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Summary of In Re: Fontainebleau Las Vegas Holdings, LLC, 128 Nev. Adv. Op. 53

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PROPERTY – LIEN PRIORITY

Summary

The Court considered three questions certified by the United States Bankruptcy Court for the Southern District of Florida relating to the application of equitable subrogation and enforceability of contractual subordination against mechanics' lien claimants under Nevada's mechanics' and materialmen's lien statutes, codified in NRS Chapter 108.

Disposition/Outcome

The Court concluded that equitable subrogation does not apply against mechanics' lien claimants. The Court also held that, pursuant to NRS 108.2453 and NRS 108.2457, subordination agreements purporting to subordinate mechanics' liens prospectively are not enforceable. However, non-prospective waivers of priority by mechanics' lienholders may be enforced provided they comply with the provisions of NRS 108.2457.

Factual and Procedural History

Fontainebleau Las Vegas Holdings, LLC (Fontainebleau), sought to construct and develop a \$2.8 billion hotel-casino resort. In 2005, Bank of America, N.A. (Bank of America), as administrative agent for a syndicate of lenders, loaned Fontainebleau \$150 million secured by a deed of trust in first priority position. Over 300 contractors and suppliers commenced work on the project, some of whom later asserted statutory mechanics' liens against the property. In 2007, the syndicated lenders agreed to loan Fontainebleau \$1.85 billion in additional construction financing. Proceeds from this loan fully satisfied the original first priority deed of trust and Fontainebleau executed a new first priority deed of trust in favor of the Bank of America. The 2007 credit agreement included a provision requiring the general contractor and subcontractors to subordinate their liens to the Bank of America deed of trust.

Construction proceeded for a time, but at some point it appears that Bank of America refused to advance further funds upon the existing loan commitments. Thereafter, work ceased on the development and Fontainebleau filed a petition for relief under Chapter 11 of the bankruptcy code. The case was filed with the United States Bankruptcy Court for the Southern District of Florida. Pursuant to these proceedings the property was sold, with the outstanding liens to attach to the proceeds, and the Chapter 11 reorganization was converted to a Chapter 7 liquidation.

Appellant Wilmington Trust FSB (Wilmington Trust) succeeded Bank of America as administrative agent for the lenders. In 2009, Wilmington Trust filed an adversary proceeding in bankruptcy court against respondents, a multitude of contractors, subcontractors, and suppliers that have asserted statutory mechanics' liens against the property. To determine lien priority for

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distribution of the proceeds, the bankruptcy court certified three questions to the Nevada Supreme Court summarized as follows:

- 1) Whether the syndicate's mortgage is senior to the mechanics' liens by virtue of the legal doctrine of equitable subrogation and/or loan replacement and modification?
- 2) Whether N.R.S. Chapter 108 prohibits the use of either equitable subrogation or replacement and modification found in the Restatement (Third) of Property – Mortgages §§ 7.6 and 7.3 respectively?
- 3) Whether subordination agreements executed by certain mechanics and materialmen lien claimants, purporting to subordinate their liens, are enforceable?

Discussion

Chief Justice Cherry wrote the unanimous opinion for the Court sitting en banc.²

The Court declined to answer the first question since it is largely factual and the discovery process is in its infancy.

A. Do Nevada's mechanics' and materialmen's lien statutes prohibit the use of equitable subrogation?

On the second question, the Court acknowledged that it had previously applied the Restatement doctrine of equitable subrogation³ in the realm of priority of mortgages.⁴ Equitable subrogation allows “a later-filed lienholder to leap-frog over an intervening lein[holder]”⁵ by permitting “a person who pays off an encumbrance to assume the same priority position as the holder of the previous encumbrance.”⁶

However, the question of whether the doctrine displaces the priority afforded to mechanics' lien claimants by N.R.S. 108.225 had not been previously addressed. The Court reviewed the history of mechanics' liens and found that they are “a ‘product of legislative fiat’ in derogation of common law”⁷ and thus mechanics' liens “ha[ve] no place in equity jurisprudence”.⁸ Since “equitable principles will not justify a court's disregard of statutory requirements”,⁹ the Court held that the unambiguous language of N.R.S. 108.225 precludes the application of the doctrine of equitable subrogation with respect to the priority of mechanics' lienholders. The language of NRS 108.225 unequivocally places mechanics' lien claimants in an unassailable priority position.

²² Justice Pickering voluntarily recused herself from participation in the decision of this matter.

³ Under the Restatement (Third) of Property: Mortgages, a mortgagee will be subrogated when it pays the entire loan of another as long as the mortgagee “was promised repayment and reasonably expected to receive a security interest in the real estate with the priority of the mortgage being discharged, and if subrogation will not materially prejudice the holders of intervening interests in the real estate.”

⁴ *Houston v. Bank of America*, 119 Nev. 485, 488, 78 P.3d 71, 73 (2003).

⁵ *Hicks v. Londre*, 125 P.3d 452, 456 (Colo. 2005).

⁶ *American Sterling Bank v. Johnny Mgmt. LV*, 126 Nev. __, __, 245 P.3d 535, 539 (2010).

⁷ *Fisher Bros., Inc. v. Harrah Realty Co.*, 92 Nev. 65, 67, 545 P.2d 203, 204 (1976).

⁸ *Lamb v. Goldfield Lucky Boys Mining Co.*, 37 Nev. 9, 16, 138 P. 902, 904 (1914).

⁹ *Pellegrini v. State*, 117 Nev. 860, 878, 34 P.3d 519, 531 (2001).

B. Are subrogation agreements executed by mechanic's lien claimants enforceable?

With regards to the third question, the Court found that the statutory scheme and legislative history of N.R.S. Chapter 108 forbids the enforcement of a prospective subordination agreement by a mechanics' lienholder. However the Court also found that neither N.R.S. 108.2453 nor N.R.S. 108.2457 completely prohibits a waiver or impairment of the right to a mechanics' lien after it arises. Thus, non-prospective subordination agreements may be enforced as long as they comply with the requirements of N.R.S. 108.2457.

Conclusion

The Restatement doctrine of equitable subrogation does not apply with respect to the priority of mechanics' liens. In addition, contract provisions which attempt to prospectively subordinate mechanics' liens are unenforceable. By contrast, non-prospective waivers of priority of mechanics' liens may be enforced provided they strictly comply with the requirements of N.R.S. 108.2457.