1 CA-CV 11-0788

IN THE COURT OF APPEALS OF ARIZONA
DIVISION 1

THE WEITZ COMPANY, LLC,

Appellee,

vs.

NICHOLAS HETH, *et alia,*

Appellants.

On Appeal from the Superior Court of Maricopa County
Case No. CV 2008-028378

APPELLEE'S SUPPLEMENTAL BRIEF

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Argument

The Court has ordered supplemental briefing to address: (1) the relevance to this case of *In re Fontainebleau Las Vegas Holdings, LLC*, 289 P.3d 1199 (Nev. 2012); and (2) whether and where the construction loan agreement between the Summit at Copper Square, LLC ("Summit") and the First National Bank of Arizona ("First National") is included in the record on appeal.

In *Fontainebleau*, the Supreme Court of Nevada held the priority of a mechanic's lien, as established by statute, was superior to any priority that might be claimed under equitable subrogation. *Id.* at 1207. While *Fontainebleau* is a Nevada decision applying Nevada law, the statute at issue is nearly identical to Arizona's and the existing law of Arizona supports the Nevada court's reasoning. Though adopting *Fontainebleau*'s holding is not required to affirm the judgment below, in affirming the judgment this Court would not be remiss in approving of it.

As well, it appears the construction loan agreement is not in the record. If required, it was Appellants' burden to produce the agreement at trial and on appeal.

A. *Fontainebleau*'s holding is equally applicable in Arizona and should be adopted and applied in affirming the trial court's judgment.

1. The relevant facts of *Fontainebleau* mirror those in this case.

Fontainebleau concerned a construction project for a Las Vegas "hotel-casino resort." 289 P.3d at 1207. Bank of America loaned Fontainebleau $150 million, after which some 300 contractors began construction, some of whom

asserted statutory mechanic's liens against Fontainebleau's property. *Id.* Thereafter, Bank of America agreed to loan Fontainebleau an additional $1.8 billion that would satisfy and supersede the first loan. In turn, Fontainebleau agreed to execute a new deed of trust to the bank. *Id.* at 1208.

This case has a similar storyline, except the transactions at issue were sales, not refinances, and the sales involved only slivers of the overall property. First National made a loan to Summit, who recorded a deed of trust on its property (Appellee's Brief 2-3). Appellee The Weitz Company ("Weitz") then began construction and asserted a statutory mechanic's lien against the property (*Id.*). Thereafter, some of the units in the project were sold to the individual Appellants, most of which were financed by the lender Appellants, who recorded additional deeds of trust (Aple. Br. 5-9). Some of those units since have been resold, with the third- and fourth-generation lenders also recording deeds of trust (Aple. Br. 5).

2. The law at issue in *Fontainebleau* mirrors the law at issue here.

Ultimately, in *Fontainebleau*, Bank of America stopped disbursing proceeds on the $1.8 billion second loan, construction ceased, and Fontainebleau filed for Chapter 11 bankruptcy relief. 289 P.3d at 1208. Wilmington Trust FSB, who succeeded Bank of America as administrative agent for the Fontainebleau loans, filed an adversary proceeding against the Fontainebleau contractors (who sought to recover as creditors on their statutory mechanic's liens), alleging that, through

equitable subrogation, the deed of trust on the $1.8 billion loan "leap-frogged" over the liens to the priority position of the first $150 million loan. *Id.* at 1208-09.

The bankruptcy court asked the Supreme Court of Nevada whether, under Nevada law, "equitable subrogation may be applied against mechanic's lien claimants, such that a mortgage incurred after the commencement of work on a project will succeed to the senior priority position of a preexisting lien satisfied by the mortgagee, despite the existence of intervening mechanics' liens." *Id.* at 1207. Put more concisely, "Do Nevada's mechanic's and materialman's [*sic*] lien statutes prohibit the use of equitable subrogation?" *Id.* at 1209.

In this case, Appellants argue an answer to much the same question. They argue, "Lenders and cash buyers who pay off construction loans are equitably subrogated to the priority of construction loan deeds of trust that have priority over mechanics' liens" (Appellants' Brief 25-28).

The Nevada lien statute at issue in *Fontainebleau*, N.R.S. § 108.225 (Appendix A1) provides:

> 1. **[Mechanic's] liens ... are preferred to:**
>
> (a) **Any lien, mortgage or other encumbrance which may have attached to the property after the commencement of construction** of a work of improvement.
>
> (b) Any lien, mortgage or other encumbrance of which the lien claimant had no notice and which was unrecorded against the property at the commencement of construction of a work of improvement.

> 2. Every mortgage or encumbrance imposed upon, or conveyance made of, property affected by [mechanic's] liens ... after the commencement of construction of a work of improvement are subordinate and subject to the [mechanic's] liens ... regardless of the date of recording the notices of liens.

(Emphasis added). The pertinent part of Arizona's lien statute, A.R.S. § 33-992 (Appx. A2), is virtually identical:

> A. **[Mechanic's] liens … are preferred to all liens, mortgages or other encumbrances upon the property attaching subsequent to the time the labor was commenced** or the materials were commenced to be furnished …. [Mechanic's] liens are also preferred to all liens, mortgages and other encumbrances of which the lienholder had no actual or constructive notice at the time the lienholder commenced labor or commenced to furnish materials ….
>
> B. A notice and claim of lien for professional services shall not attach to the property for priority purposes until labor has commenced on the property or until materials have commenced to be furnished to the property so that it is apparent to any person inspecting the property that construction, alteration or repair of any building or other structure or improvement has commenced.

(Emphasis added).

In *Fontainebleau*, the Nevada court examined the history and purpose of mechanic's liens in detail, from ancient Roman law through Anglo-American history and to the present day. 289 P.3d at 1210-11. Under modern mechanic's lien statutes like those in Nevada and Arizona, "A mechanic's lien is a statutory creature established to help ensure payment for work or materials provided for construction or improvements on land." *Id.* at 1210; *cf.* Louis Boisot, TREATISE ON MECHANICS' LIENS § 4 at 4; § 312 at 306 (1897); Aple. Br. 35-36. The statutes

"affirmatively giv[e] mechanic's lien claimants priority over all other liens, mortgages, and encumbrances that attach *after* the commencement of a work of improvement …." *Fontainebleau*, 289 P.3d at 1211 (emphasis in the original).

Like the Appellants here, however, the bank's successor in *Fontainebleau* argued that, "Despite the plain and unambiguous language of the [mechanic's lien] statute," the Nevada court should "apply equitable subrogation" to the second deed of trust so as to allow *it* first priority position above the mechanic's liens. *Id.*

Just as in Arizona, Nevada has "adopted the position taken by the Restatement (Third) of Property" as to equitable subrogation. *Id.* at 1209 (quoting *Houston v. Bank of Am.*, 119 Nev. 485, 488, 78 P.3d 71, 73 (2003) (quoting *Mort v. United States*, 86 F.3d 890, 893 (9th Cir. 1996))) (citing Restatement (Third) of Property: Mortgages § 7.6(a)(4) (1997)); *cf. Sourcecorp, Inc. v. Norcutt*, 229 Ariz. 270, 273 ¶ 12, 274 P.3d 1204, 1207 (2012) ("we adopt the Restatement approach"); Aple. Br. 16-18.

Still, however, the Nevada court observed that equitable subrogation is a creature of equity, not law. *Fontainebleau*, 289 P.3d at 1212. As in Nevada, it is a basic equitable maxim in Arizona that "equity follows the law:" "Courts of equity are as much bound by the plain and positive provisions of a statute as are courts of law, and where the rights are clearly established and defined by statute, equity has no power to change or upset such rights." *Ayer v. Gen. Dynamics Corp.*, 128 Ariz.

324, 326, 625 P.2d 913, 915 (App. 1981) (party could not obtain equitable relief of injunction where statutory remedy of replevin would lie). Thus, "equitable principles will not justify a court's disregard of statutory requirements." *Fontainebleau*, 289 P.3d at 1212 (citation omitted).

By enacting a statute expressly guaranteeing the priority of mechanic's liens over *all* proceeding encumbrances,

> The Legislature has spoken and has created a specific statutory scheme whereby a mechanic's lien is afforded priority over a subsequent lien, mortgage, or encumbrance in order to safeguard payment for work and materials provided for construction or improvements on land. Therefore, we conclude that the plain and unambiguous language of NRS 108.225 precludes application of the doctrine of equitable subrogation, as it unequivocally places mechanic's lien claimants in an unassailable priority position.

Id. (internal citations omitted). For, "When a statute is clear, unambiguous, not in conflict with other statutes and is constitutional, the judicial branch may not refuse to enforce the statute on public policy grounds. That decision is within the sole purview of the legislative branch." *Id.* (quoting *Freeman v. Davidson*, 105 Nev. 13, 16, 768 P.2d 885, 887 (1989)).

As a result, "Because principles of equity cannot trump an express statutory provision, … equitable subrogation does not apply against mechanic's lien claimants." *Id.* at 1207. Bank of America's successor could not use equitable

subrogation to annul the express, statutorily-granted priority of the Fontainebleau contractors' mechanics' liens. *Id.*[1]

3. *Fontainebleau*'s reasoning applies in this case to affirm the trial court's judgment.

While, of the various approaches to equitable subrogation, Arizona firmly has adopted the Restatement approach to guide the doctrine's application in this state (Aple. Br. 16-18), *see Sourcecorp*, 229 Ariz. at 273 ¶ 12, 274 P.3d at 1207, the Restatement (Third) of Property is not a super-statute that displaces actual statutes on point. "A Restatement is just that, an attempt to formulate what decisional law is or ought to be. It is not a statute whose precise wording is entitled to deference as an act of an equal branch of government." *PSI Energy, Inc. v. Roberts*, 829 N.E.2d 943, 958 (Ind. 2005).

As the Arizona Supreme Court readily recognized in *Sourcecorp*, "Equitable subrogation" remains an "equitable remedy …." *Id.* at 272 ¶ 5, 274 P.3d at 272. Thus, before one can analyze how the Restatement approach to equitable subrogation applies to a given case, in the first place equity must not be supplanted

[1] Other courts have analyzed the issue identically to *Fontainebleau*. *See, e.g., Richards v. Sec. Pac. Nat'l Bank*, 849 P.2d 606, 611 (Utah App. 1993) ("[t]he mechanics' lien statutes are an expression of legislative intent that should stay the hand of equity in this situation"); *Foster v. Porter Bridge Loan Co.*, 27 So.3d 481, 487 (Ala. 2009) (explaining the court could not apply equitable subrogation in *Ex parte Lawson*, 6 So.3d 7, 14 (Ala. 2008), because the priority of a materialman's lien is determined "by the unique language of the materialman's lien statute, which granted priority to materialman's liens").

by law. "When rights are defined by statute, equity has no power to change those rights," and "equitable principles" cannot "preclude" a process created by statute. *Sanderson Lincoln Mercury, Inc. v. Ford Motor Co.*, 205 Ariz. 202, 207 ¶ 22, 68 P.3d 428, 433 (App. 2003). Rather, it is the Legislature that can enact a statutory bar to any common law equitable remedy or doctrine. *Van Dyke v. Ariz. E. R.R. Co.*, 18 Ariz. 220, 228, 157 P. 1019, 1022 (1916).

Like Nevada's mechanic's lien statute, Arizona's, A.R.S. § 33-992, is precisely such a bar. It specifies exactly what a mechanic's lien's priority is. "The Legislature has spoken and has created a specific statutory scheme whereby a mechanic's lien is afforded priority over a subsequent lien, mortgage, or encumbrance in order to safeguard payment for work and materials provided for construction or improvements on land." *Fontainebleau*, 289 P.3d at 1212. Thus, "the plain and unambiguous language of [A.R.S. § 33-992]" must "preclud[e] application of the doctrine of equitable subrogation, as it unequivocally places mechanic's lien claimants in an unassailable priority position." *Id.*

Existing Arizona law does not conflict with this rationale in the context of a sale of property, as in this case. The *Fontainebleau* court suggested Arizona "employ[s] equitable subrogation in the realm of mechanics' liens." 289 P.3d at 1211 n.13 (citing *Lamb Excavation, Inc. v. Chase Manhattan Mortg. Corp.*, 208 Ariz. 478, 479-82, 95 P.3d 542, 543-46 (App. 2004); *Peterman-Donnelly Eng'r &*

Contractors Corp. v. First Nat'l Bank of Ariz., 2 Ariz. App. 321, 326, 408 P.2d 841, 846 (1965)).

While equitable subrogation may exist "in the realm" of mechanics' liens in Arizona, the circumstances of *Lamb* and *Peterman-Donnelly* are different than in this case, as Weitz already explained (Aple. Br. 38-41). Both involved mere refinancing of property for a single owner. *See Lamb*, 208 Ariz. at 479 ¶ 2, 95 P.3d at 544; *Peterman-Donnelly*, 2 Ariz. App. at 322, 408 P.2d at 842. Conversely, this case stems from actual sales of individual pieces of the overall property (Aple. Br. 38-41). As Appellants pointed out in response to *amicus curiae,* "The existence of liens on the land does not prevent the owner from selling it," and "a purchaser of land to which a mechanic's lien has attached takes *subject to such lien*" (Appellants' Response to *Amicus* 2) (quoting Boisot at §§ 312, 313).

More importantly, both before the trial court and on appeal, the parties in *Lamb* and *Peterman-Donnelly* apparently accepted that equitable subrogation could apply so as to undo a mechanic's lien's statutory priority in a refinancing situation. Unlike *Fontainebleau*, neither decision focuses on *whether* the plain language of the mechanic's lien statute bars equitable subrogation in the first place.

Rather, the main question in *Lamb* was whether subrogation applied because "there existed at least an implied agreement to subrogate." 208 Ariz. at 483 ¶ 16, 95 P.3d at 547. In *Peterman-Donnelly*, the primary question was whether the

contractor adequately had perfected its lien. 2 Ariz. App. at 322-24, 408 P.2d at 842-44. To the extent *Peterman-Donnelly* did address the question of whether equitable subrogation was permissible given the mechanic's lien statute, the Court limited its holding to the pure refinance situation before it: "the parties intended the [bank] to have the security attached to the prior mortgage" it was refinancing, and thus there was a mere "substitution of [the bank] for" the original financer, which left "the rights of the [contractor] … unaffected." *Id.* at 326, 408 P.2d at 846.

Given that *Fontainebleau*, too, was a single-owner refinance, the Nevada court may not have accepted this finer point. But the *Peterman-Donnelly* nuance is not present in this case. This case did not involve a refinance. Rather, there were sales of individual properties that all were *subject* to Weitz's lien, as Appellants concede (Aplt. Resp. to *Amicus* 2). The reasoning of *Fontainebleau* is equally applicable here and fits the law of Arizona.

B. Adopting *Fontainebleau* is unnecessary to affirm the judgment below.

Even if the Court rejects *Fontainebleau* and holds equitable subrogation somehow can trump Weitz's express, statutory right to priority, all it would mean is that equitable subrogation *may* apply to trump a mechanic's lien, not that it *does* apply in the circumstances of this case or that allowing it here is equitable.

Irrespective of *Fontainebleau*'s central question, Weitz already has shown the trial court's judgment should be affirmed both because equitable subrogation

does not apply in this case and because, even if it did, allowing it as Appellants request would be inequitable. Simply put, Arizona law forbids partial subrogation to a mortgage and no unit purchaser or its respective lender fully discharged the obligation secured by First National's original deed of trust (Aple. Br. 15-30).

Moreover, allowing subrogation here would be inequitable because it would allow Weitz's work to be sold without Weitz being paid and would require Weitz to deal with multiple first lienholders (Aple. Br. 31-43). Indeed, several months before the project was completed, Weitz was induced to continue working – and continue increasing the value of the very collateral at issue in this case – with the broken promise that it would be paid from the proceeds of unit sales. The Restatement is plain that "Subrogation is an equitable remedy designed to avoid a person's receiving an *unearned windfall* at the expense of another. Restatement at § 7.6 cmt. a (1997) (emphasis added). There is nothing remotely "unearned" about Weitz being paid, as promised, for finishing Appellants' collateral. *See In re Mortg. Ltd.,* 482 B.R. 298, 309-11 (Bankr. D. Ariz.. 2012).

Rejecting *Fontainebleau* would have no effect on these points. Rather, *Fontainebleau*'s reasoning is simply another reason to affirm the judgment below.

C. The construction loan agreement is not in the record, and its absence should be held against Appellants.

After scouring the record on appeal, counsel for Weitz reports that the construction loan agreement is *not* included. The procedural posture of this case is

such that, if a copy of the agreement is in any way necessary to decide Appellants' appeal, it was Appellants' burden to include in the record. The Court should hold its absence against Appellants.

This case was decided on summary judgment. Weitz sought foreclosure of its mechanic's lien against Appellants (Index of Record 1). Both sides cross-moved for summary judgment on the issue of lien priority (I.R. 503, 531). The court granted Weitz's motion and denied Appellants' (I.R. 586).

Appellants first claimed equitable subrogation as a defense in opposing Weitz's summary judgment motion (I.R. 531). Thus, if the loan agreement is necessary to decide that defense, it was *Appellants'* burden to produce it. *Celotex Corp. v. Catrett*, 477 U.S. 317, 324 (1986); *see also* Ariz. R. Civ. P. 56(c). Further, it is "the appellant's burden to make an adequate record on appeal." *Darner Motor Sales, Inc. v. Universal Underwriters Ins. Co.*, 140 Ariz. 383, 387 n. 5, 682 P.2d 388 (1984). If the appellant does not include a necessary document in the record, the Court will "settle all factual uncertainty in favor of supporting the judgment of the trial court." *Id.*

Conclusion

The Court should affirm the trial court's judgment.

Respectfully Submitted,

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Certificate of Compliance

Pursuant to ARCAP 14, I certify that this brief uses proportionately spaced type of 14 points or more, and is double-spaced using Times New Roman font. Pursuant to the Court's order of November 30, 2012, I also certify that this brief does not exceed twelve pages, exclusive of the table of contents, table of citations, certificates of service and compliance, and appendix.

January 3, 2013 — Date
/s/Jonathan Sternberg — Attorney

Certificate of Service

I hereby certify that, on January 3, 2012, I mailed two true and accurate copies of this Brief of the Appellee to each of the following:

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