. Winward, 47 Idaho 485, 276 Pac. 971 (1929):

“We think it cannot be questioned, that under the contract, the mortgagee’s obligation was to advance the balance of the funds upon compliance with the condition of the agreement, viz.: the improvement of the premises. *The premises were improved and the mortgagee became bound by virtue of the original agreement to advance the specified sum to pay therefor.*” (emphasis supplied)

Landers-Morrison-Christensen Co. v. Ambassador Holding Co., 214 N.W. 503 (Minn. 1927):

"The contract between the corporation and the mortgage company imposed upon the company the duty to procure the necessary funds and make the stipulated advances as the building progressed. *It cannot reasonably be construed as creating a mere option to make them. It created an obligation to make them; and the advances having been made pursuant to that obligation they take priority over the mechanic's liens.*" (emphasis supplied)

See also *C. K. Wood Lumber Co. v. Mulholland*, Calif. 5 P. 2d 669 (1937), *Hammond Lumber Co. v. Roubian*, Calif. (1934) 30 P. 2d 440, *Smith v. Anglo-California*, Calif. (1928), 271. Pac. 898, *Hance Hardware Co. v. Denbigh Hall Inc.*, Del. (1930), 152 Atl. 130, *Hyman v. Hauff*, N.Y. (1893) 33 N.E. 735, *Franklin Svgs & Ln Co. v. Fish*, Fla. (1929) 124 So. 42, *Miele v. Faldutti*, N.J. (1927) 137 Atl. 92, *Security Stove & Mfg Co. v. Sellards*, Kan (1931) 3 P. 2d 484; and see cases collected in Annot. 80 A.L.R. 2d 179, 191, Osborne, Mortgage § 120 n. 54.

APPELLANTS' AUTHORITIES

In view of the foregoing, it is instructive to consider the authorities offered by appellants:⁵

Superior Lumber Co. v. National Bank of Commerce, Ark. (1928) 2 S.W. 2d 1093, *Balch v. Chaffee*, (1905) 47 Atl. 327, and *Carey v. Rufus Lillard Co.*, Okla. (1945) 165 P. 2d 344, all involve "open-end" mortgages and do not in any way concern advances under a construction loan agreement.

5. (See appellant's brief, p. 17.)

Heller v. Gate City Building and Loan Assoc., 75 N.M. 596, 408 P. 2d 753, a decision which appears to weigh heavily in the balance with appellants, involves only the question of the lender's right to include certain costs of repair under the heading of preservation of security. It, too, contains no discussion or consideration of construction loan advancements.⁶

Other cases cited by appellants without further attempt to relate them to the question before the court are:

Finlayson v. Crooks, Minn (1891) 49 N.W. 398, which considered the question of priority where the mortgage was recorded after the commencement of work on the improvements; *Gray v. McClellan*, 214 Mass. 92, 100 N.E. 1093 (1913), involving an arrangement whereby certain mortgages were placed on property, but it was expressly covenanted between the parties that,

"... they (mortgagor and mortgagee, respectively,) would not demand either the amount agreed to be loaned, or the amount represented by each mortgage note or any part thereof."⁷

6. The open-end mortgage may be what the appellants have in mind in alleging the equitable basis for their contention, viz.: "... the lender could with impunity advance or refuse to advance as it chose, swallowing up, at its own violation, and for its own benefit, the protection intended the mechanic's lienors." (p. 14, appellants' brief). Where sums may be advanced on an already existing improvement, as is typically the case under an open-end mortgage, it is possible for the mortgagee to attempt to "feed" his security at the expense of lien claimants by advancing funds after learning of additions or improvements. However, where the security only comes into being as the improvements are made — as is true of construction loans—such an argument has no relevance or merit, and it is significant that it has never been given any credence in the cases.

8. The inaptness of the *Gray* decision is made more graphic when considered in connection with *Whelan v. Exchange Trust Co.*, 214 Mass. 94, 100 N.E. 1095 (1913) decided the same day. Here the court was dealing with priority questions where normal construction progress payments were involved. Holding such outlays to be prior, the court stated:

"It is uncontroverted that after deducting interest on the full amount, the remainder was credited on the books to the A. W. Soutter Building Account, upon which, as the value of the property was increased by the construction of the building, the mortgagor was permitted to draw ... It having been absolutely obligated to pay the loan named in the mortgage, it is immaterial that only a very small portion had been thus transferred before the plaintiffs began work, or that before the entire amount had been disbursed the company received notice of the liens." (Emphasis supplied.)

W. P. Fuller & Co. v. McClure, 48 Cal. App. 185, 191 Pac. 1027 (1920), a case specifically held inapplicable to construction mortgages in a later decision where the court was faced with the precise claim made by appellants here.⁷ *Yost-Linn Lumber Co. v. Williams*, 9 P. 2d 324 and *Elmendorf-Anthony Co. v. Dunn*, 10 Wash. 2d 29, 116 P. 2d 253, both of which involved the issue of priority for advances made *after default*, and not the issue of whether the loan agreement provided for optional or obligatory advances; and, finally, *Home Savings & Loan Association v. Sullivan*, Okla., 284 Pac. 30 (1929), which is misleading unless considered in connection with later cases in the same jurisdiction which cast extreme doubt on its current validity.⁸

With no meaningful qualification offered by appellants to the general view of construction mortgages as

7. See footnote 11, *infra*.

8a. The court in the *Sullivan* case did subordinate the advances made pursuant to a construction loan agreement on the ground that the option afforded to the mortgagee to withhold funds until lien claimants were paid rendered the mortgage one for optional advances. *Local Federal Svs. & Loan Ass'n. v. Davidson & Case Lumber Co.*, 255 P.2d 248 (Okla. 1952) and *Tulsa Ready-Mix Concrete Co. v. Dale Lumber Co.*, 381 P.2d 849 (Okla. 1963), have all but rendered this decision null and of no effect.

In the *Davidson* case, the loan proceeds were to be disbursed only upon the owner's showing that parties furnishing labor and materials had been paid. The court held all advances made under the mortgage to be entitled to priority over the claims of materialmen; the *Sullivan* case was distinguished on the ground that the agreement in that case gave the mortgagee the option to refrain from payment *until the building had been completed*. In the *Tulsa Ready-Mix* case, the mortgagee had the right to pay loan proceeds directly to parties asserting liens against the property and deduct the amounts thereof from the amount of the loan. The court was actually unable to distinguish the *Sullivan* case but stated that,

"... in any event, it was made clear in the *Davidson* case that the rule stated from C.J.S. (according priority to construction mortgages generally, 57 C.J.S., Mechanic's liens §205(b)) would be applied in cases such as this."

obligatory in form, it remains to consider the contention that the provisions covering disbursement under the present loan agreement require a different result.

DISBURSEMENT PROVISIONS

The substance of appellants' contention in this regard appears at page 11 of their brief, viz.: "Where the lender is bound to make the advances, he is unable to exercise discretion. . . ." Under this view it would follow that a construction mortgagee in order to achieve priority must be unilaterally bound to make advancements, regardless of other factors or conditions which normally qualify any such duty.

Actually, this is quite inaccurate. Certainly a lender must be given the opportunity to determine if the payout is required considering the amount of work completed and the percentage of the contract already paid.

The exercise of discretion is also required (1) where the work performed or materials furnished are defective or not in accord with specifications, or (2) where the work and materials are satisfactory but the owner nonetheless objects to disbursements on a wholly untenable ground. The right to withhold or refuse payment in the first instance is self-evident; the following has been noted in connection with the second:

" . . . the authorization to disburse funds, included in the construction loan agreement, is an essential protection to the lending institution so that it may disburse funds at its discretion in the event of any disputes between owner and contractor wherein the owner is taking an unreasonable position."
Conway, Mortgage Lending, 340 (1960)

Thus, the right to exercise discretion in making payouts may operate as much for the benefit of parties furnishing labor and materials as for the mortgagee.

Professor Corbin notes other reasons for control over construction expenditures in discussing the position of the owner relative to performance by the contractor. It is apparent that his remarks are equally applicable to a construction mortgagee, viz.:

“In order to get the contract, a bidder may bid very low; later, in order to avoid loss, or in order to make his compensatory ‘profit’ a greater one, he may ‘scamp his job.’ There are numberless ways in which this can be done without discovery by the other party to the contract. . . . A desired building can perhaps be procured by merely buying a contractor’s promise to build it; a more effective method, however, is to buy his promise and also to *make the return promise of compensation conditional upon approved performance.*” (emphasis supplied) Corbin, Contracts § 650.

This defines the issue clearly: the obligation of the mortgagee to disburse funds is contingent upon adequate performance justifying such disbursement. This concept is basic to construction financing and has been readily acknowledged in situations such as the present where lien claimants have sought to avoid a subordinate position by alleging absence of obligation to disburse.

Boise Payette Lumber Co. v. Winward, 47 Idaho 485, 276 Pac. 971 (1929), rejected this contention:

“. . . the mortgagee's obligation was to advance the balance of the funds represented by the mortgage note *upon compliance by the mortgagor with the conditions of the agreement*; viz.: the improvement of the premises. The premises were improved and the mortgagee became bound by virtue of the original agreement to advance the specific sums to pay therefor.” (emphasis supplied)

Again, in *Theilen v. Chandler*, 9 Tenn. App. (1928), the court concluded:

“It was not optional with McMillan to refuse to pay the advancements *if the value of the houses did justify further advancements*. For when the value of the houses justified additional advancements, McMillan's obligation to pay existed. The obligation to advance became absolute at the execution and registration of the trust deeds, conditioned only upon the time of advancement and the value of the security.” (emphasis supplied)

In *Hammond Lumber Co. v. Roubian*, Calif. (1934) 30 P. 2d 440, the contention of the lien claimants was stated thus:

“Respondent . . . contends that the entire loan fund . . . constituted an optional advance because under certain conditions the lender could not be compelled to advance the money and could stop payment.”

The court's reply goes to the heart of appellants' contention:

“As we understand the cases cited, none of them are authority for the proposition that where as in a case like this, the borrower has fully performed

on his part, the advances to be made under the agreement are optional with the lender.”⁹

The right reserved to the mortgagee to use its discretion in making payouts is thus nothing more than a recognition of an implied condition of the obligation to disburse; it does not relieve the mortgagee of the obligation to disburse when the condition has been met.

The appellants' quarrel with this conclusion is fairly summarized by the following excerpt from page 17 of their brief:

“Since the disbursements are relegated to the ‘sole discretion’ of the lender, no legal right inhered in the borrower to compel disbursement and no legal penalty could be imposed upon the lender if in its ‘whole’ or ‘sole’ discretion it determined not to disburse.”

Basically, then the appellants take this position: The mortgagee has reserved to itself the right to make disbursements when in its discretion such payouts are required. It may therefore refuse to make any disbursements by alleging that no payouts are warranted, or may simply decline to advance funds without justifying its

9. The appellants will no doubt assert (as on page 10 of their brief) that there is no showing that the precise language under consideration here was present in the above cited cases. Is this really respondent's burden? It is admitted the transaction in issue is one involving construction financing; the cases cited are of this type, and in addition considered and rejected the very claim now advanced by appellants. Is it not incumbent on appellants rather to distinguish these cases on some more solid ground? For, in view of what has been stated earlier as to the recognition of the need of a construction lender to exercise control over expenditures, it seems far more likely than not that language similar to the present was contained in the loan agreements in the cases cited.

refusal at all, having always the right to exercise its discretion as it chooses. Thus, there is no obligation to advance funds and the promise of the mortgage to do so is illusory and unenforceable.

This line of reasoning confuses the right to *exercise* discretion with the possibility that discretion may be *used arbitrarily*. That is, because one party is accorded the right of approval of performance as a condition to its own duty to perform, it follows that there is no mutuality of obligation because the possibility exists that the right may be exercised arbitrarily or capriciously. This is totally at variance with settled rules of construction favoring mutuality of obligation and imposing the condition of "reasonableness" upon the exercise of the right of discretion.

Mattei v. Hooper, Calif. (1958) 330 P. 2d 625, notes the general rule:

"Contracts making the duty of performance of one of the parties conditional upon his 'satisfaction' are upheld on the theory that the expression of dissatisfaction must be genuine and not arbitrary, and that an objective criterion—good faith—controls the right to determine satisfaction."¹⁰

10. See generally 3 Corbin, *Contracts* 644-647, 5 Williston, *Contracts* §675A (3rd ed.) 1961), 12 Am. Jur., *Contracts* 895-898, 17 C.J.S., *Contracts* 1006-1010, *Rodriguez v. Barnet*, 338 P.2d 907 (1959)

Paley v. Barton Savings and Loan Ass'n., 196 A. 2d 682 (1964), involved a situation where defendant had reserved the right to reject mortgages under a purchase commitment which failed to receive its counsel's "approval." Rejecting the argument that no obligation existed, the court stated: "The significant consideration here is whether or not the parties intended to enter into a binding agreement . . . As stated by Professor Corbin, 'If the parties have concluded a transaction in which it appears they intend to make a contract, the court should not frustrate their intention' . . . Thus any terms of the purchase commitment which were dependent upon defendant's satisfaction . . . would in the event of a dispute be construed by the court to be subject to the implied condition that the defendant's decision be reasonable under the circumstances."

Hannula v. Hacienda Homes, 211 P. 2d 302, 19 A.L.R. 2d 1268 (Cal. 1949), provides a helpful example of the rule's application. Here the matter in issue was a restriction in a deed against the erection of a dwelling house "until the plans and specifications with the proposed site therefor have been . . . approved" by a named party. It was contended that the restriction was not binding because,

" . . . if the defendant has the right to determine that a portion of a lot, regardless of its size, is not suitable for a dwelling, then it could make the same determination with respect to an entire lot or group of lots."

The court however determined otherwise, stating that this "result would not follow . . . It is clear from what has been said that the defendant's action must be reasonable and taken in good faith."

At another point, the court rejected the contention,

" . . . that standing alone the restrictive covenant requiring approval of plans would leave the purchaser subject to the mere whim of the seller and would therefore be too indefinite to be enforced ignores the decisions cited which hold that the power to approve . . . must not be exercised capriciously or arbitrarily."

The application of this principle can be easily recognized where the language of construction loan agreements has been in issue. In *Weiss, Dreyfous & Seiferth, Inc v. Natchez Invest. Co.*, 140 So. 736 (Miss. 1932), e.g., the agreement contained the following provision :

"If the conditions set forth . . . above have been fulfilled, and evidence of such fulfillment has been furnished to the Trustee by written certificate of

(the architects), then . . . such payments shall be made directly to the contractor . . . provided, however, that the Trustee shall have the right, but shall be under no duty to do so, to *verify the correctness* of any such certificate, and to determine whether the aggregate amount of the balance due for work theretofore done thereunder exceeds the amount then remaining in said trust fund."

Clearly, no qualitative difference exists between the reservation of a right to verify that performance has been proper, and the right to use discretion in the first instance to determine if disbursement is proper. The court reached this conclusion:

"When these laborers' and materialmen's liens arose the laborers and materialmen had constructive notice that the owner of the building had executed a deed of trust thereon to secure the payment of money to be advanced for the purpose of paying for the labor and material therefore as the construction progressed . . . *the parties to that deed of trust contemplated that its lien should be paramount, and that the mortgagee had no option as to making such advances, but was irrevocably bound to do so.*" (emphasis supplied)

In *E. K. Wood Lumber Co. v. Mulholland*, 5 P. 2d 669 (Cal. App. 1931), a construction mortgage was also held to be one for obligatory advances, notwithstanding that the mortgagee through its representative obviously retained the right to disburse in its discretion, viz.:

"Appellants further contend that the trial court erred in granting priority to the deeds of trust, as the advances made thereunder were optional,

citing *W. P. Fuller & Co. v. McClure*, 191 Pac. 1027. The authority cited is not in point.¹¹ The loan of \$40,000 in the present case was agreed upon a typical building loan agreement providing that 'said sum of \$40,000 shall be advanced *in such sum or sums as your appraiser or representative shall recommend* as the work progresses and not otherwise." (emphasis supplied)

This conclusion was reached as to the nature of the agreement:

"The only option given was in the time and amount of each advancement during the progress of the work. In the case cited (*W. P. Fuller & Co.*) it was definitely agreed that the mortgage was in no way bound to make any advances other than the initial advance of \$1,600, the further advances were 'merely voluntary advances.'"

The facts of the instant transaction call for the same conclusion. The mortgagee did bind itself to disburse in accordance with the schedule set forth; however, it had a right to insist upon adequate performance as a condition of its obligation; if the performance failed to comply with the plans and specifications, on the basis of which the agreement was made, the schedule of payments would inevitably be subject to alteration. But, as noted in *E. K. Wood Lumber Co. v. Mulholland*, *supra*, an option as to time and amount of advances does not affect the obligatory nature of the promise; rather it is the undertaking to pay upon performance that is controlling.

11. It should be noted that the *W. P. Fuller Co.* decision, a case the court here found inapplicable to construction loans is one of the principal authorities relied upon by appellants. (See page 17, appellants' brief.)

This result conforms to established rules of construction as well. Notably, that "whenever possible a contract should be so construed that there are mutually binding promises on each party. *Ross v. Producers Mut. Ins. Co.*, 4 U. 2d 396, 295 P. 2d 345. And, perhaps most importantly, that in determining both the "meaning and legal effect of an agreement, the transaction should be considered as a whole." Corbin, Contracts § 549, *Caine v. Hagenbarth*, 37 U. 98, 106 Pac. 945 (1910)

Here the mortgagor wished to undertake certain construction for which a loan was required; the lender agreed to advance the funds under the terms of an agreement which contemplated disbursement at various stages of construction, the security of the lender overall being dependent upon completion of the structure in accordance with plans and specifications. Can it be argued that, given the terms of such an arrangement, it was intended one party should not be bound to perform even though performance by the other fully complied with the conditions of the agreement? It is certain the purpose of neither party would be served under such a construction of the terms, since both the lender's security and the borrower's hope of profit are wholly dependent upon timely completion of the building.

Caine v. Hagenbarth, 37 U. 98, 106 Pac. 945 (1910), states:

"Where one construction of a contract will make it unreasonable, unfair or unusual, and another construction equally consistent with the language thereof, will make it reasonable, fair and just, the latter construction will prevail."

Beyond question the appellants, by lifting phrases out of the context and referring them to dictionary definitions rather than to the purpose and meaning of the transaction as a whole, have endeavored to pin a wholly unjustified construction upon the loan agreement relative to its disbursement provisions. The agreement, when considered in light of the relationship of the parties, the purpose in entering into the arrangement and the goal sought to be achieved, clearly created mutually binding promises in accordance with its terms.

(B) THE TRIAL COURT WAS CORRECT IN ACCORDING PRIORITY TO ADVANCES MADE BY RESPONDENT TO COMPLETE THE STRUCTURE FOLLOWING DEFAULT UNDER THE LOAN AGREEMENT. THE RIGHT OF COMPLETION WAS CONFERRED BY THE AGREEMENT AND SECURED BY THE PRIOR MORTGAGE TO THE SAME EXTENT AS OTHER PROVISIONS. ITS EXERCISE WAS REQUIRED TO PRESERVE THE INTERESTS OF ALL PARTIES.

At the date of abandonment of work on lot 10, the house was half completed. (See Appellants' Brief P. 26) The Court can fully appreciate the condition of residential property under these circumstances, it is believed, without further note.

Cottonwood Construction Company was obligated under the loan agreement to complete the structure in accordance with its terms. Respondent was accordingly bound to make progress payments. Upon the mortgagor's breach, Respondent was required to determine which

course of those provided for in the agreement it would follow. It could have proceeded with foreclosure. Instead, it chose to complete the structure, employing appellants among others for that purpose.

Appellants argue that by so doing the nature of the arrangement was thereby transformed so as to confer a priority on the lienors to the amounts expended after default, notwithstanding their subordinate position prior to that time.

In truth, the loan agreement and all its provisions, *including those which governed the rights of the parties upon breach*, were secured by the mortgage as fully as was the note. By proceeding to complete the house the mortgagee simply fulfilled the obligation of the mortgagor through exercise of a right plainly accorded by the loan agreement.

Appellants in contrast were not parties to the loan agreement, and it was clearly not executed for their benefit. Nor, it might be added, did appellants enter into the transaction with the purpose or even reasonable expectation of achieving priority. They would appear to have no valid concern therefore with the mortgagee's rights upon breach of the loan agreement.

This was recognized in *Hayward Lumber & Investment Co. v. Corbett*, Calif. 33 P. 2d 41, (1934) where a lien claimant whom the court specifically found to be subordinate to a prior construction mortgage questioned the lender's right to complete the structure following

abandonment by the mortgagor. The purpose was obviously to assert priority over amounts advanced after default. The court however ruled:

“In view of the obligation requiring the money to be set over for the particular purpose of constructing the building only, and by reason of the obligation on the part of the (mortgagor) to expeditiously proceed to completion, it may not be said that the respondent erroneously proceeded in the place of (the mortgagor) to complete the building, using only such money as was set over for that purpose by the (mortgagee) to (the mortgagor's) account. (The mortgagor) would have been powerless to have used the money in question for any other purpose but the construction of the building. *It may be that (the mortgagor) might question the (mortgagee's) right to proceed in his stead, but it does not follow from this that (lien claimant) also may raise this question.*” (emphasis supplied)

Bennett v. Worcester County National Bank, Mass., 213 N.E. 2d 254 (1966), is a recent illustration of the fact that courts today will not accept mechanical application of the theory proposed by appellants, but will consider the transaction realistically in light of attendant circumstances. In the *Bennett* case, a construction mortgagee completed a building following default by the mortgagor, and an unsuccessful attempt to sell the uncompleted structure on foreclosure. The construction loan agreement itself contained basically the same provisions as that in issue, viz.:

“In the event the contractor fails to complete the construction of the building within a reasonable

time, *Bank shall thereupon have the right but shall not be bound to take immediate possession of said premises and proceed to complete the building . . . and Bank is authorized to charge all money expended for said completion against any money not already advanced.*" (emphasis supplied)

At the time of default, some \$133,000 had been advanced under the construction loan agreement. The best offer received by mortgagee upon advertising the property in an uncompleted state was \$95,000. The mortgagee thereupon expended an additional \$60,000 to complete the structure and it was ultimately sold.

Plaintiffs were junior mortgagees who were clearly subordinate at the time of default under the construction mortgage. Their argument to achieve priority in the sums advanced for completion exactly parallels that of appellants here, viz:

"The plaintiffs contend that upon (the mortgagor's) breach by failure to complete the building the bank's obligation to advance money for the project ceased by the terms of the agreement, the bank becoming a "volunteer" as to any sums subsequently advanced and thereby not entitled to charge them against the foreclosure proceeds . . . Accordingly, the plaintiffs would limit the bank's recovery to the \$133,608.93 advanced up to the time of the breach."

The court denied plaintiffs' asserted priority, with the following observation on the merit of their theory:

"This argument ignores the fact that the bank expressly reserved the right to complete the building,

and that (the mortgagor's) *failure to complete violated a covenant, the performance of which was secured by the mortgage.*" (emphasis supplied)

The result in *Bennett* is a realistic appraisal of construction financing. The object and indeed sine qua non of the entire transaction is erection of the completed structure. The loan agreement is the vehicle adopted by the parties to accomplish this end, and its provisions, *including those governing rights upon breach*, are secured by the mortgage. An attempt to superimpose a formal theory of "optional advances" to reverse the priority contemplated by the parties the court rejected as incompatible with the real objectives of the transaction.

No contention is now made that appellants acted in other than full awareness of the purposes for which Respondent's mortgage was executed. They should not now be heard to assert a belated priority based on exercise of a right secured by that mortgage.

COMPLETION — ECONOMIC CONSIDERATIONS

It must finally be asked what real justification appellants propose for their claim to priority. For not even appellants, it would appear, are content with bald application of the optional advance concept.

Rather, the justification is said to be in the fact that at the time of breach the lender "was amply protected by the buffer afforded by the land value." And, in addition, that by "waiting and taking over the venture . . . the lender undertook to enhance its own position at the expense of already disadvantaged lienors."

This is patently incongruous. A half completed house is unquestionably less than half a loaf. It is not an adequate "buffer" for a construction mortgagee nor was it ever so intended; moreover, it would have provided no security whatever for the subordinate lien claimants. It has been aptly noted that,

"... until a building has been completed, its intrinsic value is greatly impaired. No one will buy a lawsuit or an uncompleted structure, except at a sizeable discount." (Shinehouse, *Real Estate Construction Loan — A Synopsis*, 33 Pa. Bar Ass'n Q. 63 (1961))

The lienors in this situation stood only to benefit from the mortgagee's willingness to undertake to complete the house.

It is well settled that advances made for the protection of the security of the mortgage are not optional but will be treated as obligatory advances entitled to the priority of the mortgage. This is true even though the mortgagee is under no obligation to make such advancements by the terms of the mortgage or otherwise. Included under this heading are advances for taxes, insurance, upkeep or repair, or for completion of the improvement.¹²

12. See generally 36 Am. Jur., *Mortgages* §§316-321; Osborne, *Mortgages* §120; *Crofts v. Johnson*, Utah, 313 P. 2d 808 (1957); *Columbia Trust Co. v. Farmer's & Merchant's Bank*, Utah, 22 P.2d 164 (1933). An interesting case in this connection is *Miller v. Ward*, 88 Atl. 400 (Maine 1931), where a mortgagee who had advanced funds for the erection of an improvement and had taken possession of the premises upon default of the mortgagor was held to have not only the right but "... the duty ... having taken possession ... with a house nearly finished but untenable ... to protect the interests of the mortgagor (by) the finishing of the house ... and thereby changing it from unproductive property to income producing property."

The same conclusion has been reached notwithstanding that the rights of a junior lienholder were involved. In *Logan-Moore Lumber Co. v. Bowersock*, 100 Kansas 328 (1917) 164 Pac. 156, the owner abandoned the construction of several houses under agreements which called for the expenditure of approximately \$2,300 for completion. At the time of abandonment, the improvements were estimated to be worth from \$500 to \$800. The mortgagee thereupon completed the buildings according to plans, with the exception of a few minor additions. His right to priority for all amounts expended (except only the additions just noted) was upheld over the claim of a lienholder who had furnished certain materials prior to the breach. Although the question was considered of whether the lienholder was barred by a waiver of lien executed sometime earlier, it is clear the court did not treat it as germane to the issue of priority for sums expended after breach. Rather, the matter of priority for these sums is considered on its own merits, and it is believed the court's conclusions are instructive as to the validity of the position taken by appellants here, viz.:

“... As (the mortgagor) had abandoned the property with the buildings incomplete and in such condition as to deteriorate rapidly, unless something were done to preserve them, it was natural and proper that (the mortgagee) should assume control and take steps to that end ... Here, before

(the mortgagee) began work upon the completion of the buildings, he had a first lien for \$2,700. The two lots were worth but \$2,500. The (lienholder's) second lien was therefore practically worthless as things stood. *The only reasonable prospect of its realizing anything upon its claim was through the investment by someone of enough more money to give added value to what had already been done.* The mere covering in of the incomplete buildings so as to protect them from the weather would not have accomplished this, nor have appreciably bettered the (lienholder's) condition. *The natural and reasonable method of increasing the value of the partially constructed buildings was to complete them according to the original design.* Under the peculiar circumstances presented we think the trial court was justified in giving (the mortgagee) a first lien for money expended in this way." (emphasis supplied)

In view of the state of construction in the case before the court, it would appear the rationale of *Logan-Moore Lumber Company v. Bowersock* will apply.

Elmendorf-Anthony v. Dunn cited by Appellants in support of their argument really bears little relevance to this situation since in that case the mortgagee had disbursed all but \$49.00 of a \$2200.00 loan at the time of the breach.

Overall, it is apparent the provision in question here is a common, even standard, clause in construction financing arrangements.¹³ Its presence is directly attributable to the prime object of the transaction — completion of the structure according to plans. The foregoing discussion, it is believed, demonstrates that the courts are not prepared to accept appellants' proposal to apply the optional advance concept in a rigid, mechanical fashion. They will, however, interpret the concept reasonably in light of the circumstances and refuse to apply it when obviously incompatible with the objectives of the transaction involved.

POINT II.

THE TRIAL COURT WAS CORRECT IN DETERMINING THAT THE FACTS SUBMITTED BY THE AFFIDAVITS IN SUPPORT OF THE MOTION FOR SUMMARY JUDGMENT DID NOT CONSTITUTE "COMMENCEMENT TO DO WORK OR FURNISH MATERIALS ON THE GROUND FOR THE STRUCTURE OR IMPROVEMENT" WITHIN THE MEANING OF 38-1-5 UCA (1953).

13. The Building Loan Agreement of the Federal Housing Administration (form No. 2441) contains similar provisions. Paragraph 10 of said Building Loan Agreement contains the following language:

"If the borrower at any time prior to the completion of the project abandons the same or ceases work thereon for a period of more than 20 days or fails to complete the erection of the project strictly in accordance with the drawings and specifications . . . or otherwise fails to comply with the terms hereof, any such failure shall be a default hereunder, at the option of the lender, and the lender may terminate this agreement, or the lender, at its option, at any time thereafter may enter into possession of the premises and perform any and all work and labor necessary to complete the improvements substantially according to drawings and specifications, and employ a watchman to protect the premises from injury, all sums so expended by lender to be deemed paid to borrower and secured by said mortgage."

- (A) THE PRIORITY OF MECHANICS' LIENS UNDER THE UTAH STATUTE IS CONTINGENT UPON THE TIME OF COMMENCEMENT OF WORK OR FURNISHING OF MATERIALS FOR THE INDIVIDUAL BUILDINGS OR STRUCTURES AGAINST WHICH SUCH LIENS ARE CLAIMED. IN ORDER TO SERVE AS BASIS FOR PRIORITY OVER OTHER ENCUMBRANCES THE INITIAL WORK MUST BE SUCH AS TO PROVIDE CLEAR AND VISIBLE EVIDENCE OF THE COMMENCEMENT OF THE BUILDING ITSELF. PRELIMINARY OPERATIONS, SUCH AS THE PREPARATION OF A SURVEY, OR THE CONSTRUCTION OF OFF-SITE IMPROVEMENTS DO NOT MEET THIS REQUIREMENT.

Priority among mechanics' lien claimants, mortgagees and other encumbrancers is governed by § 38-1-5, U.C.A. (1953), which, in relevant part, provides that liens of the first mentioned group,

“shall relate back, 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.” (emphasis added)

The language of 38-1-5 suggests three conditions which must be satisfied before a lien claim may take priority over a record mortgage:

- (1) work on the building, structure or improvement, or initial furnishing of materials must precede recordation of the mortgage;
- (2) the initial work or furnishing of materials must be *on the ground* or site upon which the building is being erected; and
- (3) the initial work or furnishing of materials must be *for the building* proposed to be constructed, and hence clearly recognizable as the beginning of such construction.

The first of these conditions is clearly acknowledged in *Utah Savings and Loan Association v. Meham*, 12 Utah 2d 335, 366 P 2d 598 (1961), where, in discussing the rival claims of certain mechanic lienors and a mortgagee, the court states:

“Our law provides that a properly recorded mortgage has priority over a mechanic’s lien for work or labor furnished but which has commenced after the recordation of the mortgage.”

The plain meaning of the statute establishes the second condition. Thus 38-1-5 provides that the liens “relate back to . . . the time when the building, improvement or structure was commenced, work begun, or first material furnished *on the ground*.” This latter phrase qualifies each of the preceding events and obviously requires that the initial performance take place on the site of the contemplated construction.

As to the third, the terms of the act provide that priority is contingent upon the “commencement to do work or furnish materials . . . *for the structure or improvement*.”

The general rule as to what constitutes the commencement of work on a building is contained in 57 Corpus Juris Secundum, Mechanic's Liens, P. 179.

"The commencement of the building or improvement within the meaning of mechanic's liens statutes is the visible commencement of actual operations on the ground for the erection of the building, the doing of some work or labor on the ground, such as beginning to excavate for the foundation, or work of like description which every one can readily see and recognize as the commencement of a building, and which is done with the intention and purpose then formed to continue the work until the completion of the building."

"On the other hand, work which, although it may improve the property, is merely preparatory to building operations at some future time, and does not of itself tend to contribute directly to the erection, such as clearing, leveling, filling up, or fencing the property . . . does not constitute a commencement for the purpose of fixing the time to which the lien relates. Also staking out the plan of the building or the boundary line of the tract, does not constitute a commencement of the building within the meaning of the lien statutes."

See, also, Jones, Liens § 1469, 1474.

UTAH DECISIONS

The relevant decisions in this jurisdiction are in accord with the general view requiring for priority purposes, the initial performance of work or furnishing of materials to be made in connection with, and provide clear evidence of the commencement of, the building or improvement sought to be liened. In *Teahen v. Nelson*, 6

U. 363, 23P. 764, for example, the court stated the following in commenting on an earlier version of 38-1-5, viz.:

“Section 3810 of the same chapter prefers the lien given in the chapter to any other that may have attached or been created subsequent to the time when the building, improvement or structure was commenced; also to any such lien of which the lienholder had no notice, and which was unrecorded at the time the building was commenced. This section requires other lienholders, by mortgage, or otherwise, to take notice of the *commencement of work on the building*.” (emphasis supplied)

In *Stanton Transportation Company v. Davis*, 9 U. 2d 184, 341 P. 2d 207, (1959) an action foreclosing liens in connection with services and materials used for an oil well drilling rig, the Utah Supreme Court was called upon to decide the time at which a lien for labor or materials should attach as well as exactly what materials or services are lienable items under the statutes. The court granted a lien for labor in erecting the drilling rig on the wellsite but rejected the lien claim for labor and expenses in transporting the drilling rig to the wellsite. The relevant language of the court follows:

“The purpose of the lien statutes is to protect those who have added *directly* to the value of property by performing labor or furnishing materials *upon it*. (Emphasis supplied)

The court further said:

“The lien given to contractors and laborers specified the “performing labor upon, or furnishing materials to be used in . . . or repair . . . building . . . or improvement upon (the) land.” If the more

general phrase "or in concerning which" were controlling as to that class of lien claimants, the specific language requiring the work or materials to be upon the property would be idle verbiage.

. . . (2, 3) While it is true that our statutes are to be liberally construed to give effect to their purpose and to promote justice it is equally true that they should not be distorted beyond the intent of the legislature. This principle is particularly applicable in a situation of this kind where a liability is imposed upon the property owner beyond what he contracted to bear for the improvement of his property. In order to impose upon him such additional burdens the law must clearly spell out the responsibility. Otherwise, the entering into a contract for the improvement of one's property might open the door to unforeseeable risks for the property owner. He is aware of the amount of work to be done upon his property and fairly may be charged with knowledge of the extent thereof. But that is not true of peripheral work that may be in some remote way related to the contractor's activities.

Also, *Morrison v. Carey Lombard Co.* 9 U, 33 P 238, (1893) *Carey-Lombard Lumber Co. v. Partridge*, 10 U. 332, 37 P. 572, (1894) and *Morrison v. Inter-Mountain Salt Co.* 14 U. 201, 46 P. 1104 (1896) where the attachment of liens is clearly made dependent upon the furnishing of work and materials *for the building or improvement*.

OTHER JURISDICTIONS

Generally, work of a preliminary nature and not directly involved in commencement of the structure itself

has been rejected as the date for the attachment of claims of parties performing labor or furnishing materials subsequent to the recording of a mortgage on the property.

North Shaker Boulevard Co. v. Harriman Nat. Bank, 153 N.E. 909 (Ohio Ct. A. 1926) is an instance. Here certain materialmen who had furnished supplies to the premises sought to achieve priority over a prior mortgage on the theory that "work, construction, or improvement" had been commenced on the property prior to the recording of the mortgage. This contention was based on the presence on the property of steamshovels, the location of test holes, the driving of stakes, and other work of a similar nature prior to the recording of the mortgage. Rejecting the claim of the materialmen for priority, the court states the following as the test to be applied in the determination of whether work had been commenced as contemplated by the statute:

"... was the work, improvement, or construction of such a nature that apparently, obviously and visibly it formed in and of itself a component part of the structure, so that when the structure arose from the ground the work, improvement, or construction commenced prior to the mortgage would appear as part of the structure itself, as a physical identity, which, speaking in its own behalf, would indicate the situation prior to the recording of the recording of the mortgage?"

Rupp v. Cline & Sons, Inc. 188 A. 2d 146 (Md. 1963) is the most recent expression on the subject. A Lien claimant sought priority in the proceeds of a foreclosure sale

under a deed of trust which had been recorded approximately four months after the claimant had graded the mortgaged land, but before the claimant began actual excavation for a proposed apartment development.

The Maryland mechanics lien statute is similar to the Utah Statute in providing that the lien conferred takes priority over mortgages and other encumbrances which "attach upon the said building or the ground covered thereby subsequent to the commencement thereof . . ." In determining that the initial work done by the claimant did not fix the time to which liens could relate, the Court made these observations:

" . . . before there can be the commencement of a building which would give a mechanic's lien claimant a preference over a recorded mortgage there must be (1) a manifest commencement of some work or labor on the ground which everyone can readily see and recognize as the commencement of a building and (2) the work done must have been begun with the intention and purpose then formed to continue the work until the completion of the building."

Finding these elements absent in the instant case, it was concluded that while:

" . . . the removal of soil had the effect of leveling the apartment site, that fact did not constitute *commencement* for the purpose of fixing the time to which a lien could relate . . . nor did the grading or leveling — since there was no work on the ground which everyone could readily see and recognize as the commencement of a building — have

the effect of putting the party making the construction loan on notice that the building had been commenced . . .”

The lien claimants are unable to meet either of these tests. Neither the work of surveying or construction of roads and sidewalks, water mains, sewer mains and laterals or utility poles can be considered sufficient to give notice of proposed construction on the individual lots. In addition, it is obvious there was not the necessary continuity between the initial operations — the survey was made in early 1960, the roads, sidewalks, water mains, sewer mains and laterals were not constructed until over a year had elapsed and initial construction on the home did not begin for another eighteen months thereafter — to show the “intention and purpose then formed to continue the (preliminary) work until the completion of the building.”

(See also *Fryman v. McGhee*, 163 N.E. 2d 63 (Ohio Ct. App. 1958); *Gen. Life Ins. Co. v. Birzer Building Co.* 101 N.E. 2d 408 (Ohio Ct. App. 1950); *Erickson v. Ireland*, 158 N.W. 918 (Minn. 1916); *Central Trust Co. v. Cameron Iron & Coal Co.* 47 Fed. 136 (Cir. W.D. Pa. 1891); *Kiene v. Hodge*, 57 N.W. 717 (Ia. 1894) *Puseig & Jones v. Pa. Paper Mills*, 173 Fed. 634 (1909); *Ward v. Vannelle*, 91 N.E. 7)

(B) WHETHER THE PRELIMINARY WORK IS ITSELF LIENABLE UNDER THE STATUTE HAS NO RELEVANCY TO THE QUESTION OF PRIORITY BETWEEN THE MORTGAGEES AND THE LIEN CLAIMANTS. THE ISSUE OF PRIORITY IS, RATHER, CONTINGENT SOLELY UPON THE DETERMINATION OF WHETHER ACTS OCCURRED ON

THE PREMISES SUFFICIENT TO PROVIDE
CLEAR EVIDENCE OF THE COMMENCE-
MENT OF THE INDIVIDUAL HOUSE PRIOR
TO RECORDATION OF THE MORTGAGES.

Priority between mechanics and materialmen on the one hand and a mortgagee on the other is a matter entirely distinct from the question of what is or is not lienable under the statute.

Erickson v. Ireland. 158 N.W. 918 (Minn. 1916) points up the distinction sharply. The lien claimants here sought to relate their claims back to the time of the architect's preparation of plans. The work done by the architect had predated recordation of a construction mortgage on the premises, while the work and materials furnished by the lien claimants had post-dated such recording. The relevant statute contained this language:

"All such 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 incumbrance not then of record unless the lienholder had actual notice thereof."*

An earlier case, *Lamoreaux v. Andersch*, 150 N.W. 908 Minn. (1915) established the right of an architect to

*Another clause of this provision reads as follows:

"As against a bona fide purchaser, mortgagee or incumbrancer without notice, however, no lien shall attach prior to the actual and visible beginning of the improvement on the ground."
The court found it unnecessary to consider this provision, since, for the purpose of answering the argument of the lien claimants, it accepted their assertion that the mortgagee had notice and thus was in the same position as the owner. It will be noted that the statutory language considered by the court is basically the language of 38-1-5, U.C.A.

a lien on the property, regardless of whether the improvement for which his services were required was completed. The court in the instant case noted the lien claimants' reliance on this decision in stating the issue as follows:

"It is contended that as a result of the decision in the Andersch Case all liens must be held to attach as against the owner and mortgagees with notice claiming under him as of the time the architect commenced to prepare his plans."

This argument was flatly rejected:

"It was not held in the Andersch Case that where a building is actually constructed, liens attach as against the owner of the land as of the time the architect commences the preparation of his plans.

We cannot so hold here. The statute does not admit of such construction.

"The language of the statute, when applied to a case where a building is actually constructed is not doubtful. In plain terms it says that:

'All liens 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.'

"If anything more need be said, we might say that the provision that mechanics' liens should be preferred to any mortgage or other incumbrance, not of record at the time of furnishing such first item of material or labor unless the lienholder had actual notice thereof, leads to the inference that it was intended that such liens were not to be preferred to any *mortgage which was then of record* . . . it was not the intent of the decision to throw doubt on the meaning of this language as applied to the usual case where improvement is made on the ground.

“We hold that when a building is erected all liens attach at the time the first item of material or labor is furnished on the ground. The result is that the mortgage is prior to the liens.” (emphasis added)

Rupp v. Cline & Sons, Inc. *Supra*, is another case in point.

Thus, regardless of whether a lien can be asserted for the work done or materials furnished, the question of priority remains dependent upon the same factors, namely, the performance of acts on the premises sufficient to give notice of the commencement of the building.

National Lumber Co. v. Farmer & Son, Inc., 87 N.W. 2d 32 (Minn. 1957) also contains a clear acknowledgment of the distinction between lienability of services or materials furnished and the right to priority. In determining that the erection of a fence on the premises before a mortgage was recorded did not confer priority on parties performing labor or furnishing materials for the construction of a building subsequent to the recordation, the court made this analysis:

“Appellants’ first contention is that the fence constituted an actual visible improvement upon (the) premises. Of this there can be no doubt. Nor can there be any doubt that the case of the fence would have been a lienable item if the bill . . . had not been paid . . . It is not important that the company which provided the fence later furnished materials in the construction of the dwelling for it need only be demonstrated that the fence constituted “the actual and visible beginning of the improvement on the ground’ in order for the lien

to attach. When a building is erected all liens attach at the time the first item of material or labor is furnished on the ground."

After considering several Minnesota cases dealing with the doctrine of "relation back" for purposes of priority under the mechanic's lien statute, the court concluded:

"... it appears that the line of distinction is whether or not the improvement bears directly on the construction of the building rather than whether it is part of the overall project involved."

In this light the court affirmed the finding below that "the fencing was not the beginning of the improvement within the meaning of (the statute) . . . and that the erection of the fence was severable and separable from the later work."

The same reasoning is applicable to the facts at hand. First, the initial platting of the subdivision and the construction of roads and other "off-site" improvements, did not constitute the "commencement" of the building, and, second, even though such work is deemed to be lienable and part of the overall work on the subdivision, it is clearly "separate and severable" from actual construction of the individual lots.

Appellants have relied on the case of *United States Bldg. & Loan Ass'n v. Midvale Home Finance Corp.* 86 U. 506, 44 P. 2d 1090 (1935) and cases cited therein to support their position. It is true that the Midvale Home Finance Corp. case did involve a contest for priority between Mechanic's lien claimants and the mortgagee. In

that case, however, both the lien claimants and the mortgagee asserted liens against the entire subdivision, rather than against individual lots. The question of preliminary work or off-site improvements as a basis for the attachment of lien claims is not mentioned in the case. Rather, it is apparent that actual construction of the homes was commenced before the mortgage was recorded and the lien claimants were engaged in such construction from the out-set. Thus, the Court in *MIDVALE* was faced simply with a situation where the visible beginnings of construction on the subdivision improvements were commenced prior to the recordation of the mortgage, and both lien claimants and mortgagee looked to the tract as a whole for their security. In the case before the Court, the parties have looked to the individual lots for security, individual mortgages having been recorded on each lot and notices of lien filed by lien claimants on individual lots. Thus, the lien claims must be evaluated separately as to each residence. The Midvale holding would require here, as in the case of liens asserted against the entire subdivision, that actual construction on the improvements on the individual lots precede recordation of the mortgage.

SUMMARY

If mechanics liens are to prevail over the lien of a recorded mortgage, the commencement of work or furnishing of materials must both precede the recordation of a mortgage and provide clear evidence of the beginnings of the erection of the building itself. Preliminary

and offsite operations such as were involved here are wholly insufficient to satisfy this requirement. The fact that the preliminary work may itself be lienable under the statute is of no consequence on the question of priority, in the absence of an adequate showing that the work in fact constituted the commencement of the building sought to be liened.

By the record before the Court it is clear that none of the lien claimants furnished labor or material upon Lot 10, for the home upon the lot until the mortgage in favor of Respondent had been recorded.

Carried to its logical conclusion, the argument advanced by the lien claimants would in the normal case, preclude a mortgagee from achieving priority over the liens of parties subsequently furnishing labor or materials for the construction of improvements, since work in the form of a survey or the construction of roads and sidewalks nearly always precedes actual construction of the building. This result is manifestly contrary to the intention of the parties, and is appropriately avoided by the statute and relevant case law which uniformly require the initial work to provide suitable evidence of the commencement of the building itself. The language of Sec. 38-1-10, placing all liens upon an equal footing does not alter the fact that this requirement must be met before any liens will attach to the individual lots.

CONCLUSION

On the basis of the foregoing argument, respondent respectfully prays that this Court affirm the trial court's interlocutory order appealed from:

1. By determining that the advances made by respondent under the construction mortgage were obligatory and took priority as of the date of recording the mortgage.

2. By determining that the advances made by respondent to complete the house on Lot 10 following default were made pursuant to the loan agreement and took priority as of the date of recording the mortgage.

3. By determining that the facts submitted by the affidavits in support of the motion for summary judgment did not constitute "commencement to do work or furnish materials on the ground for the structure or improvements" within the meaning of 38-1-5 Utah Code Annotated (1953)

4. Awarding to respondent its costs incurred herein.

Respectfully submitted,

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