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In re: Manhattan West Mechanic's Lien Litigation, 131 Nev. Adv. Op. 70 (Sept. 24, 2015)

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REAL PROPERTY: LIEN PRIORITY

Summary

The Court determined that (1) a general subordination agreement effects a partial subordination; and (2) NRS 108.225 does not preclude parties from contracting for a partial subordination.

Background

Scott Financial Corporation (SFC) made multiple loans to Gemstone Apache (Apache) for the purpose of developing a property (Manhattan West) in Las Vegas. The first three loans for \$38 million were recorded in July 2006 (the Mezzanine Deeds of Trust) and financed the purchase of the property. In April 2007, the petitioner APCO Construction (APCO), the contractor hired by Apache began construction, setting the priority date for mechanic's lien services.

In early 2008, Gemstone Development West, LLC (GDW), purchased Manhattan West from Apache and assumed their loan obligations. GDW then borrowed an additional \$110 million from SFC (the Construction Deed of Trust) on February 7, 2008. SFC and GDW entered into an agreement subordinating the Mezzanine Deeds of Trust to the Construction Deed of Trust. The subordination agreement did not state whether the subordination was complete or partial and did not address the priority of any potential mechanic's liens.

The relationship between APCO and GDW deteriorated. APCO stopped work on Manhattan West and filed suit against GDW and SFC. SFC and APCO both moved for summary judgment on the issue of lien priority. SFC argued that the subordination agreement partially subordinated the Mezzanine Deeds of Trust to the Construction Deed of Trust and left APCO's mechanics' liens unaffected. APCO argued that the subordination agreement completely subordinated the Mezzanine Deeds of Trust to the Construction Deed of Trust, prioritizing the Mezzanine Deeds of Trust after APCO's mechanics' liens and the Construction Deed of Trust. It further argued that NRS 108.225 (Nevada's mechanic's lien statute) precluded the Construction Deed of Trust from taking priority over APCO's mechanics' liens.

The district court determined the subordination agreement only partially subordinated the Mezzanine deeds of Trust to the Construction Deed of Trust and left the Mechanics' liens in second-priority position.

Discussion

The question the Court answered is whether a mechanic's lien takes priority over a contractually subordinated debt by creditors of a common debtor either because (1) the subordination agreement constitutes a complete subordination, or (2) NRS 108.225 precludes the partial subordination of an existing lien.

¹ By Kristian Kaskla.

The subordination agreement effected a partial subordination.

Some courts have come to different conclusions about whether a partial or complete subordination is created when the subordination agreement is silent on the issue. Here, the Court adopted the majority approach in *Caterpillar Fin. Servs. Corp. v. Peoples Nat'l Bank, N.A.*, holding that general subordination agreements lead to partial subordination.² Under this approach nonparties are unaffected by subordination agreements as the priorities of the parties simply swap. Complete subordination by contrast would “drop the subordinating creditor to the bottom of the priority ladder.”³ This approach could benefit nonparties to the subordination agreement. There doesn't seem to be a reason a subordinating party would insist on such an approach. The Court determined that absent a clear intent to create a complete subordination a “commonsense approach weighs in favor of partial subordination.”

NRS 108.225 does not preclude partial subordination.

APCO argued that NRS 108.225 does not permit partial subordination. SFC argued that the statute does not preclude other lienholders from contracting for partial subordination regarding their lien priorities. The Court held that NRS 108.225 gives priority to mechanics' liens over liens that attach after the commencement of the work and that it does not address subordination agreements between other lienholders.⁴ The Court concluded that the statute does not prohibit negotiations between lienholders with priority over mechanics' liens and those with lesser priority in situations where the mechanics' liens will be left in exactly the same positions as if the agreement never occurred. Thus, the statute does not preclude partial subordination. The fact that the subordination agreement did nothing to alter the amount of debt APCO was junior to was crucial to the Court's decision that the agreement did not violate NRS 108.225. Granting APCO first priority even though the subordination agreement did not prejudice APCO whatsoever would be an over-reading of the statute.

Conclusion

The Court affirmed the ruling of the district court holding that the subordination agreement effectuated a partial subordination. NRS 108.225 does not preclude parties from contracting for a partial subordination. The Court denied APCO's petition for a writ of mandamus and prohibition.

² 710 F.3d 691, 693–94 (7th Cir. 2013)

³ *Id.*

⁴ NEV. REV. STAT. § 108.225 (2013)