

Mechanics Liens and Mortgage Foreclosures

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A. CREATION OF MECHANICS LIENS

1. Introduction

A mechanic's lien is an interest in real estate, created by statute, and designed to protect the rights of individuals who contribute to the making of improvements of real property, through the furnishing of labor, skills, materials, or machinery. Minnesota Statutes Section 514.01, et. seq., governs mechanics liens in Minnesota. Minnesota Statutes Section 514.01 reads as follows:

Whoever performs engineering or land surveying services with respect to real estate, or contributes to the improvement of real estate by performing labor, or furnishing skill, material or machinery for any of the purposes hereinafter stated, whether under contract with the owner of such real estate or at the instance of any agent, trustee, contractor or subcontractor of such owner, shall have a lien upon the improvement, and upon the land on which it is situated or to which it may be removed

If the property owner fails to pay contractors, subcontractors, or material suppliers, such individuals – if they have complied with all the statutory requirements necessary to obtain a mechanic's lien – enjoy the protections that a mechanic's lien offers. A mechanic's lien provides several forms of protection. First (and most practically) a mechanic's lien provides leverage by acting as an encumbrance on the improved property that will often prevent the property owner from being able to obtain loans or sell the property to a potential buyer. Second, a mechanic's lien protects the lien claimant by providing a security interest in the improved property. Having a security interest, the lien claimant has priority to use the improved property to satisfy his debt in the event of foreclosure and sale. Third, an individual holding a mechanic's lien may, in the discretion of the court, be awarded cost and attorney's fees incurred in attempting to collect on his debt. Lastly, but really only relevant to subcontractors and material suppliers, a mechanic's lien provides a party not in "privity of contract" with the property owner, a direct cause of action against the property owner.

In most cases, the property owner will necessarily know about the improvements being made to his land. However, there are some situations in which he may not have actual knowledge. In these situations, Minnesota courts have held that “the property interests of a landowner who has no knowledge of improvements to his or her property cannot be subjected to a lien for those improvements.” *Anderson v. Harrison*, 160 N.W.2d 560, 562 (Minn. 1968). One common example of when this might occur is in the context of landlord-tenant relationship. In this context, it is established law in Minnesota that a tenant does not constitute an agent, trustee, contractor or subcontractor of an owner of real property. *Master Asphalt Co. v. Voss Constr. Co. of Minneapolis*, 535 N.W.2d 349 (Minn. 1995). Accordingly, the courts will not impute knowledge and notice of improvements, authorized by the tenant, to the landlord/property owner. *Id.* at 353.

2. The Pre-Lien Notice Requirement

Although mechanic’s liens are normally to be construed liberally to protect the rights of contractors and suppliers, the requirement of pre-lien notice is to be construed strictly to prevent the unfairness that would arise from a contractor or supplier foreclosing on a mechanic’s lien on the property of an unsuspecting owner. *See Dolder v. Griffin*, 323 N.W.2d 773 (Minn. 1982). Accordingly, all contractors and suppliers (with some limited exceptions discussed below) must give notice, and even minor deviations from the time and manner of notice required by statute may result in the contractor or supplier losing the protections provided by the mechanic’s lien.¹

¹ There is a caveat that, as to subcontractors and suppliers, if a good faith effort was made to comply with the form of the notice required by statute, minor deviations will not result in losing mechanic’s lien protections, unless the property owner or another lien holder proves damages that resulted from the deviation. Minn. Stat. § 514.011, subd. 2(b).

a. Contractors

“Every person who enters into a contract with the owner for the improvement of real property and who has contracted or will contract with any subcontractors or material suppliers to provide labor, skill or materials for the improvement” must provide pre-lien notice. Minn. Stat. § 514.011, subd. 1. If there is a written contract, the notice must be included in the contract, or if there is no written contract, then the pre-lien notice must be in a separate notice delivered personally or by certified mail within 10 days of the agreement for improvement. *Id.* Specifically, the pre-lien notice “must be in at least 10-point bold type, if printed, or in capital letters, if typewritten” *Id.* The content of the notice must state that:

- (a) Any person or company supplying labor or materials for this improvement to your property may file a lien against your property if that person or company is not paid for the contributions.
- (b) Under Minnesota law, you have the right to pay persons who supplied labor or materials for this improvement directly and deduct this amount from our contract price, or withhold the amounts due them from us until 120 days after completion of the improvement unless we give you a lien waiver signed by persons who supplied any labor or material for the improvement and who gave you timely notice.

Id.

b. Subcontractors and Material Suppliers

Subcontractors and suppliers are also required to give pre-lien notice to preserve their mechanic’s lien. As with the notice required of contractors, the notice required of subcontractors and suppliers must be in at least 10-point bold type, if printed, or in capital letters, if typewritten. The subcontractor or supplier must send notice within 45 days of first furnishing labor, skill, or materials, and the notice must read as follows:

This notice is to advise you of your rights under Minnesota law in connection with the improvement to your property.

Any person or company supplying labor or materials for this improvement may file a lien against your property if that person or company is not paid for the contributions.

We (name and address of subcontractor) have been hired by your contractor (name of your contractor) to provide (type of service) or (material) for this improvement. To the best of our knowledge, we estimate our charges will be (value of service or material).

If we are not paid by your contractor, we can file a claim against your property for the price of our services.

You have the right to pay us directly and deduct this amount from the contract price, or withhold the amount due us from your contractor until 120 days after completion of the improvement unless your contractor gives you a lien waiver signed by me (us).

We may not file a lien if you paid your contractor in full before receiving this notice.

Minn. Stat. § 514.011, subd. 2.

c. Exceptions to the Requirement of Pre-Lien Notice

As mentioned above, there are certain situations when pre-lien notice will not be required of a contractor or supplier. Section 514.011, subd. 4 describes these situations in which pre-lien notice will not be required. First, no notice is required when the contractor or supplier “is managed or controlled by substantially the same persons who manage or control the owner of the improved real estate.” Minn. Stat. § 514.011, subd. 4a. Second, no notice is required if the improvement consists of or provides more than four family units and is completely residential in character. *Id.*, subd. 4b. Third, pre-lien notice is not required when the property is in non-agricultural use or is wholly or partially in non-residential use, and the improvement:

- (a) is to provide or add more than 5,000 total usable square feet of floor space; or
- (b) is an improvement to real property where the existing property contains more than 5,000 total usable square feet of floor space; or
- (c) is an improvement to real property which contains more than 5,000 square feet and does not involve the construction of a new building or an addition to or the improvement of an existing building.

Id. subd. 4c.

Finally, pre-lien notice is not required if the general contractor has no subcontractors, nor if the property owner is in direct contract with the subcontractors, such as is the case when there is no general contractor or the property owner acts essentially as the general contractor. In *Owens v. Lakehead Elec. Co.*, No. A04-156, 2004 WL 2093616 (Minn. Ct. App. Dec. 14, 2004), the Minnesota Court of Appeals held that if a property owner acts as his own general contractor, then he is not entitled to pre-lien notice under Minn. Stat. § 514.011. *Id.* at *5. The court noted that “[t]his exception to pre[-]lien notice is consistent with the general purpose of pre[-]lien notice; the exception applies in cases where the owner is not unsuspecting.” *Id.* (quoting *Pelletier Corp. v. Chas. M. Freidham Co.*, 383 N.W.2d 318, 321 (Minn. Ct. App. 1986)). Similarly, the court in *Leach v. Johnson* held that “the notice required of subcontractors contemplates a general contractor-subcontractor relationship” No. C7-99-1157, 2000 WL 462345, at *2 (Minn. Ct. App. Apr. 25, 2000). Thus, when there is no general contractor, as was the case in *Leach*, “the pre-lien notice required by Minn. Stat. § 514.011, subd. 2, does not apply.” *Id.* See also *Corwin v. Bednark*, No. C9-95-518, 1995 WL 434473, at *1 (Minn. Ct. App. Jul. 25, 1995) (stating that “[s]ubdivision 4a will exempt from the notice requirement subcontractors who are under direct contract with the property owner) (citing *Simonson Cashway Co. v. Merickel Constr. Co.*, 391 N.W.2d 903, 906 (Minn. Ct. App. 1986)); *Metro Custom Homes, Inc. v. Rol*, No. C9-89-722, 1990 WL 463, at *1 (finding that the exception in subdivision 2 applies when the contractor is under a direct contract with the property owner).

3. Limits

The question of what constitutes an improvement is sometimes a source of debate. The Minnesota Court of Appeals has held that an improvement is “[a] permanent addition to or

betterment of real property that enhances its capital value and that involves the expenditure of labor or money and is designed to make the property more useful or valuable as distinguished from ordinary repairs.” *Merritt v. Mendel*, 690 N.W.2d 570, 572-73 (Minn. Ct. App. 2005) (quoting *Taney v. Indep. Sch. Dist. No. 624*, 673 N.W.2d 497, 504 (Minn. Ct. App. 2004)). A contractor or supplier may still be entitled to a mechanic’s lien even if his labor, skill, or materials, in fact, were not actually used or incorporated into the real property, so long such labor, skill, or materials were furnished in good faith. *See Minneapolis Sash & Door Co. v. Hedden*, 154 N.W. 511, 512 (Minn. 1915).

Difficulties also arise when the party seeking a mechanic’s lien is further removed from the owner. Although it is clear that the general contractor and the immediate subcontractors are entitled to a mechanic’s lien, it is less clear if subcontractors of the immediate subcontractors are entitled to a mechanic’s lien. There is caselaw that suggests that these subcontractors are still entitled to a mechanic’s lien. *See Spafford v. Dulth, R. W. & S. R. Co.*, 51 N.W. 469 (Minn. 1892). Beyond this degree of separation, it is doubtful that such subcontractors would be entitled to a mechanic’s lien. Similarly, remote suppliers might not be entitled to a mechanic’s lien to the extent that it becomes more difficult to trace the specific materials, and quantity thereof, back to the remote supplier.

More limits on mechanic’s liens are present in Section 514.03. That section provides that the amount of a mechanic’s lien is confined to either the reasonable value of the work or the contract price. Minn. Stat. § 514.03, subs. 1 and 2. Moreover, a mechanic’s lien is confined to 80 acres, or, in the case of an agricultural homestead, 40 acres.

4. Mechanic's Lien Statements

A mechanic's lien ceases 120 days after a contractor or supplier's final contributions² to the improvement are completed, unless, within those 120 days, the contractor or supplier files a lien statement with the county recorder and serves a copy on the owner. Minn. Stat. § 514.08, subd. 1. The lien statement must set forth the contractor or supplier's intention to claim and hold a lien; the amount that is due for his contribution; the name and address of the claimant and the name of the person who furnished the contribution; the dates of the first and last contribution; a description and reasonable identification of the premises to be charged and the name of the owner; an acknowledgement that a copy of the statement must be served on the owner, his authorized agent, or the person whom entered into the contract with the claimant; and, if pre-lien notice was required under Minn. Stat. § 514.011, that such pre-lien notice was given. Minn. Stat. § 514.08, subd. 2.

B. FORECLOSURE OF MECHANICS LIENS

A holder of a mechanic's lien may commence a foreclosure proceeding so long as the lienholder has filed a lien statement and served a copy upon the owner and made all other lienholders defendants in the action. Minn. Stat. § 514.11. The lienholder must commence the foreclosure action within one year of the date of the holder's last contribution to the improved property. Minn. Stat. § 514.012, subd. 3.³ The proper venue for a foreclosure on a mechanic's lien is the district court of the county in which the real property or some part thereof is located.

² It should be noted, however, that trivial contributions meant solely to extend the time for filing may not, in fact, operate to extend the filing time. *See R.B. Thompson, Jr. Lumber Co. v. Windsor Dev. Corp.*, 374 N.W.2d 493, 498 (Minn. Ct. App.1985).

³ This is a jurisdictional requirement; if a lienholder fails to either file an action to enforce his mechanic's lien or to appear in an action commenced by another lienholder within one year, the mechanic's lien simply ceases. *See Bauman v. Metzger*, 176 N.W. 497 (Minn. 1920).

Minn. Stat. § 514.10. In addition to the obvious situation in which the lienholder is the plaintiff in the foreclosure proceedings he initiated, the lienholder can also be a defendant when another lien holder initiates foreclosure proceedings on his lien⁴, when the property owner initiates an action to determine damages or adverse claims, or when any person who has an interest in or lien against the property initiates an action to remove the mechanic's lien.

In a mechanic's lien foreclosure proceeding the summons must "state that the complaint has been filed with the court administrator[,]” . . . contain a notice that the action is brought to foreclose a lien, giving the amount thereof, and a brief description of the premises affected, and of the improvement out of which the lien arose” Minn. Stat. § 514.011. In addition, the summons "shall require each defendant to file an answer to the complaint with the court administrator within 20 days after service on the defendant.” *Id.*

An individual seeking to enforce his mechanic's lien must also be aware of the importance of filing a notice of lis pendens at the beginning of the foreclosure action. Minn. Stat. § 514.12, subd. 1. Although a failure to file a notice of lis pendens within one year of the lienholder's last contribution to the improvement does not prevent the lienholder from commencing an action to enforce his mechanic's lien, such a failure might result in the lienholder being unable to enforce his mechanic's lien against a subsequent bona fide purchaser, mortgagor or other encumbrancers.

There are some rules, specific to actions to enforce a mechanic's lien that should be noted. First, Minnesota courts have held that there is no right to a jury trial in an action to

⁴ If a lienholder is not named as a party in a mechanic's lien action, the lienholder may file an answer in the court without the need of first filing a motion to intervene. *See O.B. Thompson Elec. Co. v. Milliman & Larson, Inc.*, 128 N.W.2d 751 (Minn. 1964).

⁵ If the summons is served before the complaint has been filed with the court, service will be found to be ineffective. *See Miles Const. Co. v. Krumrey*, 133 N.W.2d 361 (Minn. 1965).

enforce a mechanic's lien. *See Johnson Serv. Co. v. Kruse*, 140 N.W. 118 (Minn. 1913). Second, a lienholder will generally be able to recover prejudgment interest at the legal rate, unless a contractual provision provides otherwise. *See* Minn. Stat. § 514.135. Third, in an action to foreclose on a mechanic's lien, the lienholder, if he prevails, may be awarded costs and disbursements, *see* Minn. Stat. § 514.14, as well as attorney's fees, *see Larson-Roberts Elec. Co. v. Burdick*, 127 N.W.2d 163 (Minn. 1964).

Beyond the specifics that have been mentioned in this section, an action to foreclose on a mechanic's lien – including judgment, sale, and redemption – will be conducted in the same manner as a mortgage foreclosure action. Minn. Stat. § 514.10. *See* Sections (C) and (D), *infra*, for additional information.

C. MORTGAGE FORECLOSURES BY ADVERTISEMENT

“The purpose of a mortgage foreclosure sale, whether by or by advertisement, is ‘to terminate all interests junior to the mortgage being foreclosed and to provide the sale purchaser with a title identical to that of the mortgagor as of the time the mortgage being foreclosed was executed.’” *Gerdin v. Princeton State Bank*, 384 N.W.2d 868, 871 (Minn. 1986) (citations omitted). Foreclosure by advertisement is entirely a statutory creation, governed by the provisions of Chapter 580 of the Minnesota Statutes. Foreclosure by advertisement is, generally the faster, cheaper, more efficient, more convenient, and more common form of mortgage foreclosure. It is an *in rem* proceeding, meaning that the mortgagee proceeds against the property itself, as opposed to initiating a legal proceeding against the mortgagor. Because a foreclosure by advertisement takes place in the absence of an adversarial legal proceeding, there is a risk that it might be challenged more easily.

1. Prerequisites to Foreclosure by Advertisement

In order to be eligible to initiate a foreclosure by advertisement in the event of default, the mortgage instrument must contain a “power of sale” provision. Minn. Stat. § 580.01. Thus, the right to foreclosure by advertisement is a contractual right. Accordingly, as long as there was a clear intent to create a power of sale, such power will be recognized. An example of a common “power of sale” provision is as follows:

Mortgagor hereby authorizes Mortgagee to foreclose this mortgage or to sell the mortgaged property as one tract or otherwise at public auction and convey the same to the purchaser in fee simple, agreeable to the statute in such case made and provided, the mortgagor to remain liable for any deficiency.

If the mortgage contains a power of sale (as most mortgages do), there are additional requirements that must be met before the mortgagee can foreclose by advertisement. First, there has to of course been a default.⁶ Although default usually occurs when the mortgagor fails to pay the principal and interest, default can be triggered under some other condition specified in the mortgage. If the mortgage provides for a default triggering condition that is unusual, foreclosure by action might be the better course, as that will have the finality of a judicial decision. The mortgagee must also provide notice of the default to the mortgagor including an explanation of the nature of the default, what needs to be done to cure the default, and when the deadline for curing is (which can not be less than 30 days from the date of the notice). *See* Minn. Stat. § 47.20, Subd. 8. In addition, the notice must state that failure to cure might result in acceleration of all sums owed on the mortgage, that the mortgagee has the right to reinstate the

⁶ Under Minn. Stat. § 580.29, parties holding a mortgage junior to the foreclosing party can prevent foreclosure by curing certain defaults – such as paying taxes, assessment, insurance premiums, and even interest and principal on the senior mortgage. Upon such an occurrence, the amounts paid to cure are simply added to the amount owed on the curing party’s mortgage.

mortgage, and that the mortgagor has a right to bring an action to challenge the default and foreclosure. *Id.*

Second, no “action or proceeding [can have been] instituted at law to recover the debt then remaining secured by such mortgage, or any part thereof” Minn. Stat. § 580.02(2). If such an action or proceeding has been instituted, it must have been discontinued or any attempt to execute on a judgment rendered in such action must have been unsatisfied, either in whole or in part. *Id.*

Third, the mortgage and any assignments thereof must have been recorded, unless “the mortgage is upon registered land, [then] it shall be sufficient if the mortgage and all assignments thereof have been duly registered.” Minn. Stat. § 580.02(3). Finally, there are two additional limitations that should be noted: 1) mortgage foreclosures, whether by advertisement or action, must be commenced within 15 years of the date of maturity on the debt, *see* Minn. Stat. § 541.03; and 2) the mortgagee must have paid the mortgage registration tax, *see* Minn. Stat. § 287.10.

2. Notice of Sale

Having confirmed that all of the prerequisites to foreclosure have been met, the mortgagee is now ready to issue a notice of sale. The mortgagee must give published notice⁷ of the foreclosure sale each week, in a qualified legal newspaper in the county in which the property lies, starting at least six weeks prior to the sale, and must serve (in the same manner one

⁷ Prior to the first published notice, but not more than six months prior, the mortgagee must also file a notice of pendency of the foreclosure with the county recorder. Minn. Stat. § 580.32, subd. 3. In addition, fourteen days before the sale, the mortgagee must mail a copy of the notice of sale to any party holding a redeemable interest in the property that has recorded a request for notice of mortgage foreclosure by advertisement with the county recorder. *Id.*, subds. 1 and 4. Failure to comply does not invalidate the foreclosure, but creates a cause of action in the party who recorded a request for notice against the foreclosing mortgagee. *Id.*, subds. 5 and 6.

would serve a summons in a civil action) upon the person in possession of the property at least four weeks prior to the sale. Minn. Stat. § 580.03. Note that the notice must be served on the person in possession, and not necessarily the mortgagor.

The notice of sale must include the name of the mortgagor and the mortgagee (and of the assignees, if any); the original principal amount of the mortgage; the date of the mortgage; when and where the mortgage was recorded, unless of course the mortgage is upon registered land, in which case the notice should state that the land is registered; the amount that the mortgagee claims is due on the mortgage; a legal description of the premises that substantially conforms with that in the mortgage; the time and place of the sale; the time allowed by law for redemption; specific language if the mortgagee desires to reduce the redemption period under Minn. Stat. § 582.032.

3. Reinstatement

Provided that the requirements of the notice of sale have been complied with, the right to foreclose on the mortgage is ripe and the foreclosure proceedings may begin. However, despite the initiation of the proceedings, a foreclosure sale might not necessarily occur. Under the statutes, the mortgagor, anyone holding a junior mortgage, lien, or other encumbrance, any other interested party, or anyone on the behalf of any of the above-mentioned, may, at any time prior to the sale, pay to the foreclosing mortgagee the amount actually due on the mortgage, plus attorneys fees, publications costs, service costs, and other lawful disbursement incurred in foreclosure proceedings. Minn. Stat. § 580.30. Upon such an occurrence, the mortgage is reinstated and the foreclosure proceedings are consequently abandoned. *Id.*

4. Foreclosure Sale

The mortgage foreclosure sale is conducted by the sheriff of the county in which the property, or some part thereof, is located. Minn. Stat. § 580.06. The sale must be in a public place between 9:00 a.m. and whenever the sun will set on that particular day. *Id.* The mortgagee may postpone the sale by publishing a notice of postponement in the newspaper that published the original notice of sale. Minn. Stat. § 580.07. In a situation where the property is comprised of several, distinct parcels, the sheriff shall sell them separately, and only sell so many as is necessary to the amount due on the mortgage, plus costs of the sale, interest, and taxes. Minn. Stat. § 580.08.

The property is to be sold to the highest bidder, which may include the mortgagee, so long as the mortgage is purchasing “fairly and in good faith.” Minn. Stat. § 580.11. To the extent that the sale results in a surplus on the amount actually owed on the mortgage, that surplus must go to the mortgagor or any assigns (which would include holders of junior liens or other encumbrances). Minn. Stat. § 580.10. In contrast, when the sale results in a deficiency on the amount owed on the mortgage, the mortgagee may obtain a deficiency judgment against the mortgagor only when the redemption period is for twelve months. Furthermore, the amount of the deficiency is limited to the difference between the amount received from the foreclosure sale (less expenses and costs) and the total amount that attaches to the sale proceeds under Minnesota Statutes Chapter 580. Accordingly, the right to a deficiency judgment in a foreclosure by advertisement is of little value.

Once the sale is made, the sheriff delivers a certificate of sale to the purchaser. This certificate of sale contains a description of the mortgage and the property sold, the price for each parcel sold, the time and place of the sale, the name of the purchaser, and the time allowed for

redemption.⁸ Minn. Stat. § 580.12. The certificate serves as prima facie evidence that the foreclosure sale complied with all of the requirements of the law, and that, once the redemption period has passed, that the purchaser has title in fee. Minn. Stat. § 580.19. In addition, other documents may be recorded, such as the affidavit of publication and the affidavit of service, to serve as prima facie evidence of the facts stated in those affidavits, Minn. Stat. § 580.15, and an affidavit of costs (recorded within 10 days of the filing of the certificate), Minn. Stat. § 580.17.

5. Redemption

Even though the sale has been completed and all certificates and affidavits have been recorded, the foreclosure action, technically, is not completed. That is because the statutes provide that the mortgagor⁹ has a right of redemption. This right of redemption extends for a period of either five weeks, six months, or twelve months, during which time the mortgagor can redeem the property by paying the sale price, plus interest from the time of the sale, taxes, and other costs. Minn. Stat. § 580.23, subd.1. The presumption is that the redemption period will be fore six months. However, the mortgagor can be entitled to a twelve month redemption period if any of the following are satisfied: 1) the mortgage was executed before July 1, 1967; 2) the amount claimed due on the mortgage is less than two-thirds of the original principal; 3) the mortgage was executed prior to July 1, 1987 and the mortgaged property's size at the time the mortgage was executed exceeded ten acres; 4) the mortgage was executed prior to August 1, 1994, the property's size was between ten and forty acres at the time of execution, and the

⁸ If the redemption period has been reduced to five weeks in compliance with statutory requirements, the certificate must be recorded within ten days of the sale, otherwise, the certificate must be recorded within twenty days of the sale. Minn. Stat. § 580.12.

⁹ In fact, the mortgagor's personal representative or assigns, the mortgagor's spouse, joint tenants, and judgment creditors, to name a few, all have the right of redemption as owners.

property was in agricultural use;¹⁰ or 5) the property exceeded forty acres at the time of execution. In contrast, the mortgagee can have the redemption period reduced, by court order, to five weeks, upon a showing made before the foreclosure sale that the property has been abandoned. Minn. Stat. § 582.032. The redemption period can also be extended by agreement between the mortgagor and the holder of the certificate of foreclosure sale, or by an automatic stay under the United States Bankruptcy Code.

If redemption is made during the redemption period, the foreclosure is annulled, and liens junior to the foreclosed mortgage are reinstated at the moment of redemption, and the right of redemption from the sale by junior lien creditors¹¹ is extinguished. During the redemption period, the mortgagor retains the right of ownership, which includes the right of possession and the right to rents and profits. *State v. Zacher*, 504 N.W.2d 468, 471 (Minn. 1993).

D. MOTGAGE FORECLOSURES BY ACTION

The plaintiff in a foreclosure by action is the foreclosing mortgagee or assignee. It is advised that the following defendants should be named: all the record owners (and each owners' spouse, if any) of the property, or any interest therein; any party holding a mortgage or lien junior to the foreclosing mortgage; and any party in possession. Therefore, an "owners and encumbrances" report should be obtained through a title company so that all proper parties are named in and served with the foreclosure complaint.

¹⁰ This also applies to mortgages executed after August 1, 1994 so long as at least a portion of the premises was classified in a certain way for tax purposes. See Minn. Stat. § 580.23, subd. 2(6) for further explanation.

¹¹ Creditors, such as a junior mortgagee or lienholder, can redeem within seven days of the expiration of the redemption period and in compliance with the provisions of Minn. Stat. § 580.24.

As opposed to a foreclosure by advertisement, foreclosure by action, since it is overseen by the court and constitutes a legal proceeding, is less susceptible to a later attack on the foreclosure. Aside from this factor, other reasons why a foreclosure might be preferable (or required) would include when the mortgage does not contain a “power of sale” provision, the mortgage is an “equitable mortgage,”¹² priority disputes will eventually be litigated, the mortgage was not recorded, the mortgaged property has a defective title, the amount of debt owed on the mortgage is in dispute, or a deficiency judgment is expected.¹³

Understanding which situations would call for foreclosure by action as opposed to foreclosure by advertisement, the specifics of how a foreclosure by action proceeds can now be discussed. As an initial matter, aside from the specific rules stated in Chapter 581, a mortgage foreclosure by action is “governed by the same rules and provisions of statute as civil actions.”¹⁴ Minn. Stat. § 581.01. Additionally, most of the rules, procedures, and guidelines mentioned in the preceding section on foreclosures by advertisement also apply to foreclosures by action. *See* Minn. Stat. §§ 581.02 and 581.10. An example of a complaint in a foreclosure by action is included below as Exhibit A.¹⁵

E. PRIORITY ISSUES

The priority of mortgages and mechanics liens is governed by the general rule of “first in time first in right.” There are, however, various exceptions to this general rule. The Minnesota Recording Act, Minn. Stat. § 507.01, et. seq., requires that any “conveyance of real estate,”

¹² A court of equity will treat a transaction as a mortgage when it has the intent, but not the form, of a mortgage. A deed or conveyance given as security for an obligation, such as a contract for deed, is an example of an equitable mortgage.

¹³ Recall that a deficiency judgment in a foreclosure by advertisement is of little value.

¹⁴ In a foreclosure by action, there is a right to a jury trial.

¹⁵ The example was taken from 6A Minn. Prac. §§ 50.5 and 50.6.

which “includes every instrument in writing whereby any interest in real estate is created, alienated, mortgaged, or assigned or by which the title thereto may be affected in law or in equity,” “be recorded in the office of the county recorder of the county where such real estate is situated . . .” Minn. Stat. §§ 507.01 and 507.34. The result of a failure to record is that the “conveyance” is void as against any subsequent “bona fide purchaser” – i.e., someone who “purchase[s] in good faith and for valuable consideration” without actual, implied or constructive notice¹⁶ of the prior, unrecorded conveyance – who records their conveyance before the previous, unrecorded conveyance. In legal terms, this makes Minnesota’s recording system a “race-notice” jurisdiction.

1. Mechanic’s Liens

The general rule of “first in time, first in right” does not apply to mechanics liens, as against each other. In other words, contractors and suppliers holding valid mechanic’s liens on improved property all have equal priority. Neither the dates on which a specific mechanic’s lienholder contributed, nor the date on which he filed his lien are relevant, because it would be unfair to grant priority on such bases, as, in the case of a new home, the contractor who lays the foundation naturally will have contributed before the electrician who wires the home.

As against mortgages and other liens and encumbrances, “first in time, first in right” does apply. A mechanics lien does not “attach prior to the actual and visible¹⁷ beginning of the improvement on the ground . . .” Minn. Stat. § 514.05, Subd. 1. However, subdivision 2 states that “[v]isible staking, engineering, land surveying, and soil testing services do not constitute the

¹⁶ If a conveyance has been properly recorded, the subsequent purchaser will, as a matter of law, be charged with constructive notice.

¹⁷ Visible means that the labor or materials would be found during a reasonably diligent inspection of the property. *See Jesco, Inc. v. Home Life Ins. Co.*, 357 N.W.2d 123 (Minn. Ct. App. 1984)

actual and visible beginning of the improvement” *Id.*, Subd. 2. Accordingly, so long as the mortgage or other lien or encumbrance is recorded before the actual and visible beginning of the improvement, then the mortgage or other lien or encumbrance will have priority over the mechanic’s lien. The same definition of “improvement,” discussed in the section on mechanic’s liens above, would be relevant to the question of what constitutes an “improvement” in a priority context. Although engineering and surveying do not constitute actual and visible beginning of work, if the mortgagee has “actual notice” of off-site work performed by an engineer or surveyor before the mortgagee records, any mechanic’s liens held by such engineer or surveyor will have priority over the mortgage. In contrast, if a holder of a mechanic’s lien has actual notice of an unrecorded mortgage prior to him furnishing contributions, then the mortgage will have priority over such a mechanic’s lien.

A mechanic’s lien can sometimes attach even before “actual and visible beginning of improvement. Under Minn. Stat. § 514.05, a contractor or supplier can file, with the county recorder, a record of his contract. If such a record of contract is filed prior to the mortgage or other lien or encumbrance, the contractor or supplier who filed the record of contract will have priority over the mortgage or other lien or encumbrance.

2. Mortgages

A mortgage will take priority from the date of its recording, except to the extent that the holder has actual or constructive knowledge of a potential superior claim, such as in the case of a party in possession. The issue of revolving lines of credit is common. As to mortgages securing such revolving lines of credit, priority attaches on the date of recording, despite the date of any advances on the line of credit. *See* Minn. Stat. §§ 507.325 and 508.555. A mortgage that provides for future advances, as opposed to a revolving line of credit, will take priority from the

date of recording if the future advances are obligatory. On the other hand, if the future advances are optional, junior liens will have priority over future advances that the mortgagee makes after receiving notice of the junior liens.

One exception to the “first in time, first in right rule” is a purchase money mortgage. A purchase money mortgage will have priority over previous judgments or liens against the mortgagor. In addition, a purchase money mortgage is also senior to the interests of a mortgagor’s spouse who was not a party to the mortgage.

Appendix

Exhibit A – Sample Complaint in a Foreclosure by Action

COMPLAINT

For cause of action, plaintiff alleges as follows:

1. Plaintiff is a _____ corporation with its principal place of business in _____ County.
2. Defendants A.B. and C.B. are residents of _____ County.
3. That on the _____ day of _____, the defendants A.B. and C.B., husband and wife, executed and delivered to plaintiff their promissory note *[describing it or setting forth a copy]*.
4. That at the same time and to secure payment of said note, said defendants executed and delivered to plaintiff a mortgage *[setting out a copy or fully describing it. If recorded, give date of filing for records, and book and page in which recorded, and that it provides for attorney's fees in amount allowed by statute]*.
5. The mortgage securing the note constitutes a validly perfected first lien on the mortgaged premises.
6. That no part of the principal or interest due on said note has been paid (except _____) and that there is now due thereon from said defendants to plaintiff the sum of _____ Dollars principal and interest thereon at _____ percent per annum from the _____ day of _____.
7. That said defendants, contrary to the terms of said mortgage, have failed to keep the premises therein described insured for the benefit of plaintiff and have failed to pay the taxes thereon and that plaintiff accordingly procured said insurance on the _____ day of _____ at a cost of \$ _____ and paid taxes for the year _____ on the _____ day of _____ in the amount of \$ _____, no part of which sums have been repaid to him, and both of which sums are secured by the terms of said mortgage and by statute to that effect.

WHEREFORE, plaintiff asks judgment:

1. Adjudging the amount due him from the defendants A.B. and C.B. to be the respective sums hereinbefore set forth with interest.
2. Adjudging that the mortgage is a first and prior lien on the mortgaged premises.
3. Adjudging and directing a sale of said mortgaged premises as provided by M.S.A. § 581.03, together with application of the proceeds of sale, after deduction of the cost thereof, to the payment of the amount adjudged to be due with interest to the time of payment and the costs and disbursements of this action including attorney's fees.
4. Barring and foreclosing each and all of the defendants from any equity of redemption or interest in said mortgaged premises except the right to redeem from said sale as provided by statute, and for execution against said A.B. and C.B. for any balance not paid by said sale.
5. Giving such other relief as may be just and equitable.

Additional Paragraphs will need to be inserted to fit particular situations, for example:

[Notice of Default and Mortgage Foreclosure]

On or about the _____ day of _____, plaintiff notified defendants of their default under the note and mortgage and (describe the type of notice required and that it was given by plaintiff by mail and that a copy is attached as an exhibit).

[Junior Interests]

That the defendants C.D. and E.F. claim, or appear of record to claim, some interest in or lien upon said mortgaged premises, but that said interests or liens, if existing, accrued since the lien of said mortgage and are subject thereto. [Requires no addition to the prayer for relief.]

[Debt Assumed]

That on the _____ day of _____, there was filed for record and recorded in Book _____ of Deeds, page _____, in the office of said Register of Deeds, a deed of said mortgaged premises executed by said A.B. and C.B. to X wherein and whereby said X assumed and agreed to pay said mortgage indebtedness, which agreement said X has wholly failed to perform. [In the prayer, add the name of X as one of the debtors.]

[Amount Due on Prior Mortgage]

That the defendant G.H. is the owner of a prior mortgage upon said premises upon which plaintiff alleges that the amount due at this time is the sum of _____ Dollars. *[Include in the prayer a request for adjudication of amount due on the prior mortgage and that the mortgaged premises be sold subject thereto.]*

[Reformation of Description]

That at the time of the execution of said mortgage, the said A.B. was the record owner of Lot One (1), Block Two (2), Smith's Addition to Podunk in said county and that it was the intention of the defendants A.B. and C.B. that said premises should be described by said mortgage and incumbered by the lien thereof and plaintiff accepted said security on the understanding and representation that it would and did relate to said premises; but that through inadvertence and by mutual mistake of the parties thereto, said mortgage was so drafted that the number of said block and all reference to the fact that said lot is located in a block was omitted with the result that as drafted the said mortgage does not describe the premises owned by said mortgagor, nor in fact any particular lot in said addition. [Add a subdivision to the prayer, reforming the description contained in said mortgage by inserting after the number of said lot the words "in Block Two (2)."]

[Receiver]

That at the date of execution of said mortgage said premises were of the fair market value of _____ Dollars and incumbered solely by a prior mortgage to _____ on which there was then due the sum of _____ Dollars, so that the indebtedness to plaintiff was secured by an equity of the defendants in said premises, above all prior incumbrance, of the value of _____

Dollars; but that since that date the defendants (1) have failed to make needed repairs, to wit _____, which fact has reduced the physical value of said premises to _____ Dollars, (2) have allowed interest due upon said prior mortgage to remain unpaid till there is now due upon said prior mortgage the sum of _____, (3) have failed to pay taxes and special assessments against said premises for the years _____ which now aggregate the sum of _____ Dollars and which constitute a lien upon said premises paramount and superior to both mortgages, and (4) that in consequence of defendant's failure to keep the premises insured as provided by each of said mortgages, plaintiff has caused them to be insured against fire (and windstorm) in the _____ Insurance Company for a period of _____ years from the _____ day of _____ at a cost of _____ Dollars. *[Add to the prayer an item as to "appointing a receiver for said mortgaged premises to collect the rents and profits and to make repairs," etc.]* The mortgage secures a note with a principal balance of \$500,000.00 or more and, as additional security for the repayment of such note, defendants granted plaintiff an assignment of all of the rents and profits from the mortgaged premises.