



Priority of Construction Liens

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In Michigan, it is generally common knowledge that contractors may file a construction lien to secure payment for their labor or material costs provided on a project. There is often uncertainty, however, regarding whether the contractor's construction lien will have priority over interests, such as a mortgage, that a bank or another entity has recorded prior to the construction lien. According to MCL 570.1119(3) of the Construction Lien Act ("CLA"), a construction lien will have priority over all other interests recorded subsequent to the first actual physical improvement. MCL 570.1103(1) defines an "actual physical improvement" as follows:

"Actual physical improvement" means the actual physical change in, or alteration of, real property as a result of labor provided, pursuant to a contract, by a contractor, subcontractor, or laborer which is readily visible and of a kind that would alert a person upon reasonable inspection of the existence of an improvement. Actual physical improvement does not include that labor which is provided in preparation for that change or alteration, such as surveying, soil boring and testing, architectural or engineering planning, or the preparation of other plans or drawings of any kind or nature. Actual physical improvement does not include supplies delivered to or stored at the real property.

Recently, the Michigan Court of Appeals examined this provision in *Michigan Pipe & Valve-Lansing Inc. v Hebler Enterprises, Inc.*,^[1] when it affirmed a trial court's decision holding that a plaintiff's construction lien had priority over a bank's mortgage filed subsequent to an actual improvement on a property. In this case, Windy Pines View, LLC was the owner of property in St. Johns, Michigan and intended to develop the property into a 77-Unit residential subdivision. To secure financing on the project, Windy Pines granted a mortgage on the property to Firstbank. Two days earlier, a well drilling company drilled a 245 foot deep well on the property. Windy Pines, however, capped the well after it decided the subdivision would receive its water supply from Bingham Township. Two years later, Windy Pines contracted with Hebler Enterprises to build the infrastructure and

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roads for the subdivision. Hebler purchased the pipes and other materials from plaintiffs. After completion of the project, Windy Pines paid Hebler in full, however, Hebler failed to pay the plaintiffs. As a result, plaintiffs recorded construction liens and filed a complaint against Hebler. The trial court held that the well drilled two days before Firstbank recorded its mortgage constituted an "actual physical improvement."

Firstbank appealed the trial court decision and argued the well was not an "actual physical improvement" because it did not add value to the property. The Michigan Court of Appeals disagreed reasoning that nothing in the definition of "actual physical improvement" requires an improvement add value to the property.

In addition, Firstbank also argued that the well did not constitute an actual physical improvement because it was only a test well and, thus, falls under MCL 570.1103(1)'s exception for labor performed in preparation for a change or alteration. The appellate court dismissed this argument reasoning that exception does not include labor which makes a "readily visible physical change to the property," such as digging a well.[2]

In *Jeddo Drywall Inc. v. Cambridge Investment Group Inc.*,[3] plaintiffs recorded a construction lien after defendant failed to pay plaintiffs for the labor and materials they supplied to build a residential structure in a subdivision in 2006. In 2005, in exchange for a \$757,500 loan, defendant executed a land acquisition future advance construction mortgage with Amtrust Bank on a parcel of property that included the subdivision. The plaintiffs claimed their construction lien had priority over Amtrust Bank's mortgage and argued that, in 2002, the Wayne County Department of Public Services issued three permits to different entities to provide the same subdivision with paved roads, utility construction, storm sewers and other services. Plaintiffs also submitted appraisals sent to a prior lending bank which provided that the improvements made in 2002 to the underground utilities were completed. The trial court agreed with plaintiffs and held there was an actual physical improvement made to the subdivision.

AmTrust Bank appealed the trial court's decision and argued that the plaintiffs' lien could not relate back to the improvements made to the subdivision in 2002 because those improvements were part of a different project that was owned and managed by different entities. The Michigan Court of Appeals, however, held that plaintiffs' labor and materials related to the same project as the improvements done in 2002. The court stated that "a change in general contractors does not establish the existence of a new project if the work that is the subject to the lien was part of a single project." In addition, the court added that the different entities, which received permits in 2002, had partial common ownership and created a continuous development project.

Most recently, in *E.T. Mackenzie Company, v Sutton Place-Raisin Twp. LLC and United Bank & Trust*,[4] the Michigan Court of Appeals reversed a trial court's decision and held that plaintiff's construction lien had priority over a bank's first mortgage lien. In this case, defendant, Sutton Place, wanted to purchase two parcels of property located in Raisin Township. Prior to purchasing the property, Sutton Place had some well testing performed by a company called Alcock Drilling ("Alcock"). In August 2006, Alcock completed eight wells on eight different lots on the property. On September 29, 2006, Sutton Place granted a mortgage to defendant, United Bank & Trust, for an amount of \$2,000,000 and purchased the property for \$900,000. On May 17, 2007, plaintiff, E.T. Mackenzie Company, agreed to provide storm sewers, retention basin beds, road construction and other services for the property. Sutton Place paid E.T. Mackenzie \$854,951.79 for its services



but E.T. Mackenzie maintained that Sutton Place still owed \$325,008.30. As a result, E.T. Mackenzie recorded a claim of lien and filed a complaint against Sutton Place. After a hearing on E.T. Mackenzie's motion for partial summary disposition, the trial court held that United Bank & Trust's mortgage had priority over E.T. Mackenzie's lien because the bank recorded its mortgage first and Alcock's well tests did not meet the statutory definition of an actual physical improvement.

The Michigan Court of Appeals, however, reversed the trial court's decision. The court, citing *Mich Pipe & Valve-Lansing, Inc.*, held that Alcock's well testing created an actual physical improvement. The court reasoned that the wells were "readily visible and of a kind that would alert a person upon reasonable inspection of the existence of an improvement." As a result, the wells did not qualify under the exception to an actual physical improvement provided in MCL 570.1103(1).

It is worth noting that United Bank & Trust also argued that E.T. Mackenzie's construction lien did not have priority over its mortgage because E.T. Mackenzie's work was not related to Alcock's well drilling. The court disagreed stating that the CLA does not specify that the specific projects must be related. Nonetheless, the court added that if such a requirement existed, the well testing and E.T. Mackenzie's subsequent work were related because the improvements were necessary for the construction of the subdivision as a whole.

In sum, contractors who file construction liens can have priority over a previously filed mortgage when an actual physical improvement has occurred on the subject property. Priority will be decided on a case-by-case basis. The actual physical improvement must be one that is "readily visible and of a kind that would alert a person upon reasonable inspection of the existence of an improvement." Indeed, mere preparation, such as surveying, soil boring, or testing, will be insufficient to grant a contractor priority over a bank's recorded mortgage.

[1] *Michigan Pipe & Valve-Lansing Inc. v Hebel Enterprises, Inc.*, Case No. 294530, 2011 WL 1004660 (Mich App March 22, 2011).

[2] It is worth noting that, under MCL 570.1119(4), an advance made pursuant to a mortgage recorded subsequent to the first actual physical improvement shall have priority if the mortgagee has received a contractor's sworn statement, made disbursements pursuant to the sworn statement and has received waivers of lien from the contractor and all subcontractors, laborers, and suppliers who have provided notices of furnishing.

[3] *Jeddo Drywall Inc. v. Cambridge Investment Group Inc.*, Case No. 295726, 2011 WL 3299812 (Mich App August 2, 2011).

[4] *E.T. Mackenzie Company, v Sutton Place-Raisin Twp. LLC and United Bank & Trust*, Case No. 297864 (Mich App November 22, 2011).
