

## DIRT DAILY DEVELOPMENT for September 26, 2012

Bob DeGeorge Associates, Inc. v. Hawthorn Bank

Supreme Court of Missouri

2012 WL 4054143 (Sept. 11, 2012)

Synopsis: Missouri Supreme Court unanimously concludes that a purchase money deed of trust was subordinate to mechanic's liens asserted by contractor/subcontractor who began work on the site while the purchase money deed of trust remained unrecorded.

Facts: On June 4, 2008, Blue Springs Xtreme Powersports (Xtreme) purchased a building and three parcels of land using the proceeds of a \$2.5125 million purchase money loan from Hawthorn Bank. While Xtreme received a warranty deed covering the parcels and executed a purchase-money deed of trust in favor of Hawthorn Bank, neither was recorded at the time.

Before completing the purchase, Xtreme had already contracted with Bob DeGeorge Associates (DeGeorge) to remodel the building. DeGeorge began work on June 6, 2008; a subcontractor, KD Christian, began work on June 17, 2008. Although both DeGeorge and KD Christian completed their work, Xtreme never paid the approximately \$148,000 it owed DeGeorge (which in turn never paid the approximately \$17,500 it owed KD Christian).

On November 18, 2008, DeGeorge filed a mechanics' lien. The next day, November 19, Xtreme's deed and Hawthorn Bank's purchase money deed of trust were finally recorded. KD Christian filed its mechanics' lien the next day, November 20. DeGeorge then filed an action against Xtreme to foreclose on its lien; KD Christian intervened to enforce its lien as well. DeGeorge and KD Christian then brought claims against Hawthorn Bank, seeking to establish the priority of their respective lien claims over Hawthorn Bank's purchase money deed of trust. DeGeorge moved for summary judgment; Hawthorn Bank responded by likewise moving for summary judgment, arguing that its deed of trust had priority over the mechanics' lien claims and that foreclosure of the liens would thus have no effect on its deed of trust. The trial court granted summary judgment for DeGeorge, ruling that its mechanics' lien claim was superior to Hawthorn Bank's deed of trust and that DeGeorge and KD Christian had priority and were entitled to foreclose their liens. Hawthorn Bank appealed to the Missouri Court of Appeals, and the case was thereafter transferred to the Missouri Supreme Court.

The Missouri Supreme Court reasoned that under Missouri's "first spade" rule [reflected in R.S.Mo. § 429.060], a mechanics' lien against the land relates back to the date on which site work began — in this case, June 6, 2008. The Court noted that although Hawthorn Bank had acquired its purchase money deed of trust before that date, it did not record that deed of trust until after that date — and that under Missouri's "notice" recording statute [R.S.Mo. § 442.400], Hawthorn Bank's unrecorded deed of trust was invalid against third parties such as DeGeorge and KD Christian until that time.

Hawthorn Bank argued, however, that it was entitled to priority under an existing Missouri Supreme Court precedent, *Westinghouse Electric Co. v. Vann Realty Co.*, 568 S.W.2d 777 (Mo. 1978). In that case, the Court had stated, without reference to Missouri's recording statute, as follows:

Mechanic's liens do not take precedence over a purchase money deed of trust which secures repayment of funds used to purchase land upon which the improvements giving rise to the lien claims are erected. [*Vann Realty*, 568 S.W.2d at 781.]

Hawthorn Bank argued that this statement demonstrated an intention that a purchase money deed of trust would have priority over mechanic's liens in all circumstances, even if the purchase money deed of trust was unrecorded. Hawthorn Bank further argued that this result was consistent with Restatement (Third) of Property — Mortgages § 7.2(b), which states that “[a] purchase money mortgage, whether or not recorded, has priority over any mortgage, lien, or other claim that attaches to the real estate but is created by or arises against the purchaser-mortgagor prior to the purchaser-mortgagor's acquisition of title to the real estate.”

The Missouri Supreme Court unanimously rejected Hawthorn Bank's argument, noting that the purchase money deed of trust in *Vann Realty* had been recorded before work commenced on the property. Thus, the Court concluded, the *Vann Realty* case had not established that an unrecorded purchase-money deed of trust was entitled to priority over mechanic's liens that arose after the owner's acquisition of title. The Court refused to extend the *Vann Realty* case that far, concluding that giving unrecorded purchase-money deeds of trust such broad priority would “discourage prompt recording of liens on real estate after closing and would frustrate the purpose of the recording statutes to provide a system of statutory priorities for encumbrances on real estate based on constructive notice of prior encumbrances.”

Comment 1. Hawthorn Bank's argument in the case reflected a misunderstanding of the proper application of Restatement § 7.2(b) and its “whether or not recorded” language. Section 7.2(b) is intended to protect a purchase-money deed of trust from liens or claims that had arisen against the trustor/mortgagor before it acquired title to the property. For example, suppose Creditor has a unpaid judgment against X, and X acquires Blueacre in a transaction in which X grants a purchase money deed of trust to Bank. Creditor's pre-existing judgment would cause a judgment lien to attach to Blueacre at the instant the deed is delivered to X; thus, by the time that X executes and delivers the purchase money deed of trust, a strict “first-in-time” approach would mean that Bank would take its deed of trust lien subject to Creditor's already-existing judgment lien (which would take priority over Bank's deed of trust). That would be an inappropriate result as a policy matter; X would have acquired Blueacre only by virtue of Bank's extension of purchase money credit; giving Creditor priority would be to accord Creditor an undeserved windfall. Restatement § 7.2 comment b.

Section 7.2(b) avoids this result by making clear that Bank's purchase money deed of trust would have priority over Creditor's judgment lien, regardless of whether Bank's deed of trust was recorded. The “whether or not recorded” language in Section 7.2(b) merely makes clear that recording is irrelevant with respect to Bank's priority as against Creditor's pre-existing lien claim. This is sensible, as the recording act is designed to protect subsequent purchasers from unrecorded interests — not pre-existing claimants like Creditor.

This does not mean, however, that a purchase money deed of trust need never be recorded to establish priority versus any mechanic's lien claimant or other conflicting interest. As the comments to the Restatement make clear, “recording is necessary in order to protect the purchase-money mortgagee against liens or other interests that arise against the purchaser-mortgagor subsequently to the latter's acquisition of title.” Restatement § 7.2 comment b.

Comment 2. In a footnote, the Court also justified its result by pointing out that the broad rule urged by Hawthorn Bank could create a foreseeable circular priority problem. For example, suppose the following sequence of events: (1) Owner grants purchase money deed of trust to First Bank. (2) Contractor begins work. (3) Owner grants deed of trust to Second Bank, which promptly records (and has no notice/knowledge of First Bank's unrecorded deed of trust). (4) Contractor files mechanic's lien claim. In this scenario, if the Hawthorn Bank argument was correct, then First Bank's unrecorded deed of trust would have priority over Contractor's mechanic's lien; Contractor's mechanic's lien would have priority over Second Bank's later deed of trust; and Second Bank's deed of trust would have priority over First Bank's unrecorded deed of trust. By requiring recording of the purchase money deed of trust to give effective notice to the Contractor (as well as to subsequent mortgagees like Second Bank), the Court's holding avoids such a circular priority problem.

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