IN THE SUPREME COURT OF THE STATE OF NEVADA

In Re Manhattan West Mechanic's Lien Litigation

APCO CONSTRUCTION, INC., a Nevada corporation, *et al.*,
Petitioners,
vs.
The Honorable Susan W. Scann, Judge, Eighth Judicial District Court, Clark County, Nevada,
Respondent,
and
SCOTT FINANCIAL CORPORATION, a North Dakota Corporation, *et al.*,
Real Parties in Interest.

[Full Caption On Next Page]

No. 61131

District Court No. 08A571228
Consolidated with:

08A574391	A-09-589195-C
08A574792	A-09-589677-C
08A577623	A-09-590319-C
09A579963	A-09-592826-C
09A580889	A-09-596924-C
09A583289	A-09-597089-C
09A584730	A-09-606730-C
09A587168	A-10-608717-C
	A-10-608718-C

Original Petition

PETITIONERS' JOINT SUPPLEMENTAL BRIEF

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IN THE SUPREME COURT OF THE STATE OF NEVADA

In Re: Manhattan West Mechanic's Lien Litigation	No. 61131
APCO CONSTRUCTION, A NEVADA CORPORATION; ACCURACY GLASS & MIRROR COMPANY, INC.; BUCHELE, INC.; BRUIN PAINTING CORPORATION; CACTUS ROSE CONSTRUCTION; FAST GLASS, INC.; HD SUPPLY WATERWORKS, LP; HEINAMAN CONTRACT GLAZING; HELIX ELECTRIC OF NEVADA, LLC; INTERSTATE PLUMBING & AIR CONDITIONING; SWPPP COMPLIANCE SOLUTIONS, LLC; AND WRG DESIGN, INC., Petitioners, vs. THE EIGHTH JUDICIAL DISTRICT COURT OF THE STATE OF NEVADA, IN AND FOR THE COUNTY OF CLARK; AND THE HONORABLE SUSAN SCANN, DISTRICT JUDGE, Respondents, and SCOTT FINANCIAL CORPORATION, A NORTH DAKOTA CORPORATION; AHERN RENTALS, INC.; ARCH ALUMINUM AND GLASS CO.; ATLAS CONSTRUCTION SUPPLY, INC.; BRADLEY J. SCOTT; CABINETEC, INC.; CELLCRETE FIREPROOFING OF NEVADA, INC.; CAMCO PACIFIC CONSTRUCTION CO., INC.; CLUB VISTA FINANCIAL SERVICES, LLC; CONCRETE VISIONS, INC.; CREATIVE HOME THEATRE, LLC; CUSTOM SELECT BILLING, INC.; DAVE PETERSON FRAMING, INC.; E&E FIRE PROTECTION, LLC; EZA, P.C.;	

FERGUSON FIRE AND FABRICATION, INC.; GEMSTONE DEVELOPMENT WEST, INC.; GRANITE CONSTRUCTION COMPANY; HARSCO CORPORATION; HYDROPRESSURE CLEANING; INQUIPCO; INSULPRO PROJECTS, INC.; JEFF HEIT PLUMBING, CO., LLC; JOHN DEERE LANDSCAPE, INC.; LAS VEGAS PIPELINE, LLC; NEVADA PREFAB ENGINEERS; NOORDA SHEET METAL COMPANY; NORTHSTAR CONCRETE, INC.; PAPE MATERIAL HANDLING; PATENT CONSTRUCTION SYSTEMS; PROFESSIONAL DOOR AND MILL WORKS, LLC; READY MIX, INC.; RENAISSANCE POOLS & SPAS, INC.; REPUBLIC CRANE SERVICE, LLC; STEEL ENGINEERS, INC.; SUPPLY NETWORK, INC.; SUNSTATE COMPANIES, INC.; THARALDSON MOTELS II, INC.; THE PRESSURE GROUT, COMPANY; TRI CITY DRYWALL, INC.; UINTAH INVESTMENTS, LLC; AND ZITTING BROTHERS CONSTRUCTION, INC., Real Parties in Interest.

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STATEMENT OF RELEVANT FACTS

Petitioners hereby incorporate the Statement of Relevant Facts from the Joint Petition For Writ of Mandamus or, in the Alternative, Prohibition, including the "Procedural Note" reservation of rights set forth therein, for purposes of this Supplement. Certain key facts are reiterated below for ease of reading.

Scott Financial Corporation ("SFC") is a loan syndicator who sells loan participation interests to banks and investors, and then loans that money to borrowers. 4 App. 547-558. SFC agreed to loan money to the developer of the ManhattanWest Mixed Use Project (the "Project"). Initially, SFC made three preconstruction loans in the total amount of $38,000,000.00. 2 App. 316, 400-427. After commencement of construction on the Project, SFC made an additional loan of $8,000,000.00, bringing the total Project loan amount to $46,000,000.00. 3 App. 486-498.

In late January 2008, SFC agreed to make a $110,000,000.00 construction loan to the developer. 3App. 519-541. This loan was syndicated to a large group of banks and investors, hereafter the "Construction Lenders." The construction loan was secured by a Senior Debt Deed of Trust and Security Agreement with

Assignment of Rents and Fixtures Filing (Construction) (the "Construction DOT"). 3 App. 604-626.

The prior $46,000,000.00 loans were restructured into a single note for $46,000,000.00, called the Mezzanine Note. 3 App. 515, 543-545. The Mezzanine Note was funded entirely by Club Vista Financial Services, LLC (the "Mezzanine Lender"). 3 App. 547-557. The deeds of trust securing the Mezzanine Note are hereafter the "Mezzanine DOTs." 3 App. 627-639.

Also part of the construction loan financing was the recording of the Mezzanine Deeds of Trust Subordination Agreement (the "Subordination Agreement"). 3 App. 641-648. The primary clause of the Subordination Agreement stated:

> 1. Lien Priority. ***The lien*** of the $110,000,000 Senior Debt Deed of Trust and the indebtedness secured thereby **shall** in all respects **be deemed prior to and superior to *the lien*** of the Mezzanine Deeds of Trust and the indebtedness secured thereby, **as though the Mezzanine Deeds of Trust had been recorded subsequent to the recordation** of the $110,000,000 Senior Deed of Trust.

Id. at 642. (emphasis added).

SUMMARY OF THE ARGUMENT

Petitioners filed this Writ proceeding seeking intervention and direction from this Court after Department 29 of the Eighth Judicial District Court re-heard the same motion previously briefed, argued and decided by the predecessor judge,

the Honorable Kathleen Delaney, Department 25, and thereafter reversed the written Order of Judge Delaney. Initially, Judge Delaney found that the loan syndicator/lender, SFC, recorded the Subordination Agreement subordinating the Mezzanine DOTs to the Construction DOT. 4 App. 848-850. Judge Delaney also found that the express language of the Subordination Agreement provided that the $46 million dollars' worth of Mezzanine DOTs were to be treated "as though the [Mezzanine DOTs] had been recorded subsequent to the recordation of the $110,000,000 Senior Deed of Trust." *Id.* In reaching her decision, Judge Delaney correctly concluded that NRS 108.225 determined the priority of the liens, and that the only way to provide the relief SFC and the Construction Lenders were requesting was to resort to equitable principals. *Id.*

Judge Delaney's underlying reasoning, was recently confirmed by this Court in *In Re: Fontainebleau Las Vegas Holdings, LLC*, 128 Nev.Adv.Op. 56 (Oct. 2012). In *Fontainebleau*, this Court found that NRS 108.225 gives mechanic's lien claimants priority over "every other mortgage or encumbrance imposed after the commencement of construction." *Id.* at 18. *Fontainebleau* also confirmed that principals of equity cannot trump the express statutory provisions, such as the priority provided by NRS 108.225. *Id.* at 29.

As set forth in the Writ Petition, the mechanic's lien claimants are asking this Court to follow the statutory dictates of NRS 108.225, and find that (1) the Mezzanine Lender, through SFC, subordinated the priority of the Mezzanine DOTs

"for all purposes;" (2) because the Construction DOT was recorded after construction commenced on the work of improvement, the mechanic's liens have priority over both the Mezzanine DOTs and the Construction DOT; and (3) the Construction DOT, which was recorded after the construction began, can only attain priority over the mechanic's liens by application of equitable principles that elevate its priority, which is expressly prohibited by *Fontainebleau*.

ARGUMENT

A. The Fontainebleau Decision Affirmed the Primacy of NRS 108.225 on Priority

In *Fontainebleau*, this Court unequivocally held:

> NRS 108.225 is the controlling authority in Nevada regarding the priority of mechanic's liens. It expressly provides that every other mortgage or encumbrance imposed after the commencement of construction of a work of improvement is subordinate and subject to the mechanics' liens regardless of the recording dates of the notice of liens.

Id. at 18.

This Court likewise held:

> Amended in 2003, NRS 108.225 affirmatively gives mechanic's lien claimants priority over all other liens, mortgages, and encumbrances that attach ***after*** the commencement of a work of improvement.

Id. at 28 (original emphasis).

As a result of the language of NRS 108.225, as adopted by the Nevada Legislature, this Court held:

> Because principles of equity cannot trump an express statutory provision, we conclude that equitable subrogation does not apply against mechanic's lien claimants.

Id. at 18.

The Construction DOT was recorded more than seven (7) months after construction of the work of improvement commenced. As a result, this Court's analysis must begin with the mechanic's lien claimants having priority over the Construction Lenders' Construction DOT. The issue is whether the Construction Lenders can advance the priority of the Construction DOT through the Subordination Agreement.

B. The Clear Language of the Subordination Agreement Does Not Advance the Priority of the Construction DOT

"Contract interpretation is subject to a de novo standard of review." *May v. Anderson*, 121 Nev. 668, 672, 119 P.3d 1254, 1257 (2005)(citing *Diaz v. Ferne*, 120 Nev. 70, 73, 84 P.3d 664, 665-66 (2004)).

This Court has established standards for the review and interpretation of a contract. Contracts are to be interpreted from the plain meaning of the contract's language. *Ellison v. C.S.A.A.*, 106 Nev. 601, 603, 797 P.2d 975, 977 (1990). The Court may not revise or reform the contract under the guise of interpretation.

Watson v. Watson, 95 Nev. 495, 496, 596 P.2d 507, 508 (1979). Evidence of intent is not admissible unless the contract terms are ambiguous. *Trans Western Leasing v. Corrao Constr. Co.*, 98 Nev. 445, 447, 652 P.2d 1181, 1183 (1982).

The applicable provisions of the Subordination Agreement state:

> 1. Lien Priority. ***The lien*** of the $110,000,000 Senior Debt Deed of Trust and the indebtedness secured thereby **shall** in all respects **be deemed prior to and superior to *the lien*** of the Mezzanine Deeds of Trust and the indebtedness secured thereby, **as though the Mezzanine Deeds of Trust had been recorded subsequent to the recordation** of the $110,000,000 Senior Deed of Trust.
>
> 1. [sic] Subordination. The payment of all of the Restructured Mezzanine Note is hereby expressly subordinated to the extent and in the manner hereinafter set forth to the payment in full of the Senior Debt Notes; and regardless of any priority otherwise available to [SFC on behalf of the Mezzanine Lender] by law or by agreement, [SFC on behalf of the Construction Lenders] shall hold a first security interest in all collateral securing payment of the Senior Debt Notes (the "Collateral"), and **any security interest claimed therein (including any proceeds thereof) by [**SFC on behalf of the Mezzanine Lender] **shall be and remain fully subordinated for all purposes** to the security interest of [SFC on behalf of the Construction Lenders] therein for all purposes whatsoever.
>
> 2. No Payments. Until all of the Senior Debt Notices has (sic) been paid in full, [SFC on behalf of the Mezzanine Lender] **shall not demand, receive or accept any payment** (whether of principal, interest or otherwise) from the Borrower in respect of the Restructured Mezzanine Note, . . .
>
> 4. Action on Restructured Mezzanine Note. [SFC on behalf of the Mezzanine Lender] **will not commence any action or proceeding against the Borrower to recover all or any part of the Restructured Mezzanine Note** or join with any [SFC on behalf of the Mezzanine Lender] reorganization, readjustment of

> debt, arrangement of debt receivership, liquidation or insolvency law or statute of the federal or any state government, **or take possession of, sell, or dispose of any Collateral, or exercise or enforce any right or remedy available to** [SFC on behalf of the Mezzanine Lender] with respect to any such Collateral, **unless and until the [Construction DOT Notes] has (sic) been paid in full**.

3 App. 642-643 (emphasis added). The language of the Subordination Agreement is clear on its face. SFC, on behalf of the Mezzanine Lender, subordinated the Mezzanine DOTs' priority position "for all purposes." *Id*. The Subordination Agreement also provides the method of subordination of the Mezzanine DOTs. After the recording of the Subordination Agreement, the Mezzanine DOTs will be treated "as though the Mezzanine Deeds of Trust had been recorded subsequent to the recordation of [the Construction DOT]." *Id*. The Mezzanine Lender through SFC, also agreed that it would not seek or receive any money owing on the Mezzanine DOTs and the loans associated with them, or engage in any collection activities of any kind, including foreclosure actions, with respect to such money unless and until the construction loan has been paid in full. *Id*.

The Subordination Agreement language is clear and specific as to the effect of the Subordination Agreement on the Mezzanine DOTs and the Construction DOT. Paragraph 1, titled "Lien Priority," provides "[I]n all respects," **the lien** of the Mezzanine DOTs are to be deemed as if they were recorded after **the lien** of the Construction DOT. *Id*. The second Paragraph 1 of the Subordination Agreement (which was incorrectly numbered), titled "Subordination," provides

that the "security interest" of the Mezzanine DOTs are subordinated "for all purposes." *Id*. Paragraph 2, titled "No Payments," provides the Mezzanine DOTs may not receive any payment "in respect of the Restructured Mezzanine Note." *Id*. Paragraph 4, titled "Actions On Restructured Mezzanine Note," provides that no action to "enforce any right or remedy available to [SFC on behalf of the Mezzanine Lender] with respect to any such Collateral" shall be taken unless and until the Construction DOT and the associated notes are paid in full. *Id*. The result of the Subordination Agreement was to (1) change the priority position of the Mezzanine DOTs, and (2) prevent any action to assert or enforce any potential priority of the Mezzanine DOTs, until the Construction DOT was fully paid.

Glaringly absent from the express language of the Subordination Agreement is language allowing the Construction Lenders, or the Construction DOT, to step into the priority position of the Mezzanine Lender and the Mezzanine DOTs. In a misguided attempt to twist the language of the Subordination Agreement, the Construction Lenders suggest that the Subordination Agreement should be treated as an assignment agreement. Stated differently, the Construction Lenders ask this Court to elevate the priority position of the Construction DOT ahead of the mechanic's liens as if the Construction Lenders had taken an assignment of the Mezzanine DOTs. In fact, the Subordination Agreement clearly does the opposite, it subordinates the Mezzanine DOTs and all priority, rights and remedies they may

possess, to the Construction DOT "as though the [Mezzanine DOT's] had been recorded subsequent to the recordation of the [Construction DOT]." *Id*.

There is a clear and recognized difference between the acts of subordination and assignment. "Subordination" is defined as "The act or process by which a person's rights or claims are ranked below those of others." *Black's Law Dictionary* p. 1426 (6th ed. 1990). *Black's* also defines a "subordination agreement" as:

> An agreement by which one holding an otherwise senior lien or other real estate interest consents to a reduction in priority vis-à-vis another person holding an interest in the same real estate.

Black's Law Dictionary p. 1426 (6th ed. 1990). In contrast, "assignment" is defined as "The act of transferring to another all or part of one's property, interest, or rights." *Black's Law Dictionary* p. 119 (6th ed. 1990).

As a result, (1) the Subordination Agreement does not provide a contractual basis for the advancement of the Construction DOT, and (2) unless the Construction DOT is advanced by equitable means, the mechanic's liens must be given priority under NRS 108.225. As discussed more fully below, this Court's decision in *Fontainebleau* precludes equitable advancement of the Construction DOT over mechanic's liens.

C. The Construction Lenders Rely Upon Equitable Principals to Advance the Priority of the Construction DOT

The applicable statutory and common law does not provide an avenue for the Construction Lenders to advance the priority of the Construction DOT. NRS 108.225 expressly provides that mechanic lien claimants have priority over any deed of trust recorded after commencement of construction of the work of improvement. Because the Construction DOT was recorded after construction had commenced, the priority position of the Construction DOT cannot be equitably advanced in front of the mechanic's liens.

Equity is defined as, "Justice administered according to fairness as contrasted with the strictly formulated rules of common law." *Black's Law Dictionary* p. 540 (6th ed. 1990). Although dressed in the language of contractual subordination, the Construction Lenders seek the same relief as that sought by the subsequent-in-time lenders in *Fontainebleau*, who sought to elevate their priority over the priority and rights afforded to mechanic's lien claimants by NRS 108.225, through application of the doctrine of equitable subrogation.

Equitable subrogation "acts as an exception to modern recording statutes and enables 'a later-filed lienholder to leap-frog over an intervening lien [holder].'" *American Sterling Bank v. Johnny Mgmt. LV*, 126 Nev.Adv.Op. 41, 245 P.3d 535, 539 (2010) (*quoting Hicks v. Londre*, 125 P.3d 452, 456 (Colo. 2005)). The application of equitable subrogation has the practical effect of "permitting the

subrogee to enforce the seniority of the [prior] lien against junior lienors." *Id*. Equitable subrogation has the effect "of an assignment" of the prior lien. *Id*.

Just as this Court refused to permit equitable subrogation for the *Fontainebleau* lenders, this Court should decline to grant the Construction Lenders priority over mechanic's liens by equitable means.

The fact that the Construction Lenders are seeking the same equitable result as the *Fontainebleau* lenders can be seen from the arguments made to support the remedy requested by the Construction Lenders. For example, one basis for the support of equitable subrogation is:

> an intervening lienholder is not materially prejudiced by applying equitable subrogation because it remains in the same priority lien position, and on the contrary, may receive a windfall by being elevated to a higher priority status if subrogation is not applied.

American Sterling Bank, supra, 245 P.3d at 539. Compare this language with the primary case cited by SFC, *Bratcher v. Buckner*, 90 Cal.App.4th 1177 (Cal. Ct. App. 2001), which justifies the remedy sought by the Construction Lenders by stating:

> Thus, for all practical purposes, the priorities remain unchanged as to the intervening lienholder: its position is neither benefited nor prejudiced. The court in *AmSouth* also ignores the uncontracted-for *windfall* that its decision gives to an intervening lienholder. . . .

Id. at 1188 (italics in original). The same result is seen in another case relied upon by SFC, *In Re Price Waterhouse*, 46 P.3d 408, 412 (Ariz. 2002), where the Arizona Supreme Court supported its decision to follow the partial subordination approach by holding "Because [the mechanic's lienclaimant's] position is unaffected, a result that appears ***fully equitable***, we embrace the partial subordination analysis." (Emphasis added). The reason these arguments are the same is because the remedy being sought is essentially the same, *i.e.* an equitable remedy.

Here, the Construction Lenders and Mezzanine Lender have changed the effective priority of the Mezzanine DOTs by their own recorded instrument (the Subordination Agreement). Because it was recorded, the Subordination Agreement gives notice to the world of each of the lender groups' intent to treat the Mezzanine DOTs as if they were recorded after the Construction DOT. The Replacement Order issued by Department 29 recognized that the Subordination Agreement moved the priority of the Mezzanine DOTs to a lien position behind the Construction DOT. In the Replacement Order, Judge Scann held:

> **SFC's loan of $110,000,000.00 is in first position priority regarding the other claimants in the principal amount of $38,000,000.00.** Thereafter, the mechanic lien claimants are in second position and the remainder of SFC's $110,000,000.00 principal amount loan, namely $72,000,000.00 in principal is in third position, and the **Original Mezzanine Deeds of Trust along with the post-April 2007 Mezzanine Deeds of Trust are in junior priority position to the aforementioned encumbrances**; . . .

5 App. 1154 (emphasis added). However, Judge Scann treated the Subordination Agreement as if it were an assignment of the Mezzanine DOTs' pre-subordination priority position, to the extent of the first $38,000,000.00. *Id*. The Subordination Agreement no more advanced the priority of the Construction DOT than paying off of the first position lien did in *Fontainebleau*.

The District Court gave the Construction Lenders a remedy equivalent to equitable subrogation. By its terms and logic, the Replacement Order granted the Construction Lenders an equitable assignment of the Mezzanine DOTs' priority position, allowing them to leapfrog the mechanic's liens. Allowing the Construction Lenders to jump ahead of mechanics' lien claimants under equitable principles is erroneous as it is plainly at odds with the express provisions of NRS 108.225, as well as Nevada's policy favoring lien claimants, as this Court found in *Fontainebleau*.

D. Adopting the Full Subordination Approach Would Not Prevent Lenders From Being Able to Protect Their Interests

One advantage to adopting the Full Subordination Approach is that lenders, the party in the best position to protect themselves, would still be able to do so. This Court noted in dicta in the *Fontainebleau* decision that the lender "had ample means to minimize its financial risk through the proper channels of contractual subordination." *Id*. at 29, n.13. In support, the Court cited to *Ex Parte Lawson*, 6

So.3d 7, 15-16 (Ala. 2008). The *Lawson* case was about equitable subrogation. *Id*. However, the principals applied serve the same purpose if applied in a subordination context. In *Lawson*, the Supreme Court of Alabama overruled a lower court ruling applying equitable subrogation against a mechanic's lien claimant. *Id*. In doing so, the *Lawson* Court held:

> The lenders . . . are sophisticated mortgage companies that could have easily protected their interests. Based upon the statutory preference given to materialmen, it is the commercial lenders who bear the burden of protecting themselves.

Id.

If this Court adopts the Full Subordination Approach, sophisticated lenders will continue to be able to protect their own interests by obtaining assignments of the rights to payment belonging to the first position liens. Lenders could then make the economic calculation of whether assignment or subrogation, or even some hybrid of the two, would best protect their interests.

The Construction Lenders and SFC, who are obviously sophisticated parties, knew about the break in priority, and took the steps they determined were necessary to protect their interests. First, the Construction Lenders made sure that the Mezzanine DOTs were subordinated to the Construction DOT, for all purposes. 3 App. 641-648. The Construction Lenders obtained a Guaranty of the construction loan from Gary Tharaldson, for which they paid $5,000,000.00. 3 App. 559-563. The Construction Lenders also obtained a title insurance

endorsement against loss of priority due to mechanic's liens, after the developer provided a "Construction Loan Loss of Priority Questionnaire" and an "Indemnity Agreement (Mechanic's Liens)" to the title company to obtain that protective endorsement. 3 App. 584, 595 and 597-602, respectively.

SFC and the Construction Lenders took all of the steps they deemed necessary to protect their interest in the transaction. However, this did not include taking an assignment of the Mezzanine DOTs' priority position. Instead, SFC and the Construction Lenders are now asking this Court for an equitable assignment that they simply did not contract for.

CONCLUSION

For the reasons set forth above, petitioners, appearing jointly through their respective counsel, together with any other parties that my join them, respectfully request that this Court issue the requested writ to the district court affording them the relief set forth in the petition, or such other relief in their favor as this Court deems appropriate.

Respectfully Submitted:

Dated this 31st day of December, 2012

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CERTIFICATE OF SERVICE

I hereby certify that on this date, the 31st day of December, 2012, I submitted the foregoing **Petitioners' Joint Supplemental Brief** for filing via the Supreme Court's eFlex electronic filing system. According to the system, electronic notification will be sent to the following registered participants:

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I further certify that, on this same date, I submitted the foregoing document for service on all parties in the district court action (a mandatory electronic filing case) through the Eighth Judicial District Court's electronic filing system.

/s/ Beau Sterling

BEAU STERLING