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

REPLY IN SUPPORT OF JOINT PETITION FOR WRIT OF MANDAMUS OR, IN THE ALTERNATIVE, PROHIBITION

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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, INC., 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; WRG DESIGN INC.,

Petitioners,

vs.

The Honorable Susan W. Scann, Judge, Eighth Judicial District Court, Clark County, Nevada,

Respondent,

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.;

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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; HD SUPPLY WATERWORKS, LP; 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 MATERIALS HANDLING; PATENT CONSTRUCTION SYSTEM; PROFESSIONAL DOOR AND MILL WORKS, LLC; READY MIX, INC.; RENAISSANCE POOLS & SPA, 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; ZITTING BROTHERS CONSTRUCTON, INC.

Real Parties in Interest.

[Continued From Previous Page]

Table of Contents

Table of Authorities

Cases

Statutes

Other Authority

REPLY IN SUPPORT OF PETITION FOR WRIT OF MANDAMUS OR PROHIBITION

I. INTRODUCTION.

The case before this Court boils down to which of two liens will be given priority to any funds that may be recovered from the sale of the Project. On one side are the mechanic's lien claimants who provided work and materials to improve the property. On the other side are the Construction Lenders who loaned money to the Project that was supposed to be used to pay for the work and materials provided by the mechanic's lien claimants. There is not, nor has there ever been, a dispute that any liens, other than the mechanic's liens and the Construction DOT are the liens that are vying for priority.

The priority claims of both the mechanic's lien claimants and the Construction Lenders arise out of the Mezzanine Deeds of Trust Subordination Agreement (the "Subordination Agreement"), recorded on February 7, 2008. The mechanic's lien claimants' position is that the recorded Subordination Agreement gave public notice to the world that the "Mezzanine Deeds of Trust and the indebtedness secured thereby" were to be deemed "as though the Mezzanine Deeds of Trust had been recorded subsequent to the recordation of the [Construction DOT]." The Construction Lenders' position is that the Subordination Agreement allows a portion of the lien of the Construction DOT to jump or leap frog over the mechanic's liens in priority.

Ultimately, this Court must answer two questions: (1) Whether a recorded Subordination Agreement can alter the mandated statutory priority set forth in NRS 108.225 between mechanic's lien claimants and a later filed deed of trust holder; and (2) If such an alteration can be made, does the express language of the Subordination Agreement at issue, accomplish that? Looking at the language used in the Subordination Agreement, the facts of the case and the legal authorities, the answer in both cases must be no.

The Answering Briefs of Scott Financial Corporation ("Scott") and the Third Parties in Interest attempt to hide these essential questions, and misstate the arguments made by the Petitioners[1]. For example, the Petitioners are not arguing against the freedom to contract, but rather, are arguing for the freedom to contract subject to applicable and existing law.

The third party beneficiary argument is also a distraction. It is Scott who is seeking to enforce a subsequently recorded document to alter the mandated statutory priority set forth in NRS 108.225. The mechanic's lien claimants are only asking this Court to enforce the terms of the recorded Subordination Agreement as they are written, and the statutory rights granted mechanic's lien claimants by the Nevada Legislature.

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[1] Unless otherwise indicated, all references to "Scott" shall refer to both Scott Financial Corporation and the Third Parties in Interest, Club Vista Financial

The Petitioners submit that by following the example of the courts that follow the Complete Subordination approach, the Court will be upholding the Nevada legislature's intent regarding priority of mechanic's liens set forth in NRS 108.225, while still allowing sophisticated financial institutions an opportunity to protect their interests through contractual assignment of any prior rights to payment. Lenders are in the best position to protect themselves, and lenders would still retain the ability to protect themselves even under the rule urged by the mechanic's lien claimants.

II. REPLY ARGUMENT.

A. THE SUBORDINATION AGREEMENT IS A COMPLETE SUBORDINATION.

Both parties have used the terms Complete Subordination and Partial Subordination in their respective briefs. However, Scott's Answering Brief attempts to use the term to mean something beyond its intended meaning. Scott, without any citation or support, proposes that "Partial Subordination" must be interpreted to mean that any time a subordination agreement is entered into, regardless of the rights subordinated or the language of the Subordination Agreement, the later priority lien holder takes over the earlier priority position up to the amount of the prior lien. However, the terms "Complete Subordination" and "Partial Subordination" were developed for very different reasons, which are important in this case.

"Partial subordination" was a term given to a set of cases in which the subordination of the rights of the prior lien holder were not completely subordinated to the interests of a subsequent-in-time lien. In other words, there was always some limitation of the subordination, or a limitation on the lien that was being subordinated. For example, one particular bankruptcy court allowed the third lien holder to take up the priority position of the first lien holder when the first lien holder agreed to subordinate a discrete portion of its lien with respect to a specific portion of the collateral. *In Re Cliff's Ridge Skiing Corp.*, 123 B.R. 753 (W.D. Mich. 1991). The first lien holder held a deed of trust covering real property and any improvements or fixtures attached to ski resort property. *Id.* at 755. The first lien holder then subordinated its lien relating only to a piece of ski lift equipment to a third lien holder. *Id.* The Court held:

> [The first lien holder] did not subordinate its entire real estate mortgage to [The third lien holder]; [The first lien holder] only subordinated its mortgage interest to the extent it covered the chairlift to be attached as a fixture.

Id. at 767-768. The remainder or balance of the first position lien stayed in place and in first position.

In *Duraflex Sales & Service Corp. v. W.H.E. Mechanical Contractors*, 110 F.3d 927 (2^{d} Cir. 1997), the first lien holder subordinated only a discrete portion of its lien to a third position lien holder. *Id.* at 929-930. The subordination agreement in *Duraflex* specifically stated that except for the portion subordinated,

the lien of the first position lender would remain as a first position lien. *Id.* at 930. The Second Circuit Court of Appeals also held that **if there had been a Complete Subordination of the first mortgage**, both the first and third position mortgages would be behind the second position mechanic's lien. Specifically, the Second Circuit held:

> Although these cases are of little help in resolving this appeal, we note that the *RJB* scheme employed here is not necessarily inconsistent with them. In *Shaddix* and *McConnell*, the lienholder with first priority subordinated *all* of that lien to the lienholder with third priority. Under the *RJB* analysis, had Charter Federal subordinated the whole of its $3.95 million mortgage to FNBS, then Charter Federal's lien priority would have been entirely subordinate to the Duraflex mechanic's lien. And, in the absence of any stated rationale in *Shaddix* and *McConnell*, we read those cases to say no more than **when a first lienholder subordinates its entire lien to the lien of a third lienholder, the original first lien is subordinated to the liens of both the second and third lienholders.** (Citations omitted). In *RJB*, *Shaddix*, and *McConnell*, the second lienholder was left in a position no worse or better than it would have been in, absent the subordination.

Id. at 935 (emphasis added).

Another example is *Bratcher v. Buckner*, 90 Cal.App.4th 1177 (Ct. App. 4th Div. 2001). In *Bratcher*, the subordination agreement specifically stated that it only affected the priority between the two liens discussed in the subordination agreement. *Id.*

Scott also relies heavily upon *In Re Price Waterhouse Ltd.*, 46 P.3d 408 (Ariz. 2002) to support the Partial Subordination position. However, *Price Waterhouse* is not applicable for the following reasons. The subordination

agreement in *Price Waterhouse* limited the effect of the subordination "only insofar as would affect the priority between the deeds of trust hereinbefore specifically described." *Id.* at 410. The third place lien in *Price Waterhouse* was for only a portion of the total amount of the first priority lien. *Id.* Finally, there is also a fundamental difference in Arizona and Nevada law. Arizona law allows a junior lien holder to equitably advance its priority over a prior in-time mechanic's lien. *See, e.g., Lamb Excavation, Inc. v. Chase Manhattan Mortgage Corp.*, 95 P.3d 542 (Ariz. 2004). In fact, this Court took specific note of the holding in *Lamb Excavation* and rejected the same in favor of the statutory provisions found in Nevada law. *In Re: Fontainebleau Las Vegas Holdings, LLC*, 128 Nev.Adv.Op. 53, p. 28-29, FN13. In this regard, Arizona law is completely contrary to Nevada law.

In contrast, the Complete Subordination cases relied on by the Mechanic's Lien Claimants are substantially similar to the type of subrogation agreement that is seen in this Case. In the Complete Subordination cases, the subordination agreement provides that the first lien will be subordinated completely to the later lien. By completely subordinating its interest to the later lien, the intent is to change the priority position of the first place lien to that of the third place lien. *See, e.g., Old Stone Mortgage And Realty Trust v. New Georgia Plumbing, Inc.*, 231 S.E.2d 785 (Ga. App. 1977) ("*Old Stone* 1"), and *Old Stone Mortgage And Realty Trust v. New Georgia Plumbing, Inc.*, 236 S.E.2d 592 (Ga. 1977) ("*Old*

Stone 2"); *Blickenstaff v. Clegg*, 97 P.3d 439 (Ida. 2004); *AmSouth Bank v. J & D Financial Corp.*, 679 So.2d 695 (Ala. 1996).

Scott attempts to cast the Subordination Agreement at issue here as a Partial Subordination, rather than a Complete Subordination of the Mezzanine DOTs to the Construction DOT. However, the language of the Subordination Agreement clearly shows that the parties intended a Complete Subordination. 3 App. 641-648. In fact, the Subordination Agreement subordinates the Mezzanine DOTs priority and all other rights and interests to the Construction DOT. *Id.* There is no language in the Subordination Agreement limiting the effect of the subordination. *Id.* Instead, the Subordination Agreement actually provides the opposite. The Subordination Agreement states:

> . . .
>
> C. SFC has agreed and hereby intends to evidence that **the Mezzanine Deeds of Trust and the indebtedness secured thereby shall be subordinate** to the $110,000,000 Senior Debt Deed of Trust and the indebtedness secured thereby.
>
> AGREEMENT
>
> 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 (as lender of the Restructured Mezzanine Note) by law or by agreement, SFC 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 (as lender of the Restructured Mezzanine Note) shall be and remain fully subordinated for all purposes** to the security interest of SFC therein for all purposes whatsoever.
>
> 2. No Payments. Until all of the Senior Debt Notes has (sic) been paid in full, SFC (as lender of the Restructured Mezzanine Note) **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 (as lender of the Restructured Mezzanine Note) **will not commence any action or proceeding against the Borrower to recover all or any part of the Restructured Mezzanine Note** or join with and SFC (as lender of the Restructured Mezzanine Note) 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** (as lender of the Restructured Mezzanine Note) with respect to any such Collateral, **unless and until the Senior Debt Notes has (sic) been paid in full.**

Id. at 642-43 (emphasis added).

Scott's primary argument is that the Subordination Agreement only affected the application of payments between the Mezzanine Loan and the Construction Loan. This argument asks the Court to overlook the actual language of the Subordination Agreement. The Subordination Agreement has a specific term

relating solely to the issue of lien priority. The first paragraph numbered "1"[2] on page 2 of the Subordination Agreement titled "Lien Priority" provides that "**the lien** of the [Mezzanine DOTs]" are to be deemed as if they were recorded after "**the lien** of the [Construction DOT]". *Id.* at 642. The Subordination Agreement language relates to the liens of the Mezzanine DOTs and the Construction DOT, not just a reordering of payment as Scott claims. *Id.* In fact, Scott's argument pretends that the first substantive paragraph in the "Agreement" section of the Subordination Agreement does not exist.

The Subordination Agreement also differentiates between the security interests of the Mezzanine DOTs and the Construction DOT, and the payment interests of the underlying debt. The Subordination Agreement subordinates both the "Mezzanine Deeds of Trust" and the "indebtedness secured thereby." *Id.* The "indebtedness secured thereby" refers to the $46,000,000 Mezzanine Note, the payment of which is subordinated to payment of the Construction Note of $110,000,000. *Id.* The other interest subordinated is the "Mezzanine Deeds of Trust" interest, which is the security interest lien for the Mezzanine Note. *Id.* The "Mezzanine Deeds of Trust" themselves are subordinated to the "$110,000,000 Senior Debt Deed of Trust." *Id.* The clear and express terms of the Subordination

[2] In an apparent scrivener's error, the "Agreement" section of the Subordination Agreement has two paragraphs identified as "1" (*i.e.* "1. Lien Priority." and "1. Subordination.").

Agreement provide that both the security interest **and** the payment interest of the Mezzanine financing are being moved behind the security and payment interests of the Construction financing.

The remaining paragraphs of the Subordination Agreement also establish the intent to treat the Mezzanine DOTs as if they were filed after the Construction DOT. The second paragraph numbered "1" on page 2 of the Subordination Agreement titled "Subordination," provides that "any security interest claimed [by the Mezzanine DOTs] shall be and remain fully subordinate for all purposes." *Id.* Paragraph 2, regarding Payments, provides that the Mezzanine DOTs may not receive any payment "in respect of the Restructured Mezzanine Note." *Id.* Paragraph 4, regarding actions on the Restructured Mezzanine Note, provides that the Mezzanine DOTs will not commence any action to "exercise or enforce any right or remedy available to SFC (as lender of the Restructured Mezzanine Note) with respect to any such Collateral." *Id.* at 643. Thus, every priority, right or other interest belonging to the Mezzanine DOTs was subordinated to the priority, rights and interests of the Construction DOT. Therefore, the Subordination Agreement was a Complete Subordination with no conditions or limitations on the subordination.

The language of the Subordination Agreement also calls for the application to be consistent with the Complete Subordination cases. The facts of the instant Case are directly on point with those contained in *Old Stone 1* and *Old Stone 2*

cases from Georgia. *Old Stone Mortgage And Realty Trust v. New Georgia Plumbing, Inc.*, 231 S.E.2d 785 (Ga. App. 1977), and *Old Stone Mortgage And Realty Trust v. New Georgia Plumbing, Inc.*, 236 S.E.2d 592 (Ga. 1977). In *Old Stone 1*, the Court held that under Georgia law, "A contractor's lien attaches from the time work is commenced or material furnished." *Id.* at 787. This is the same as Nevada law. NRS 108.225. The *Old Stone 1* Court also involved a third position lien given with knowledge of the intervening mechanic's liens, and a subordination of the first position lien behind the third position lien. *Id.* Under this scenario, the Georgia Appellate Court went on to hold that "[o]ne who subordinates a first lien to a third lien makes his lien inferior to both the second and the third liens." *Id.* at 788.

The Georgia Supreme Court affirmed this holding in *Old Stone 2*, when it held that the subordination was not conditional. *Id.* at 594. The Court also held the subordination agreement did not contain any language to permit an interpretation that the parties were switching positions of priority in the form of a subrogation (as opposed to subordination) agreement. *Id.* Finally, the *Old Stone 2* Court held that allowing a secured party to jump in front of a known mechanic's lienholder would "destroy the legal rights of the intervening statutory lienholder and cannot be approved." *Id.* at 593.

There is also no reason why Partial and Complete Subordination cannot be reconciled and used together. In *Duraflex Sales & Service Corp. v. W.H.E.*

Mechanical Contractors, 110 F.3d 927 (2[d] Cir. 1997), the Second Circuit Court of Appeals did just that. In *Duraflex,* the first lien holder subordinated only a discrete portion of its lien to the third position lien holder. *Id.* at 929-930. Unlike the Subordination Agreement in this case, the subordination agreement in *Duraflex* specifically stated that except for the portion subordinated, the lien of the first position lender would remain as a first position lien. *Id.* at 930. The Second Circuit Court of Appeals held that **if there had been a Complete Subordination of the first mortgage**, both the first and third position mortgages would be behind the second position mechanic's lien. Specifically, the Second Circuit held:

> Although these cases are of little help in resolving this appeal, we note that the *RJB* scheme employed here is not necessarily inconsistent with them. In *Shaddix* and *McConnell*, the lienholder with first priority subordinated *all* of that lien to the lienholder with third priority. **Under the *RJB* analysis, had Charter Federal subordinated the whole of its $3.95 million mortgage to FNBS, then Charter Federal's lien priority would have been entirely subordinate to the Duraflex mechanic's lien**. And, in the absence of any stated rationale in *Shaddix* and *McConnell*, we read those cases to say no more than **when a first lienholder subordinates its entire lien to the lien of a third lienholder, the original first lien is subordinated to the liens of both the second and third lienholders.** (Citations omitted). In *RJB*, *Shaddix*, and *McConnell*, the second lienholder was left in a position no worse or better than it would have been in, absent the subordination.

Id. at 935 (emphasis added).

All of the subordination cases cited rely primarily on the language used in the particular subordination agreement at issue. Here, rather than addressing the text of the Subordination Agreement, Scott makes broad generalizations and

conclusory statements to try to turn the Subordination Agreement into something it is not: a limited, Partial Subordination. Notably, Scott provides almost no citation to support its interpretation of the actual language of the Subrogation Agreement. There is no language in the Subordination Agreement stating that the Construction DOT will step into the priority position of the Mezzanine DOTs. 3 App. 641-648. Nor is there a provision stating that the Construction DOT shall be treated as if it had the priority of the Mezzanine DOTs. *Id.* There is also no differentiation between the portion of the Mezzanine DOTs that were prior to the commencement of construction ($38 million), and the portion of the Mezzanine DOTs that are clearly behind the mechanic's lien claims (the additional $8 million). *Id.* The recorded Subordination Agreement simply provides notice to the world that the full $46,000,000 of the restructured and consolidated Mezzanine DOTs are to be treated and deemed as if they had been **recorded after** the Construction DOT. *Id.* Scott even went so far as to record two new deeds of trust securing the $46,000,000 restructured and consolidated Mezzanine Note **after** recording the Construction DOT. 3 App. 627-639.

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B. THIS CASE IS ABOUT PRIORITY BETWEEN THE LIEN CLAIMANTS AND THE CONSTRUCTION LENDERS

This case is, and has always been, about whether the mechanic's liens or the Construction DOT has priority on the Project. The Replacement Order[3] issued by District Court held:

> IT IS FURTHERED ORDERED ADJUDGED AND DECREED that SFC's loan of $110,000,000.00 is in first 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. The District Court's Replacement Order gave the Construction DOT and the Construction Lenders priority over the mechanic's lien claimants even though the Construction DOT was recorded after commencement of the work of improvement. *Id.* at 1148-1155. The Replacement Order also recognized that the Subordination Agreement moved the priority of Mezzanine DOTs behind the Construction DOT. *Id.* In sum and substance, the Replacement Order is a re-ordering of the lien priority.

Scott also acknowledges that the Replacement Order adjusts the priority positions of the mechanic's liens and the Construction DOT and is not just an

[3] The Initial Order issued by Judge Delaney found priority for the mechanic's lien holders.

assignment of the right to payment. Scott argues that the result of the Subordination Agreement was to change the priority of the Mezzanine DOTs to the end of the priority line, while somehow elevating the priority of the Construction DOT to the extent of a portion of the Mezzanine DOTs. *See* Scott Financial's Answering Brief, p. 7, l. 11-12 and p. 10, l. 1-12. Scott also argues several times that the Subordination Agreement should be interpreted to give the loan secured by the Construction DOT the priority of the loan secured by the Mezzanine DOTs. For example, and despite the non-existence of any language in the document supporting the same, Scott argues that the "the subordination agreement intended that the Construction Loan Agreement would be in first priority position on the Manhattan West property." *Id.* at p. 34, l. 15-17.

In essence, Scott argues that the Court should ignore the plain language of the Subordination Agreement it drafted and allow the Construction DOT to, in part, jump over the statutory priority provided the mechanic's lien claimants by NRS 108.225.[4] Indeed, Scott asks the Court to provide Scott the position it (allegedly) ***intended*** to have rather than the priority it ***actually*** possesses by way of

[4] NRS 108.225 provides a specific, statutory statement that the policy of the State of Nevada is that mechanic's lien claimants will be allowed to recover against the real property before any other party who has a debt secured by a lien recorded after the commencement of construction. NRS 108.225. *See also, In Re: Fontainebleau Las Vegas Holdings, LLC*, 128 Nev.Adv.Op. 53 (Oct. 2012), ps. 18 and 28. To that end, this Court has already held in no uncertain terms that "NRS 108.225 affirmatively gives mechanic's lien claimants priority over all other liens . . . that attached after the commencement of a work of improvement." *Id.*

the express language of the Subordination Agreement. However, the lower-court was not empowered to do this without ignoring a fundamental tenet of Nevada law (reiterated most recently by this Court in *Fontainebleau*) that "equitable principles will not justify a court's disregard of statutory requirements." 128 Nev. Adv. Op. 53 (Oct. 2012), p. 28 (*citing Pellegrini v. State*, 117 Nev. 860, 878, 34 P.3d 519, 531 (2001)).

A party seeking to obtain a first priority lien has the ability to purchase an assignment of the first party lien holders' rights. By way of the assignment, the purchasing party becomes the first party lien holder, subject to the same rights and restrictions. Here, the Subordination Agreement is not an assignment. Nothing in the Subordination Agreement assigns, transfers or conveys to the Construction Lenders the Mezzanine DOTs' rights in its first deed of trust nor the indebtedness secured by it, or any part thereof. 3 App. 627-632. To the contrary, the Subordination Agreement expressly places the rights and liens of the Mezzanine Lenders behind the rights and liens of the Construction Lenders. *Id.* As applied to the facts of this case, NRS 108.225 renders the liens of the mechanic's lien claimants superior to those of Scott.

C. SCOTT'S RELIANCE ON FOOTNOTE 13 OF THE *FONTAINEBLEAU* DECISION IS MISPLACED.

In another attempt to create new rights under Nevada law, Scott takes one small portion of Footnote 13 of the *Fontainebleau* decision entirely out of context

in support of the proposition that a lender can advance the priority of a lien through a subordination agreement that by its express terms only subordinates a superior lien.[5]

Footnote 13 to the *Fontainebleau* decision related to this Court's consideration of the lender's argument that other states had allowed equitable subrogation even in light of mechanic's lien statutes. *In Re: Fontainebleau Las Vegas Holdings, LLC*, 128 Nev.Adv.Op. 53, p. 28-29. After listing the cases cited by the lender, the Court noted that Nevada's mechanic's lien statutes were "exclusive to this state," and that the Court would not allow equitable subrogation to overcome the express statutory provisions of NRS 108.225. *Id.* Despite the Court's lengthy consideration of equitable subrogation in Footnote 13, the last sentence provided therein states that the lender "had ample means to minimize its financial risk through the proper channels of contractual subordination." *Id.* at 29, FN 13. That otherwise unremarkable observation in no way supports Scott's effort to infer a holding that was not part of the *Fontainebleau* decision. Stated differently, this Court's prohibition on the use of equitable subrogation to supersede the statutory priority provided to mechanic's liens by NRS 108.225 cannot be overcome by renaming subrogation as "subordination."

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[5] As discussed in the Petitioners' Supplemental Brief, "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).

The Petitioners respectfully submit that by reference to "proper channels of subordination," this Court was suggesting that the lenders could have sought a non-prospective subordination agreement from the mechanic's lien claimants, which this Court also held "may be pursued through compliance with the requirements of NRS 108.2457." *Fontainebleau,* pp. 29-30. No evidence has been submitted in this case that Scott ever entered into a non-prospective subordination agreement with any mechanic's lien claimant pursuant to NRS 108.2457. Accordingly, the language of Footnote 13 relied upon by Scott has no bearing on this case.

Additionally, Scott's attempt to twist the meaning of Footnote 13 is also unsupported by a review of the underlying citation. After the final sentence of Footnote 13, the Court cited to *Ex Parte Lawson*, 6 So.3d 7, 15-16 (Ala. 2008) to support the proposition that lenders had ample means to minimize their financial risks. Much like the *Fontainebleau* case, the *Lawson* case was about the application of equitable subrogation in the context of a statutory provision of priority to mechanic's liens. *Id.* In *Lawson*, the Supreme Court of Alabama overruled a lower court ruling applying equitable subrogation against a mechanic's lien claimant. *Id.* The *Lawson* Court reversed the lower court decision because, even though Alabama had long recognized the doctrine of equitable subrogation, the lower court ignored the statutory priority given to mechanic's liens provided by Alabama statue. *Id.*

In holding that equitable subrogation would not preempt the statutory rights provided to mechanic's lien claimants, the *Lawson* Court held:

> The lenders . . . are sophisticated mortgage companies that could have easily protected their interests. [FN2] Based upon the statutory preference given to materialmen, it is the commercial lenders who bear the burden of protecting themselves.

Id.

In Footnote 2, the *Lawson* Court noted that the lenders had made several arguments of ways the lien claimants could have protected themselves without having to resort to their lien rights. *Id.* Rather than placing the obligation to try to protect themselves on the more vulnerable lien claimants, the *Lawson* Court noted, "It is also true that the lenders could have obtained a **subrogation agreement or assumed the rights of the earlier lender by an assignment** of the construction mortgage." *Id.*, FN2 (emphasis added). Although the Alabama Court did discuss a "***subrogation*** agreement," there was no mention of using a ***subordination*** agreement by the *Lawson* Court.

The Alabama Supreme Court's omission of contractual ***subordination*** from that analysis was no accident. In fact, the Alabama Supreme Court had already held that a lender in third priority cannot move to first priority by way of a subordination agreement. *See, e.g., Shaddix v. National Surety Co.*, 128 So. 220 (Ala. 1937). *See also AmSouth Bank, N.A. v. J & D Financial Corp.*, 679 So.2d 695 (Ala. 1996). In other words, the very holding Scott seeks to infer from a

snippet of Footnote 13 had already been rejected by the very court whose decision is arguably the basis of that same snippet.

In any event, the Construction Lenders did minimize their risk through contractual subordination, though not in the way they now assert. The Mezzanine DOTs were for a total amount of $46 million dollars (even though only $38 million dollars were recorded before the lien claimants commenced work on the Project). Without the Subordination Agreement, the Mezzanine DOTs would have to be paid $46 million dollars before the Construction DOT would receive any payments. As a result, the Construction Lenders minimized their financial risk by $46 million dollars though the Subordination Agreement. This was in addition to minimizing their financial risk by obtaining a title endorsement for the known break in lien priority, and by obtaining a Guaranty of the Construction Loan. Despite all the arguments after-the-fact, it is clear that Scott, on behalf of the Construction Lenders, thought about and took the steps necessary to make themselves comfortable in giving the Construction Loan despite their knowledge of the potential for mechanic's lien's to be in a priority position relative to the Construction Loan.

D. THE LIEN CLAIMANTS POSITION SUPPORTS THE FREEDOM TO CONTRACT.

One of the more perplexing arguments made by Scott is that application of the Complete Subordination approach would impair the freedom of contract. The

lien claimants have never argued against this right. In fact, the lien claimants support the rights of the Mezzanine Lenders and the Construction Lenders to enter into an agreement which subordinates the lien of the Mezzanine DOTs to the lien of the Construction DOT. The lien claimants also support the right of the lenders to give public notice by recording the Subordination Agreement. The lien claimants' have never challenged these rights.

The mechanic's lien claimants have also never taken issue with the ability of parties to assign or sell their rights to another party. The Mezzanine Lenders could have assigned their rights to the Construction Lenders, and the Construction Lenders could have taken over the Mezzanine Loan.

The freedom to contract is not an issue in this case. What is at issue is the interpretation of the language actually used in the Subordination Agreement. Scott is attempting to completely change the terms of the recorded document to say and mean something that is not indicated anywhere in the Subordination Agreement, nor intended by the parties thereto. Scott recorded a document that moved the lien priority of the Mezzanine DOT behind the lien priority of the Construction DOT. 3 App. 627-632. The mechanic's lien claimants are simply asking the Court to apply the Subordination Agreement as written and recorded for all the world to see and rely upon.

E. THE TITLE INSURANCE ENDORSEMENTS AGAINST MECHANIC'S LIENS IS RELEVANT TO THIS CASE.

Scott's Answering Brief seeks to cast the issue of the title insurance mechanic's lien endorsement as nothing more than a red herring. Answering Brief at 32. Scott is wrong. The facts surrounding the issuance of the title policy endorsement are highly relevant to the Construction Lenders' state of mind and their acknowledgement of the existence and priority of mechanic's liens. What's more, Scott does not dispute the factual issues that led to Scott obtaining the title policy endorsement.

The facts surrounding the title insurance show that Scott understood that any mechanic's liens could have priority over any payments for the Construction Loan. None of the following facts have been disputed by Scott's Answering Brief:

- Scott argued in a related matter, *Club Vista Financial Services, LLC, et al., v. Scott Financial Corp., et al.*, Case No. A579963, that the title insurance was to address **broken priority**. As part of SFC's opening statement, SFC took the position that SFC obtained the mechanic's lien endorsement, known as a 101.3, to deal with broken priority. 7 App. 1618:8-19, and 7 App. 161620:2-10.
- During that trial, a representative of the largest participant, and Scott's Co-Lead Lender, Bank of Oklahoma, testified that the bank understood that if liens were recorded, those liens could "prime" the

Construction DOT, and that was why the 101.3 was obtained. 7 App. 1635:5-1637:22 (Bench Trial, Partial Transcript – Partial Testimony of Phillip Timothy James Only).

- As part of the process to obtain the title insurance and the mechanic's lien endorsement, Commonwealth Land Title Insurance Company required a "Construction Loan Loss of Priority Questionnaire." 3 App. 595.
- The "Construction Loan Loss of Priority Questionnaire" stated that as of January 11, 2008, work on the "Foundation, Framing" was ongoing. *Id.*
- The Questionnaire also noted that the Mezzanine Deeds of Trust were to be subordinated to the construction loan. *Id.*
- Commonwealth Land Title Insurance Company also required an Indemnity Agreement (Mechanic's Liens). 3 App. 597-602.

All of these facts show that Scott obtained the mechanic's lien endorsement because it believed that the mechanic's liens would have priority over the Construction DOT due to the Subordination Agreement. The Questionnaire noted that work was already on-going and that the Mezzanine DOTs were going to be subordinated to the construction loan, providing the need for the mechanic's lien endorsement. 3 App. 595. The title insurance endorsement was not just a normal prudent part of the transaction. Instead, it was obtained specifically because Scott

believed that the mechanic's liens would have priority if the Construction Loan failed to pay for the construction work and materials, as indeed they did.

F. THE CONSTRUCTION DOT CANNOT BE GIVEN PRIORITY WITHOUT A RESORT TO EQUITY.

The Construction Lenders insist that they are only seeking enforcement of a legal remedy because the Subordination Agreement is a contract to move the priority of the Construction DOT. There is no legal remedy for advancing the priority of the Construction DOT as requested by the Construction Lenders. The Construction Lenders asked the District Court, and are now asking this Court to ignore the plain language and intent of the Subordination Agreement and find as a matter of fairness and equity that the Construction DOT should be given the priority of the Mezzanine DOTs.

The Construction Lenders are not asking for relief based solely upon any language in Subordination Agreement. In fact, the Subordination Agreement does not provide an assignment of the Mezzanine DOTs' priority or otherwise purport to treat the Construction DOT as if its priority were to be elevated ahead of the Mezzanine DOTs.[6] The Construction Lenders are arguing, without actually saying as much, that the Subordination Agreement should be given the effect of an assignment agreement, *i.e.,* an equitable assignment. In effect, the Construction

[6] Indeed, such a provision would expressly violate NRS 108.225 and this Court's holding in *Fontainebleau.*

Lenders are requesting the Court to find that the result of the Subordination Agreement should be to keep the Mezzanine DOTs in first position, while allowing the Construction Lenders to take an assignment of a portion of the Mezzanine DOTs' priority rights. The language of the Subordination Agreement does not support this contention, and such a holding certainly cannot be inserted into the Subordination Agreement under the guise of contract interpretation. *Watson v. Watson*, 95 Nev. 495, 496, 596 P.2d 507, 508 (1979) ("Courts are bound by language which is clear and free from ambiguity and cannot, using the guise of interpretation, distort the plain meaning of an agreement.").

Scott argues that under the Subordination Agreement the Mezzanine DOTs remain in first position, but payment is somehow being shifted for the payment of the Construction Loan. Scott's theory, while expedient for this case, would lead to a result that directly contradicts the actual language of the Subordination Agreement. Under Scott's theory, if the Mezzanine DOTs remained in first position, but payment was shifted to the Construction DOT, upon re-payment of the first $46 million, the Mezzanine DOTs would be satisfied and have to be released. The Mezzanine DOTs only secure the first $46 million dollars of payment. However, the Subordination Agreement makes it clear that the Mezzanine DOTs are to stay in place and secure payment of the Mezzanine Loan after payment of the full amount of the $110,000,000 Construction Loan. 3 App. 627-632. Likewise, there would have to be some language in the Subordination

Agreement allowing an assignment of the last $46 million dollars against the Construction DOT to be paid to the Mezzanine Loan to ensure that the Mezzanine Loan was secured. This type of language is not in the Subordination Agreement because there was never any such intent.

The Construction DOT was recorded almost eight (8) months after the commencement of construction on this work of improvement. NRS 108.225 provides that the mechanic's lien claimants have priority over any lien recorded after the commencement of construction of a work of improvement. Even if it were legally possible to do so, nothing in the Subordination Agreement advances the lien position of the Construction DOT ahead of the lien position of the mechanic's liens. The only way in which the Construction DOT could be deemed to have priority over the mechanic's liens is through the application of equitable principles.

The equitable nature of the request by the Construction Lenders can be seen by comparing the request for relief in this case with a construction lender's request for relief in an equitable subrogation claim context.

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).	In this case, Scott is attempting to overcome the express provisions of NRS 108.225, to allow the lien of the Construction DOT to jump over the intervening mechanic's liens.
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.*	Scott's position would have the practical effect of allowing a lower priority lien holder [the Construction DOT] to enforce the lien priority of Mezzanine DOTs.
Equitable subrogation has the effect "of an assignment" of the prior lien. *Id.*	Scott's position would have the effect of an assignment of the Mezzanine Loan's right to payment.

The policy arguments in favor of equitable subrogation are also the same policy arguments made in favor of the partial subrogation approach. A prime argument in favor 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. Scott repeatedly makes the same argument that the mechanic's lien claimants would not be prejudiced by allowing the Construction DOT to take the priority of the Mezzanine DOTs because they would be in the same position behind $38 million dollars. *See, e.g.*, Answering

Brief, ps. 20-21. Scott also repeats the argument that the mechanic's lien claimants will receive a windfall if the Mezzanine DOTs are moved into third position as called for in the Subordination Agreement. *Id.* at p. 18. The only windfall that would result from Scott's position would be in favor of the Construction Lenders who, with eyes wide open, made a loan and recorded a lien after commencement of construction.

Scott, on behalf of the Construction Lenders, recorded a Subordination Agreement that provided public notice that the liens of the Mezzanine DOTs were to be treated as if they were recorded after the Construction DOT. 3 App. 627-632. There is nothing in Nevada law or the Subordination Agreement that allows the lien of the Construction DOT to be advanced. Instead, the District Court, in the Replacement Order, granted the Construction Lenders an equitable remedy allowing the Construction DOT to move up in priority, rather than giving effect to the recorded Subordination Agreement, and moving the Mezzanine DOTs lien behind the Construction DOT as was initially done by Judge Delaney. The Construction Lenders were allowed an equitable assignment of the portion of the Mezzanine loan in priority position in contravention of this Court's determination that equitable remedies cannot trump the express provisions of NRS 108.225.

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III. CONCLUSION.

For the reasons set forth above, Petitioners, appearing jointly through their respective counsel, 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.

DATED this 1st day of May 2013

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CERTIFICATE OF COMPLIANCE

1. I hereby certify that this brief complies with the formatting requirements of NRAP 32(a)(4), the typeface requirements of NRAP 32(a)(5) and the type style requirements of NRAP 32(a)(6) because:
[**X**] This brief has been prepared in a proportionally spaced typeface using Word 2007 in 14 font size and Times New Roman type style; or
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2. I further certify that this brief complies with the page- or type-volume limitations of NRAP 32(a)(7) because, excluding the parts of the brief exempted by NRAP 32(a)(7)(C), it is either:
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3. Finally, I hereby certify that I have read this brief, and to the best of my knowledge, information, and belief, it is not frivolous or interposed for any improper purpose. I further certify that this brief complies with all applicable Nevada Rules of Appellate Procedure, in particular NRAP 28(e)(1), which requires every assertion in the brief regarding matters in the record to be supported by a reference to the page and volume number, if any, of the transcript or appendix where the matter relied on is to be found. I understand that I may be subject to sanctions in the event that the accompanying brief is not in conformity with the requirements of the Nevada Rules of Appellate Procedure.

DATED this 1st day of May 2013

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Certificate of Service

Pursuant to NRAP 25, I certify that I am an employee of Howard & Howard Attorneys PLLC and that on this 1st day of May 2013, the foregoing REPLY IN SUPPORT OF PETITION FOR WRIT OF MANDAMUS OR PROHIBITION was filed electronically with the Clerk of the Nevada Supreme Court, and was (1) electronically served on all parties registered in this case; and (2) by mailing a true and correct copy thereof, postage prepaid, addressed to:

The Honorable Susan W. Scann
Department 29, Eighth Judicial District Court
330 S. 3rd Street
Las Vegas, NV 89155

\s\ Barbara Dunn
An Employee of Howard & Howard Attorneys PLLC