UNITED STATES BANKRUPTCY COURT

IN AND FOR THE DISTRICT OF ARIZONA

In Re **KAVIR DEVELOPMENT,** **Debtor.**	**Chapter 11 Proceedings** **Case No. 08-BK-02978-PHX-CGC** **Adv. No. 08-00370-CGC**
CAVIR DEVELOPMENT, INC.; MAX MAZOON, **Plaintiffs,** **v.** **JAPEH YOUSSEFI, et al.,** **Defendants.**	**UNDER ADVISEMENT DECISION RE: MOTION FOR SUMMARY JUDGMENT**

I. Introduction

Cavir Development, Inc. ("Cavir") and Stearns Bank Arizona ("Stearns") dispute the relative priorities of their liens on a project developed by the debtor, Kavir Development, LLC ("Kavir").

Cavir was Kavir's general contractor for the Gilbert Corporate Office Center ("Project") at Neely and Baseline in Gilbert, Arizona ("Property"). Stearns made two loans to Kavir; a land loan secured by a deed of trust recorded on July 27, 2000 and a construction loan that paid off the land loan and provided financing for construction of the Project. The construction loan was secured by a deed of trust recorded on August 19, 2005. Cavir filed its mechanic's lien on August 30, 2005.

Cavir claims that work commenced on the Project in late June or early July, but in no event later than August 4, 2005. Accordingly, Cavir argues that under Arizona law, its lien, even though recorded after Stearns' deed of trust, is entitled to priority. Stearns counters that there is a factual dispute regarding when construction commenced and that, in any event, it is entitled to be subrogated to the priority of the land loan which was recorded well prior to any conceivable date that construction may have commenced.

Based on the above, Cavir seeks summary judgment that its mechanic's lien is first in priority. The Motion is opposed by Stearns, Kavir and Olympic Communication's Inc. Reduced to their essence, there are two key issues before the Court: 1) when did work commence on the Project; and 2) even if work commenced before August 9, 2005, is Stearns entitled to subrogation.

II. Facts

The following facts are largely undisputed except as noted.

On July 1, 2005, Cavir and Kavir entered into a general contract for the Project ("General Contract"). Stearns recorded its deed of trust on August 19, 2005, paying off the land loan and providing funds for construction of the project.

Maricopa County issued two permits related to the Property: 1) a dust control permit to IS Development on May 24, 2005; and 2) a certificate for construction and extension of a groundwater system to Japeh Youssefi, CEO, Kavir Development, LLC on June 9, 2005.

On July 7, 2005, Lee A. Lewis issued an invoice for grubbing the Property. According to his deposition, he agreed to do the work in late June or early July and the work was completed after the Fourth of July. The invoice was addressed to Max Mazoon, the principal of Cavir, not directly to Cavir.

Cavir retained Plote Backhoe Services, Inc. ("Plote") to perform earthmoving services. Cavir's subcontract with Plote was effective as of August 5, 2005 and signed August 18, 2005 ("Plote Contract"). As part of its billing, Plote submitted an invoice dated September 20, 2005 to Cavir ("September Invoice"). Included in the September Invoice is

a separate invoice from K.L.P. Enterprises, Inc. ("KLP") to Plote dated August 4, 2005 and stamped received August 18, 2005 for work done on August 4, 2005 ("KLP Invoice"). There is a hand-written note on the September Invoice stating that the work was done for "Cavir's Gilbert Professional Dev."

Cavir filed two 20-Day Notices to support it claimed mechanic's lien; one dated August 30, 2005 and the other dated August 31, 2006.

On July 24, 2007, the Environmental Protection Agency ("EPA") issued Notice of Violation ("NOV") to Cavir development for air quality violations at the Property and a separate property in Glendale, Arizona. The NOV refers to four inspection dates: June 22, 2005; July 5, 2005; September 11, 2006; and December 29, 2006. The report does not state on which days violations were observed specifically at the Property.

III. Arguments of the Parties

Cavir asserts that, as a matter of law, its mechanic's lien is in first priority. It argues that under A.R.S. § 33-992, mechanics liens have priority over a lender's lien not recorded within 10 days of the commencement of construction performed under the contract. Here, the deed of trust was recorded August 19, 2005. According to Cavir, the Maricopa County permits, the grubbing by Lee Lewis, the earthmoving by Plote, and the NOV from the EPA are all evidence that construction commenced before August 9, 2005 (10 days prior to Stearns' recordation date).

Stearns counters that Cavir failed to comply with Arizona law because the lien was untimely recorded, it contained an incorrect legal description, it did not properly reference the General Contract, and service of the 20 Day notice was improper.

Stearns disputes Cavir's characterization of when construction commenced, arguing: 1) that obtaining permits does not equate to commencing construction; 2) that Lee Lewis was not a subcontractor under the General Contract and if anything was an independent contractor; and 3) that the work done by Plote is not persuasive because the invoice date is September 20, 2005, the Plote contract date is August 18, well within the 10-day reach back

period and Cavir's internal construction schedule suggests that Plote started earthwork on August 29, 2005, ten days after the deed of trust was filed.

Finally, Stearns argues that even if construction did commence before August 8, 2005, it is entitled to be subrogated to the priority of the land loan, citing *Lamb Excavation, Inc. v. Chase Manhattan Mortg. Corp.*, 208 Ariz. 478, 95 P.3d 542 (Ariz.App. 2004).

In addition to Stearns' arguments, Kavir argues that Cavir must show, under the 20-day language of A.R.S. 33-992.01(F), that work was done between August 9 and 18, 2005. Absent such a showing, their lien does not have first priority. Cavir counters that this reading of the statute is simply incorrect.

IV. Analysis

A. Extent of Ruling

As a preliminary matter, the Court notes that the existence and amount of Cavir's lien is in dispute and is not addressed in the pending motion. The determination of this matter is to be decided at the upcoming trial.

B. Summary Judgment Standard

Summary judgment shall be granted where no genuine issue of material fact exists and the moving party is entitled to a judgment as a matter of law. Fed. R. Civ. P. Rule 56(c); Fed. R. Bankr. P. Rule 7056(c). "[T]he mere existence of some alleged factual dispute . . . will not defeat [a] . . . motion for summary judgment; the requirement is that there be no *genuine* issue of *material* fact." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 247-248 (1986). A genuine issue of material fact exists when "the evidence is such that a reasonable jury could return a verdict for the nonmoving party." *Id.* at 248. The moving party bears the initial burden of demonstrating to the court that no genuine issue of material fact exists and to further show that the moving party is entitled to judgment in their favor as a matter of law. *Celotex Corp. v. Catrett*, 477 U.S. 321, 323 (1986). The burden then shifts to the nonmoving party to show that there are specific facts creating a genuine issue for trial. *Id.* at 324.

C. Commencement of Construction

All parties agree that the applicable law is Arizona's Mechanics' and Materialmen's Liens statute as interpreted by the Arizona courts. *See* A.R.S.§ 33-981 *et seq*.

Lien priority is governed by A.R.S. §33-992. "[A] mechanic's lien attaches and begins to accrue at the time the labor is commenced or the materials are furnished." *James Weller, Inc. v. Hansen*, 21 Ariz.App. 217, 223 (Ariz.App. 1973) (citing to *Wylie v. Douglas Lumber Co.,* 39 Ariz. 511, 8 P.2d 256 (1932); *Wahl v. Southwest Savings & Loan Ass'n*, 106 Ariz. 381, 476 P.2d 836 (1970); A.R.S. § 33-992). Further, "the recording of a mechanic's lien relates back to the act of the contractor." *Adams Insulation Co. v. Los Portales Associates Ltd. Partnership*, 167 Ariz. 112, 113 (Ariz. App. 1991). Under the "'first spade' rule, all mechanics' liens have preference over any other encumbrances which are perfected subsequent to the first date that any person begins improvement on property." 56 C.J.S. Mechanics' Liens § 243 (citing to Missouri law.)

However, A.R.S. §33-992(A) provides an exception to the "first spade" rule for mortgages "given as security for a loan made by a construction lender … if the mortgage or deed of trust is recorded within ten days after labor was commenced." Here, the deed of trust securing the Stearns' construction loan was recorded on August 19, 2005; therefore, Stearns' lien has priority over any mechanics lien (including Cavir's) *if* work commenced on August 9, 2005 or later. Likewise, if construction commenced on August 8, 2005 or earlier, then all mechanics' liens, including Cavir's, have priority over Stearns.

Work must be commenced pursuant to a contract for the mechanic's lien statute to apply. A.R.S. § 33-992(E). Therefore, any work that commenced before July 1, 2005, the date of the General Contract, is not protected by the statute. Thus, Cavir must show that the work that constitutes "commencement of construction" was performed: 1) between July 1, 2005 and August 8, 2005; 2) on the Project; and 3) under the General Contract. Cavir relies on the following support its claim: 1) permits issued by Maricopa County; 2) work in June/July 2005 by Lee Lewis; 3) work in August 2005 by Plote; and 4) the NOV.

The permits issued by Maricopa County are not probative on this issue because: 1) they were issued before the General Contract was effective; 2) they were issued to IS Development and Japeh Youssefi, (CEO, Kavir Development, LLC), not to Cavir; and 3) in any event, they do not show that actual construction commenced between July 1 and August 8, 2005.

The NOV is equally unpersuasive. The NOV lists four dates that violations were observed: 1) June 22, 2005; 2) July 5, 2005; 3) September 11, 2006; and 4) December 29, 2006. Only July 5 falls within the relevant date range and the NOV does not specify the observation noted relates to the Property. This is inadequate for purposes of summary judgment.

The record suggests that Mr. Lewis' work on the Property might have commenced in early July 2005. Mr. Lewis testified that he performed grubbing work right after the Fourth of July, a time period that corresponds with his invoice dated July 7. However, that invoice was issued to Max Mazoon, not Cavir. This creates a genuine issue of fact whether the work was performed under the General Contract, thereby precluding summary judgment on this basis.

What remains is Plote's earthmoving, documented by the KLP Invoice dated August 4, 2005, attached to Plote's September Invoice. The language - "8/4/05 Tractor & Disc w/operator" – clearly indicates that the billing was for services performed on August 4, 2005. The KLP Invoice was addressed to Plote, an acknowledged subcontractor of Cavir; therefore, the KLP/Plote work was performed under the General Contract. With these facts, Cavir has met its initial burden under *Celotex*, having shown that work was performed between July 1, 2005 and August 8, 2005, on the Project under the General Contract. The burden now shifts to Stearns to raise a material issue of fact.

Stearns raises several objections to the September Invoice, none of which creates a material factual dispute within the meaning of *Celotex*. Stearns argues that the September 20, 2005 billing date establishes the date the labor was performed. However, there is nothing in the September Invoice to suggest that that date coincides with the date the work was done.

Indeed, the only evidence on that point is the KLP Invoice, which clearly showed that work was performed on August 4.

Stearns also objects on two additional grounds: 1) the Plote Contract was signed on August 18, 2005, effective as of August 5, 2005; and 2) the August 29, 2005 start date for earthwork on the construction timeline. Neither of these raises a material issue of fact. The Plote Contract dates do not change the fact that KLP commenced work on the Project on August 4, 2005, the General Contract for which was signed July1, 2005. If anything, the August 5, 2005 effective date reinforces the fact that work was being done on the Project in early August 2005. The construction timeline is equally unpersuasive. There is no evidence that this document was anything other than an internal road map for the Project or was tied to actual dates of work performed.

Accordingly, the Court concludes that work on the Project commenced no later than August 4, 2005 and will grant Cavir partial summary judgment on that issue.

D. Subrogation

Stearns argues that even if construction commenced prior to August 9, 2005 it still holds a first priority position based on equitable subrogation. In support of its theory, Stearns relies on instructions given to its title company as evidence of its intent to be subrogated as required under *Lamb*. Cavir counters that there is no express or implied agreement for subrogation.

Under *Lamb*, a subsequent lender whose loan pays off a preexisting senior encumbrance may be entitled to be substituted into the "priority position of the primary lienholder, despite the recording of an intervening lien." 95 P.3d at 544. The Court restated Arizona law in this way:

> As this court stated in *Herberman v. Bergstrom*, 168 Ariz. 587, 590, 816 P.2d 244, 247 (App.1991), "[f]or equitable subrogation to apply, there must be an agreement, either express or implied, that the subsequent lender will be substituted for the holder of the prior encumbrance." *See also* [*Peterman-Donnelly Eng'rs & Contractors Corp. v. First Nat'l Bank of Ariz.*, 2 Ariz.App. 321, 408 P.2d 841 (1965)]. In addition, the subsequent mortgagee must not be a volunteer. *Id.* Because subrogation is a creature of equity, "its application may be defeated by intervening rights which would be prejudiced by the substitution." *Id.* at 326, 408 P.2d at 846. As an equitable construct,

> "[i]t rests upon the principle that substantial justice should be attained, regardless of form." [*Mosher v. Conway*, 45 Ariz. 463, 468 46 P.2d 110, 115 (1935)].

Lamb, 95 P.2d at 545-46.

Thus, there are two fundamental questions that control whether subrogation is appropriate: 1) is there an express or implied agreement to subrogate; and 2) would subrogation unfairly prejudice the rights of intervening creditors. The *Lamb* court specifically held that additional considerations, such as whether the subsequent lienholder had notice of the intervening right or was a sophisticated lender, were not relevant under Arizona law. *Id.,* 95 P.2d at 546.

Stearns has not sought summary judgment on subrogation. To the extent that Cavir asks the court to resolve the issue, the record is inadequate to make the factual determinations necessarily underpinning the application of this equitable remedy. Therefore, the issue will abide trial.

E. Impact of 20 Day Notice

Cavir and Kavir agree that the matter is interpreted under Arizona's Mechanics' and Materialmen's Liens statute. *See* A.R.S.§ 33-981 *et seq.* There is a dispute, however, regarding the interplay between Sections 992(A) and 992.01. Kavir claims that because Cavir filed its Notice more than 20 days after labor began, August 30, 2005, if there is a lien, it cannot attach before August 10, 2005. The Court disagrees.

As a prerequisite to a mechanic's lien, a contractor is required to give notice within twenty days of beginning work to the owner of the property. A.R.S. 33-992.01(F). Failure to do so will limit the extent of the lien to work done "twenty days prior to the service of the notice and at any time thereafter." A.R.S. § 33-992.01(E). Kavir argues that the language in Section 992.01(E) limits the date-range in which Cavir can establish the priority of its lien. Cavir misinterprets the statute. The filing of the 20-Day notice does not impact the commencement of work; Section 992.01 affects only the extent of the lien, not its priority.

VI. Conclusion

For the foregoing reasons, partial summary judgment is granted on the sole issue that work commenced on the Project no later than August 5, 2005 for purposes of establishing lien priority.

In all other respects, the motion is denied. Counsel for Cavir is to submit a form of order.

So ordered.

DATED: February 24, 2009

Charles G. Case II
UNITED STATES BANKRUPTCY JUDGE

COPY of the foregoing mailed by the BNC and/or sent by auto-generated mail to:

DAVID C. TIERNEY
JOSHUA BLAKE MAYES
SACKS TIERNEY PA
4250 N DRINKWATER BLVD #400
SCOTTSDALE, AZ 85251-3647,
Attorneys for Cavir Development, Inc. and
Attorneys for Max Mozoon

DEAN M. DINNER
NUSSBAUM & GILLIS
14500 N. NORTHSIGHT BLVD.
SUITE 116
SCOTTSDALE, AZ 85260-0001 ,
Attorneys for Debtors

RICHARD Q. NYE
RICHARD Q. NYE, LTD.
4201 N. 24TH STREET, SUITE 100
PHOENIX, AZ 85016 ,
Attorneys for Amy Youssefi and
Attorneys for Japeh Youssefi

SEAN P. O'BRIEN
CHRISTOPHER MCNICHOL
ERIC ALLISON MCGOTHLIN
GUST ROSENFELD P.L.C.
201 E. WASHINGTON, #800
PHOENIX, AZ 85004-2327,
Attorneys for Stearns Bank Arizona

CLAUDIO E. IANNITELLI
CHEIFETZ IANNITELLI MARCOLINI PC
1850 N CENTRAL AVE 19TH FLR
PHOENIX, AZ 85004,
Attorneys for Olympic Communications, Inc.