

UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF	)	
	)	
FARNAM ASSOCIATES LIMITED	)	
PARTNERSHIP,	)	CASE NO. BK91-80845
	)	
DEBTOR	)	A91-8119
	)	
FARNAM ASSOCIATES LIMITED	)	
PARTNERSHIP,	)	
	)	CH. 11
Plaintiff	)	
vs.	)	
	)	
ANDERSEN CONSTRUCTION COMPANY	)	
OF COUNCIL BLUFFS, INC.,	)	
GREGORY M. GORSKI, as Trustee	)	
for the PATRICIAN MORTGAGE	)	
COMPANY, THE PATRICIAN MORTGAGE	)	
COMPANY, a District of Columbia	)	
corporation, GREGORY M. GORSKI,	)	
as Trustee for KRUPP INSURED	)	
PLUS II LIMITED PARTNERSHIP,	)	
a Massachusetts limited	)	
partnership, KRUPP INSURED	)	
PLUS II LIMITED PARTNERSHIP,	)	
DEMARCO BROTHERS COMPANY,	)	
RAY MARTIN COMPANY, BAXTER	)	
ELECTRIC, INC., CONTINENTAL	)	
FIRE SPRINKLER COMPANY,	)	
and ALLIED CONSTRUCTION	)	
SERVICES, INC.	)	
	)	
Defendant	)	

MEMORANDUM

Hearing was held on February 6, 7 and 8, 1996. Appearances: Janice Woolley for the debtor Farnam Associates Limited Partnership (FALP), Neil Danberg for Patrician Mortgage Company (Patrician), Scott Rasmussen and Doug Lash for Andersen Construction Company of Council Bluffs, Inc., (Andersen).

This adversary proceeding is not a core proceeding under 28 U.S.C. § 157(b)(2). It concerns prepetition contract and state law lien rights and is otherwise related to the Chapter 11 case filed by FALP. The parties consented to this bankruptcy judge

determining and entering appropriate orders and judgments pursuant to 28 U.S.C. § 157(g)(2). This memorandum contains the findings of fact and conclusions of law required by FED. R. CIV. P. 52 as incorporated in FED. R. BANKR. P. 7052.

### Background

This adversary proceeding was brought by the debtor to obtain a determination of the extent and priority of various liens claimed by the defendants. One defendant, Andersen, filed an amended answer and cross-claim against other defendants, including Patrician. Summary judgment was entered in favor of plaintiff and Patrician by a memorandum filed on December 7, 1992, at Filing No. 124. Such summary judgment resolved divisions one and two of the cross-claim dealing with priorities asserted by Andersen and other defendants under the Nebraska Construction Lien Act and the assertion by Andersen and other defendants that the priority position and claim of Patrician should be equitably subordinated to that of the other defendants.

The two issues considered in this memorandum are:

1. Does Andersen have an equitable lien against any funds of the debtor which were in possession of Patrician when the Project was completed and Patrician learned that Andersen's claims had not been satisfied by FALP?

2. Does Andersen have any rights under an April 9, 1990, loan agreement between Schneider Ten, Inc. (Schneider), and Patrician?

### Decision

1. Andersen does not have the right to an equitable lien against any funds held by Patrician at the time of conclusion of the contract.

2. Andersen does not have any rights under the loan agreement between Patrician and Schneider dated April 9, 1990.

### Findings of Fact

1. At all times material hereto, FALP was the owner of certain real estate known as 900 Farnam Street, Omaha, Nebraska (the Property), and of renovation of the building on the Property which became known as the "Greenhouse Project" (the Project).

2. On June 2, 1987, FALP and Andersen entered into a lump sum construction contract dated December 30, 1986, in the amount of \$7,490,477 (the First Contract) providing for renovation of the Property.

3. Construction commenced on or about June 15, 1987, under the First Contract.

4. FALP initially had a loan commitment with Puller Mortgage Associates, Inc. (Puller), which was never funded.

5. As a result of this lack of funding, FALP failed to pay Andersen in accordance with the terms of the First Contract. On December 28, 1987, Andersen shut down the job and ceased work on the First Contract. On December 30, 1987, Andersen filed a Construction Lien in the amount of \$1,821,804 against the Property. On April 29, 1988, Andersen filed an Amendment to Construction Lien which increased the lien amount to \$1,953,718.

6. At the time of the First Contract, Andersen entered into written subcontracts (the Subcontracts) with various subcontractors, including Allied Construction Services, Inc. (Allied); Baxter Electric, Inc. (Baxter); Continental Fire Sprinkler Co. (Continental); and Ray Martin Company (Martin).

Andersen did not pay these subcontractors the amounts owed under the Subcontracts. As a result, Allied filed a construction lien for \$699,223 on December 30, 1987; Continental filed a construction lien for \$81,025 on January 6, 1988; and Martin filed a construction lien for \$1,000,927.65 on April 15, 1988.

7. From December 28, 1987 until January 24, 1989, neither Andersen nor the Andersen subcontractors performed any new construction at the site.

8. Patrician was contacted by FALP to determine whether it would provide funds to revive the Project. While analyzing the potential loan, Patrician requested information regarding the total cost of completing the renovation. Patrician received a document referred to as "Contractor's Cost Breakdown," signed by Herbert Andersen, the President of Andersen, which stated a total cost of \$5,138,547 to complete the Project. The Contractor's Cost Breakdown also provided a detailed breakdown of the remaining costs associated with the renovation.

9. On or about January 5, 1989, FALP and Patrician entered into a Building Loan Agreement (BLA) setting forth the terms under which Patrician would lend FALP the sum of \$8,810,900 for construction and permanent financing for the Property to be secured by, among other things, a first deed of trust on the Property. The BLA incorporated a copy of the \$5,138,547 cost of completion statement which both Andersen and FALP had previously signed. The BLA was structured to meet Department of Housing and Urban Development (HUD) requirements so that HUD would guarantee or insure the loan.

10. Patrician is an organization authorized by HUD to do all the paperwork, investigation and verification necessary to cause the mortgage to be insurable under HUD regulations and mortgage banking standards. When all of the construction activities are complete, Patrician, acting on its own behalf and on behalf of HUD, submits the mortgage loan to HUD, for insurance purposes, through a procedure the parties call "Final Endorsement."

11. On or about January 12, 1989, FALP and Andersen entered into another construction contract (the Second Contract) for completion and renovation of the improvement on the Property. The Second Contract incorporated the \$5,138,547 cost of completion.

12. On January 12, 1989, FALP executed and delivered to Andersen a Promissory Note (the Note) for \$462,316 and a "Collateral Understanding" (the Agreement). The Note included interest accrued on unpaid amounts remaining from the First Contract and increases in construction costs for completion of the Project which would not be paid from the Patrician financing arrangement.

13. Patrician was unaware of the Note and the Agreement at the time of closing, January 24, 1989.

14. On January 24, 1989, the Patrician Deeds of Trust, Assignments of Rents and Security Agreements dated January 5, 1989, in the amount of \$8,810,900, were filed in the Office of the Douglas County Register of Deeds.

15. On or about January 25, 1989, the sum of \$1,588,277.02 was paid through the American Land Title Co., Omaha, Nebraska, to Andersen and certain of its subcontractors from proceeds of the BLA funds advanced on behalf of FALP. This amount was apparently negotiated by Andersen and FALP to induce Andersen to release the construction liens and to get the Project restarted. The money came from that portion of the BLA that was not necessary to pay the \$5,138,547 lump sum construction contract to complete the Project.

16. Shortly thereafter, Andersen, as well as its subcontractors, executed and delivered a lien waiver entitled "Release of Construction Lien."

17. Work under the Second Contract commenced on January 25, 1989. A Certificate of Final Inspection, Occupancy and Compliance (Certificate of Occupancy) for the property was issued by the City of Omaha on November 22, 1989.

18. Although the Certificate of Occupancy was issued in November, 1989, Andersen and its subcontractors continued to work

on completion of the Project pursuant to direction from representatives of FALP and Patrician from November, 1989, to March, 1990. The work was itemized on a document referred to as a "punch list." This list included cleanup; testing of electrical and plumbing systems; installation of cabinets, doors, sinks, fire extinguishers, etc. All of the punch list work was required by the terms of the contract.

19. In February of 1990, Patrician received a certification from FALP that is on a HUD form used to prepare final settlement documents on the BLA and the Project. Patrician had no direct contact with Andersen at this time and, on March 15, 1990, based upon representations in the certificate made by FALP and assurances from a title insurance company that no liens were outstanding, Patrician distributed some remaining funds to FALP, held back some funds as permitted under the BLA and requested HUD to insure the loan. This procedure is referred to as "final endorsement." At that time, representatives of Patrician believed that there were no outstanding claims or amounts due Andersen.

20. Shortly thereafter, Andersen notified Patrician that it had not been paid in full. On March 23, 1990, Andersen filed a Construction Lien (the 1990 Lien) against the Property. On May 10, 1990, Andersen amended the 1990 Lien to reduce the amount due. After the initial Andersen 1990 Lien was filed, the Andersen subcontractors filed construction liens. The amount of the Andersen subcontractors' liens is included in the Andersen 1990 Lien.

21. FALP owes Andersen \$225,173.62 on the Second Contract. This is the net amount of retainage that was held back by FALP during the construction period and not paid at the end.

22. In addition to the amount FALP owes Andersen on the Second Contract, Andersen is due under a judgment rendered against FALP on the \$462,316 Note the sum of \$533,694.55, consisting of \$492,861.91 in the principal amount of the judgment and accrued interest thereon of \$40,832.64 from July 7, 1990 until April 16, 1991. Interest has not been accrued since the bankruptcy filing date.

23. Andersen also claims FALP owes it, from the First Contract, \$266,019 for unpaid retainage.

24. After Andersen notified Patrician that there were still amounts outstanding, Patrician and the general partner of FALP, Schneider, entered into negotiations to come up with a solution to the Anderson "problem" by the use of certain funds which would eventually be available to FALP pursuant to the BLA. Those funds have been discussed during the trial as GNMA points, and it was anticipated by FALP, Schneider, and Patrician that such funds

would be returned to FALP or Schneider once all of the documentation on the Project was completed. Those funds were estimated to be returned in July of 1990. Based upon the understanding of Patrician and Schneider that such funds would be available, they entered into a "loan agreement" whereby Patrician would loan Schneider approximately \$176,000 to be used to pay Andersen under the Second Contract and to be repaid between early April of 1990 and July 1 of 1990 from the GNMA points. The new loan, however, was contingent upon a written agreement from Andersen that such payment would cause Anderson to release the 1990 Lien and contingent upon instructions from Schneider or FALP with regard to the entity to which the funds should be delivered.

25. Andersen did not agree to accept \$176,000 in return for a release of the 1990 Lien. Therefore, the loan was not consummated. No funds were distributed to FALP, Schneider or any other entity under the terms of the proposed loan agreement. Patrician did not at any time receive any instructions with regard to the distribution of the funds. Patrician did receive the \$176,000 from GNMA in early June of 1990.

26. The filing of the 1990 Lien by Andersen was an event of default under the BLA between Patrician and FALP. The BLA permitted Patrician, upon default, to take a variety of actions to protect its interest. One of the actions that was authorized by the documents was the application of the GNMA points and any other funds being held by Patrician to the FALP obligation under the BLA. At some point after July of 1990, Patrician did apply all of the funds it held and all of the funds received from the GNMA points to interest, costs or principal under the BLA. The BLA had been in default since March, 1990, because monthly payments had not been made and because of the construction lien.

27. At the time the bankruptcy case was filed in April of 1991, there were no remaining FALP funds in the hands of Patrician from the GNMA points or any other source.

28. Patrician had a contract with FALP which was represented by the BLA and other related documents. FALP had a lump-sum contract with Andersen. In other words, the Project was to be built by Andersen at a fixed price, subject to any change orders. Neither the First Contract nor the Second Contract between FALP and Andersen was a cost plus contract. Andersen had no contract with Patrician.

29. At the time the BLA between Patrician and FALP was executed in 1989, Patrician also received from FALP and Andersen an assignment of the Second Contract between FALP and Andersen. In addition, Andersen, at the time of such assignment, promised in writing not to look to Patrician for any funds, but to look solely to FALP.

30. Patrician, under the BLA, had no obligation to make any disbursement directly to Andersen and had no obligation to see that Andersen was paid in full for construction services rendered to the Project.

### Conclusions of Law and Discussion

#### I. Division III of Crossclaim

##### A. General

The claim by Andersen that it is entitled to an equitable lien on debtor's funds that were in the possession of Patrician during the several months following the final endorsement of March 15, 1990, and which represented various deposits and escrows that the debtor had placed with Patrician at the beginning of the mortgage loan process, is based on the theory that Andersen has a right to such funds which is superior to that of the debtor and superior to that of Patrician. However, as found in the statement of facts listed above, Patrician had a contractual right to apply any funds from such deposits or escrows to servicing the BLA if FALP was in default. The fact is, as found above, FALP was in default immediately following the final endorsement on March 15, 1990, and continued in default thereafter until this very day. One element of the default was the failure of FALP to make regular monthly mortgage payments. Another element of the default was the failure of FALP to eliminate the 1990 Lien filed by Andersen.

It is the position of Andersen that because, after final endorsement, Patrician had possession of significant funds which would have been available to FALP, but for the default, Patrician had a duty to make certain those funds went to Andersen. Although such an argument is appealing, because Andersen is an innocent party in this whole problem, the argument is not compelling.

There is no statutory or case law authority for Andersen to impose an equitable lien against any interest of Patrician in this case.

##### B. HUD Handbook

Andersen claims that because Patrician operated as both a mortgage lender and a representative of HUD in the mortgage insurance process, Patrician must follow the "HUD Handbook," to the letter and if Patrician fails to do so, Patrician becomes liable to Andersen. The problem with Andersen's position is that the HUD Handbook is not a statute or regulation. It is a set of guidelines that Patrician agreed to follow when dealing with its borrower, FALP. By following the guidelines generally, the mortgage loan that Patrician and FALP agreed to would receive the

benefit of a mortgage insurance program that the parties have identified as Section 221(d) of the HUD Handbook. This is a federal government HUD program which provides financial benefits to borrowers and lenders. The substance of the benefits provided by such a program is not the subject of this case. HUD has accepted this loan for insurance and HUD is aware of this dispute and has not criticized the procedures followed by Patrician.

The HUD Handbook does not provide Andersen with a private cause of action. Roberts v. Cameron-Brown Co., 556 F.2d 356, 360, reh'g denied, 559 F.2d 1217 (5th Cir. 1977); M.B. Guran Co., Inc. v. City of Akron, 546 F.2d 201, 205 (6th Cir. 1976); See also Green v. St. Louis Housing Auth., 911 F.2d 65 (8th Cir. 1990). Andersen has no contractual relationship with Patrician. Patrician's duties, if any, pursuant to the HUD Handbook, are to FALP, the entity with whom Patrician had contracted to provide a mortgage loan, and to HUD, the governmental organization which accepts certain qualified loans for the Section 221(d) program.

#### C. Consent to Assignment

Andersen, by execution of a consent to the assignment of the Second Contract to Patrician, at the very beginning of this process in January of 1989, is contractually prohibited from bringing an action against Patrician for any amounts due under the Second Contract between Andersen and FALP. By that consent, Andersen specifically agreed not to look to Patrician for any funds due from FALP.

#### D. Equitable Lien

##### 1. Unclean Hands

Although Patrician claims that Andersen has no right to an equitable lien because Andersen did not act with clean hands, the decision does not rest upon any findings of unclean hands on the part of Andersen. There is no question that Andersen told Patrician that the cost of construction would be a little over \$5 million, when Andersen knew that there would be additional costs which were represented, in part, by the Note executed in January of 1989 by FALP to Andersen. However, notwithstanding the efforts by Patrician to paint Andersen's actions as improper and to convince the court that Patrician would not have proceeded with closing the mortgage loan and permitting construction to go forward had it known there were additional costs, there is insufficient evidence in this record to convince the court that Patrician ever communicated that information directly to Andersen. In other words, there is little, if any, evidence that Andersen was aware that the Agreement with FALP was inappropriate or improper. Andersen told Patrician that it would look to FALP for payment of a little over \$5 million, the source of which was to be the mortgage loan from Patrician. The fact that Andersen

was looking to FALP separately, and not Patrician, for more than \$400,000 in costs, may be relevant with regard to the reason why the Project failed on a cash flow basis, but is not relevant with regard to whether Andersen did something improper. Even under the HUD Handbook and any of the contractual documents in evidence, Andersen had no obligation to inform Patrician of the loan. If any entity had an obligation to do so, it was FALP. As Patrician emphasized throughout this case, it did not have any contract or dealings with Andersen concerning any money, at least until final endorsement.

Therefore, as mentioned above, this decision is not dependent upon Andersen's "unworthiness" because of unclean hands.

## 2. Equity Follows the Law

The equitable lien that Andersen attempts to impose upon funds once held by Patrician is an attempt to obtain a lien against funds due under the Second Contract. Those funds were subject to the first mortgage of Patrician and to the contractual right of Patrician to apply those funds to the mortgage loan if the mortgage loan was in default. Imposing an equitable lien on those funds would give Andersen a security interest with priority over that of Patrician's first mortgage, and there is no authority for such a procedure.

As Patrician has argued, Andersen is seeking in equity which it cannot obtain in law. Nebraska courts have consistently asserted that "equity follows the law." In Guy Dean's Lakeshore Marina, Inc. v. Ramey, the Nebraska Supreme Court stated, "[a] court of equity is bound by a contract as the parties have made it, and has no authority to substitute for it another and different agreement." 246 Neb. 258, 261, 518 N.W.2d 129, 131 (1994), (quoting Linn Corp. v. LaSalle Nat'l. Bank, 424 N.E.2d 676, 678 (Ill. App. Ct. 1981)). The court further noted that "equitable relief is not justified merely by the fact that a party will suffer some sort of economic detriment." Id. at 261-62; at 132 (quoting and following dissent in J.N.A. Realty Corp. v. Cross Bay Chelsea, Inc., 366 N.E.2d 1313 (N.Y. 1977)). The court then, following its own precedent, once again asserted:

The maxim "equity follows the law" in its broad sense means that equity follows the law to the extent of obeying it and conforming to its general rules and policies whether contained in common law or statute. The maxim is strictly applicable whenever the rights of parties are clearly defined and established by law.

Id. at 264, at 133 (citations omitted).

In this case, Patrician owes no duty to Andersen to provide funds to Andersen that were owed to Andersen by FALP. Patrician's contract was with FALP. Andersen agreed not to look to Patrician for any payment concerning the contract between Andersen and FALP. Andersen had a statutory right to a construction lien and has a contractual right to collect the payments from FALP, but FALP apparently has no funds. Andersen has no right under any of the contractual documents to any payment directly from Patrician. To put Andersen in a priority position ahead of Patrician would override all of the legal rights of the parties and give Andersen a special position because, and solely because, it is being economically deprived by the actions of FALP. See generally, Miller v. School Dist. No. 69 of Pawnee County, 208 Neb. 290, 295-96, 303 N.W.2d 483, 487 (1981) (stating general principles of equity).

The case law in Nebraska prohibits a suit in equity when the plaintiff has a plain and adequate remedy at law. Southwest Trinity Constructors, Inc. v. St. Paul Fire & Marine Ins. Co., 243 Neb. 55, 58, 497 N.W.2d 366, 368 (1993). In Southwest Trinity, the plaintiff sued both in equity and on a performance bond to seek recovery of amounts due and owing to it as a subcontractor, after the contractor had become insolvent. The court affirmed the lower court decision that since the plaintiff had the opportunity to make a claim under the statutory payment bond, the plaintiff could not also elect an equitable remedy. Id. Recently, the Nebraska Supreme Court stated:

An adequate remedy at law means a remedy which is plain and complete and as practical and efficient to the ends of justice and its prompt administration as the remedy and equity.

Clayton v. Nebraska Dept. of Motor Vehicles, 247 Neb. 49, 55, 524 N.W.2d 562, 567 (1994) (quotation omitted).

In this case, Andersen filed construction liens under the Nebraska Construction Lien Act. It has been determined by this court during previous proceedings on cross motions for summary judgment that Andersen's construction lien, if any, does not have as high a priority as Patrician's first mortgage. There is nothing in the statute nor in the case law that permits a claimant under a construction lien that does not have as high a priority as it wishes to resort to equity to seek that which the law will not allow. See Emry v. American Honda Motor Co., Inc., 214 Neb. 435, 447-49, 334 N.W.2d 786, 794-95 (1983).

Courts in jurisdictions other than Nebraska have specifically found that no equitable lien arises to favor one who had a lien right under a construction lien statute, even though the filing and execution of such a lien would not have provided the contractor with a complete remedy. See, for example,

Sequatchie Concrete Serv., Inc. v. Cutter Labs, 616 S.W.2d 162 (Tenn. Ct. App. 1980); and First Fed. Sav. & Loan Ass'n. v. Connelly, 437 N.E.2d 742 (Ill. App. Ct. 1982), rev'd. on other grounds, 454 N.E.2d 314 (Ill. 1983). In O'Connor Lumber Co., Inc. v. Pratt Gen. Contractors, Inc., (In re Pratt Gen. Contractors, Inc.), the court found that construction lien statutes similar to the Nebraska Construction Lien Act provide an exclusive remedy to the preclusion of equitable jurisdiction. 142 B.R. 47, 49-50 (Bankr. D. Conn. 1992),

There are Nebraska cases which suggest that an equitable lien may be appropriate if it is used in aid of existing legal rights and not in controvention of them. In Grantham v. Kearney Mun. Airport Corp., the court used an equitable lien as a remedy to provide a subcontractor who had filed a valid mechanic's lien in the funds delivered by the owner to the contractor and assigned by the contractor prior to the perfection of the mechanic's lien. 159 Neb. 70, 73, 65 N.W.2d 325, 327 (1954). The subcontractor was the only party with a legally enforceable lien, and the court fashioned an equitable remedy to protect that lien interest. Id. In this case, Patrician has a superior legal interest represented by a first mortgage, and there is no basis, under the maxim, "equity follows the law," to permit Andersen to leapfrog Patrician's priority.

*Corpus Juris Secundum* deals with the issue as follows:

[I]n the absence of an express contract, an equitable lien, based on those maxims which lie at the foundation of equity jurisprudence, may arise by implication out of general considerations of right and justice, where, as applied to the relations of the parties and the circumstances of their dealings, there is some obligation or duty to be enforced.

However, the tendency is to limit rather than extend the doctrine of constructive liens, and, in order that such a lien may be claimed, either the aid of a court of equity must be requisite to the owner so that he can be compelled to do equity or there must be some element of fraud in the matter as grounds of equitable relief.

53 C.J.S. *Liens* § 8 (1987) (footnote omitted); see also 51 AM. JUR. 2D *Liens* § 30 (1970).

In this case, there are no obligations or duties owing from Patrician to Andersen. Andersen has a legal remedy in the form of a construction lien, and the priorities with regard to the construction lien vis-a-vis the Patrician mortgage interest have previously been determined.

3. The Trans-Bay Doctrine Does Not Apply.

Andersen seeks to escape the clear provisions of the contractual documents by arguing that it has an equitable lien right against Patrician under a series of cases known as the Trans-Bay cases. However, a review of those cases reveals that Andersen has no such rights and that the cases are completely distinguishable from the present case.

In the case which created the doctrine, Trans-Bay Eng'rs & Builders, Inc. v. Hills, 551 F.2d 370 (D.C. Cir. 1976), the court considered the plaintiff's claim that it was entitled to an equitable lien on holdback amounts under a private mortgage insured by HUD. Trans-Bay was the general contractor for the "owner," MOHR, a nonprofit developer. Id. at 374. The private mortgagee declared a default and assigned the mortgage to HUD, which foreclosed. Id. at 375. Trans-Bay filed suit against HUD to recover the holdback, but the district court granted HUD's motion for summary judgment. Id. at 373.

The D.C. Circuit Court considered Trans-Bay's argument that it was entitled to the fund on the basis of traditional equitable doctrines. Id. at 381. The court began by noting: "HUD, was not merely the mortgage insurer for [the project], it was the guiding spirit behind the entire project." Id. The court concluded:

It is neither fair nor realistic to treat HUD as a mere mortgage insurer in this transaction....This was not a typical marketplace transaction where the contractor relied on the reputation and financial integrity of the owner to pay the construction costs. The owner here was a non-profit community based organization without any significant assets, a fact known to all parties....[MOHR was a] "*creature of HUD*" created and fully financed to carry out a government inspired social purpose.

Id. at 381-82 (citation omitted) (emphasis supplied).

Trans-Bay claimed "that it had been led to expect that HUD would make good on any sums rightfully due it under the construction contract," and the court saw "little that would lead to a contrary expectation," and concluded "without the expectation that HUD would cover such costs, no general contractor would ever agree to build [a project of this type]." Id.

The basis for holding HUD liable on an equitable lien theory was that HUD had assumed the role of titleholder. Armor Elevator Co. v. Phoenix Urban Corp., 655 F.2d 19, 21 (1st Cir. 1981) (citing Trans-Bay). The case did not apply or discuss applying

the equitable lien theory to private lenders, and subsequent cases have not imposed liability on a private lender based upon the Trans-Bay doctrine.

Andersen has relied on Bennett Constr. Co., Inc. v. Allen Gardens, Inc., 433 F. Supp. 825 (W.D. Mo. 1977). This is a typical Trans-Bay case. A contractor brought an action against HUD to recover unpaid retainages after the nominal owner of the Project defaulted in its obligation to the original mortgagee. Id. at 827-28. The contractor claimed that it was entitled to the holdback fund as a matter of equity. Id. at 830. The court, citing Trans-Bay, found that HUD "was the guiding spirit behind the entire project." Bennett, 433 F.Supp. at 835 (citing Trans-Bay, 551 F.2d at 381). "[HUD] knew from the beginning that [the project owner] was incapable of offering any financial support to the project development." Bennett, 433 F. Supp. at 835 (emphasis supplied). The court then concluded that "[t]he sum and substance of the relationship between HUD and the nominal owner of the project is that [the project owner] was a 'creature of HUD' used to effect a governmental program of low income housing." Id. (citations omitted).

Bennett does not extend the Trans-Bay doctrine to private lenders. As a result, Andersen may not rely on Bennett to establish an equitable lien against Patrician.

In ATC Petroleum, Inc. v. Sanders, the court considered the assertions of two suppliers who claimed they were entitled to an equitable lien on a holdback fund after the contractor on a Small Business Administration (SBA) project failed to maintain current payments on their accounts. 860 F.2d 1104 (D.C. Cir. 1988). The appellate court found that while the SBA did not insure the contractor's performance, it did subsidize that performance. Id. at 1114. Even so, the "heavy dependence upon SBA subsidies by the contractor did not bring [the] case within the rationale of Trans-Bay." Id. The court found that the contractor did not exist merely as an entity through which the SBA could achieve its own objectives, as did MOHR in the Trans-Bay case. Id. Consequently, the court held that the suppliers were not entitled to relief under Trans-Bay.

A case somewhat analogous to the present case which specifically rejected the Trans-Bay doctrine is United States v. Big Apple Indus. Bldgs., Inc., 1993 WL 437787 (S.D.N.Y. Oct. 26, 1993). In that case, three contractors claimed that they were entitled to an equitable lien against the Economic Development Administration (EDA). The EDA foreclosed on the Project after the mortgagor, Big Apple, defaulted and the EDA filed a motion for summary judgment with regard to the priority of its lien. The contractors, relying "heavily" on the Trans-Bay doctrine, maintained that allowing the EDA to have such priority would constitute unjust enrichment. Id. at \*3. The court found that

the cases cited by the contractors were "easily distinguishable from the case at bar" and that the EDA did "not have the same relationship to the Property and its owner that HUD had [in the Trans-Bay cases]." Id. at \*4. At the time it became involved in the Project, Big Apple was a "for-profit enterprise already doing business." Id. The court found that there were no facts indicating that the EDA had a pervasive role in the management of the property, but, rather, that Big Apple had authority to make substantial changes in the Project. Id.

The logical conclusion reached after reviewing the case law is that Andersen is not entitled to rely upon the Trans-Bay doctrine and has no legal ground for imposing an equitable lien.

4. There Must be a Fund to Which an Equitable Lien can Attach

Even if an equitable lien did exist under Nebraska law in circumstances such as those present in this case, there must be a res to which the lien could attach. If there is no res "to attach," there can be no equitable lien. See 51 AM. JUR. 2D *Liens* § 24 (1970). Prior to the bankruptcy being filed and prior to this adversary proceeding being brought by the debtor, Patrician paid out the entire amount due under the BLA either to FALP, or pursuant to the loan documents, applied the funds to the loan obligations of FALP.

Comment E of Section 161 of the Restatement of Restitution provides:

An equitable lien can be established and enforced only if there is some property which is subject to the lien.

RESTATEMENT OF RESTITUTION § 161 cmt. e (1937).

This proposition was followed in Bonneville Power Admin. v. Washington Pub. Power Supply Sys., where a bank improperly allocated funds on a construction project. 956 F.2d 1497 (9th Cir. 1992). Even when funds are misallocated, "the bondholders are not entitled to a lien upon the now dissipated bond proceeds." Id. at 1508. The court cited comment e to Section 161 of the Restatement of Restitution, referred to above, and then held: In this case there is no "identifiable res" on which a lien can be imposed, because the allegedly misallocated funds have been disbursed." Id. at 1507.

The lender in this case has not retained any funds due under the BLA and is not in possession of any "identifiable res." As in Bonneville, the funds under the BLA have been fully disbursed, and there are no funds to which an equitable lien might attach.

Another example of the application of this rule can be found in the case of Monfort, Inc. v. Kunkel, (In Re Morken), where the court refused to impose an equitable lien under Minnesota law, stating that an equitable lien is merely a form of a constructive trust. 182 B.R. 1007, 1022 (Bankr. D. Minn. 1995). The court added that in order for a bankruptcy court to recognize an equitable lien or a constructive trust, it must have been recognized prior to the bankruptcy filing, and thus, as the court wrote:

Unless a court has already impressed a constructive trust upon certain assets...the claimant cannot properly represent to the bankruptcy court that he was, at the time of the commencement of the case, a beneficiary of a constructive trust held by the debtor. No court imposed a constructive trust before these cases were filed.

Id. at 1022 (quotation omitted).

A North Carolina appellate court, in Embree Constr. Group v. Rafcore, Inc., in reviewing the application of the doctrine of equitable lien, determined that an equitable lien should be limited to only those cases where there was an undisbursed loan fund:

This situation differs markedly from that in which the lender has disbursed all loan funds to the borrower, who diverts the funds to purposes other than paying contractors. See Lefcoe & Shaffer, Construction Lending and the Equitable Lien, 40 S. Cal. L. Rev. 444 (1967) (if funds disbursed once already, lender not unjustly enriched); Urban & Miles at 350 ("[T]here is justification for the [equitable lien] doctrine's application when the contractor has completed performance, the entire project itself is completed, and the lender forecloses, becoming the owner of the completed project seeking to retain undisbursed funds. But there is little justification for the doctrine's application when the lender has made a disbursement for all labor or materials furnished up through foreclosure without any knowledge of any unpaid claims, and funds are diverted from the project by the borrower. In that instance, application of the doctrine results in the inequity of the lender having to in effect pay twice for the same thing. Any application of the doctrine, therefore, should be restricted to obvious cases of unjust enrichment.").

411 S.E.2d 916, 922 n.3 (N.C. 1992).

Moreover, the Embree court specifically admitted that equitable liens have not generally been accepted:

In other jurisdictions, attempts made to reach construction funds remaining with the lender under equitable assignment, third party beneficiary, and trust fund theories have been generally unsuccessful.

Id. at 921 (citing William H. Higgins, Construction Lending-- General Contractor v. Lender, 54 N.C. L. REV. 952, 954 n.12 (1976); Edmund T. Urban, Future Advances Lending, 13 WAKE FOREST L. REV. 297, 344 n.281 (1977); Gordon Bldg. Corp. v. Gibraltar Sav. & Loan Ass'n, 55 Cal. Rptr. 884 (Cal. Ct. App. 1966)).

## II. Division Four of the Crossclaim

As mentioned above in the findings of fact, after Patrician learned that FALP had misrepresented to Patrician that Andersen had been paid in full on the second contract, Patrician worked with FALP to find at least a partial solution to the Andersen "problem." FALP had a right to payment or reimbursement of approximately \$176,000 in what has previously been discussed as GNMA points. Patrician entered into an agreement with FALP whereby Patrician would loan FALP approximately \$176,000 to be used to pay Andersen, and those funds were to be repaid to Patrician on or before July 1, 1990. A representative of Patrician testified at the trial that there were two unwritten pre-conditions to the proposed loan agreement. First, a written statement was required from Andersen acknowledging that the funds so released would extinguish all or virtually all of Andersen's remaining claims to funds under the Second Contract such that the 1990 Lien filed by Andersen could be removed. Second, wire instructions were required from Schneider (FALP's general partner) concerning a time and method of disbursement of funds.

Because the written loan agreement appears to be an integrated document and has an integration clause, all testimony concerning the two unwritten pre-conditions was objected to on the grounds that such testimony would introduce parol evidence concerning an integrated contractual document. This loan agreement was between Patrician and Schneider. The testimony which was allowed over the parol evidence objection is that the two additional unwritten conditions were actually terms of the loan agreement. Under Nebraska case law, the parol evidence rule cannot be invoked by a third party to prevent a party to a writing from adducing extraneous evidence as to the terms of a contract, even if that evidence varies or contradicts the terms of a writing. Grover, Inc. v. Papio-Missouri River Natural Resources Dist., 247 Neb. 975, 979-80, 531 N.W.2d 531, 534 (1994); see also State Bank of Beaver Crossing v. Mackley, 121 Neb. 28, 236 N.W.2d 165 (1931).

Factually, the funds were never disbursed pursuant to the loan agreement because Andersen did not provide a written statement concerning the release of the 1990 Lien and because no instructions were provided by Schneider as to the disbursement of the funds to Andersen, a title company or any other entity.

In Empfield v. Ainsworth Irrigation Dist., the Nebraska Supreme Court stated:

The general rule is where a contract is executed but its effectiveness or fulfillment is dependent upon the doing of an agreed-upon condition before it shall become a binding contract, such contract cannot be enforced unless the condition is performed.

204 Neb. 827, 832, 286 N.W.2d 94, 97 (1979); see also Metschke v. Marxsen, 176 Neb. 240, 125 N.W.2d 684 (1964); Chadd v. Midwest Franchise Corp., 226 Neb. 502, 412 N.W.2d 453 (1987).

The rule that contracts are not effective until conditions or pre-conditions have occurred, applies even where the condition precedent is dependent upon the act or will of a third person. The Nebraska Supreme Court has stated in favor of this proposition:

When an obligation to pay money is, by agreement, made to depend upon the action of another party, over whom neither party has control, payment cannot be exacted, unless the specific act is performed.

Coyle v. Janssen, 212 Neb. 785, 789, 326 N.W.2d 44, 47 (1982) (quotation omitted).

In Coyle, the contract was conditioned upon approval by one of the party's accountants. 212 Neb. at 786, 326 N.W. 2d at 46; see also O'Brien v. Fricke, 148 Neb. 369, 27 N.W.2d 403 (1947) (contract conditioned upon ability to obtain loans); Evans v. Platte Valley Public Power & Irrigation Dist., 144 Neb. 368, 13 N.W.2d 401 (1944) (contract conditioned upon the approval of a federal agency).

The pre-conditions to disbursement of the loan funds were never met, and the contract never did become effective. As a result, Andersen has no claim to any funds which were the subject of the Second Contract.

#### Conclusion

Andersen, although still owed over \$225,000 on the Second Contract by FALP, is not entitled to an equitable lien against

any funds of FALP once held by Patrician. Andersen has no right to the funds which were the subject of a loan agreement between Patrician and Schneider that was dependent upon conditions precedent, which did not occur. Judgment shall be entered in favor of Patrician and against Andersen on Counts III and IV of Andersen's cross petition.

Separate journal entry to be filed.

DATED: June 21, 1996

BY THE COURT:

Timothy J. Mahoney  
Timothy J. Mahoney  
Chief Judge

Copies faxed by the Court to:

PELSTER, MARTIN	390-9221
BURMEISTER, ANGELA	397-4633
EPSTEIN, CYNTHIA	397-1535
GOTSCHALL, JAMES	402-336-2294
WOOLLEY, JANICE	496-4494
STEINER, DWIGHT	341-8290
DANBERG, NEIL	397-8450
LASH, DOUGLAS/RASMUSSEN, SCOTT	345-8853
PISTILLO, MICHAEL	330-9911

Copies mailed by the Court to:  
United States Trustee

Movant (\*) is responsible for giving notice of this journal entry to all other parties (that are not listed above) if required by rule or statute.

UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF )  
FARNAM ASSOCIATES LIMITED )  
PARTNERSHIP, )  
 )  
\_\_\_\_\_  
DEBTOR(S) )  
 )  
FARNAM ASSOCIATES LIMITED )  
PARTNERSHIP, )  
 )  
Plaintiff(s) )  
vs. )  
 )  
\_\_\_\_\_  
Defendant(s) )

CASE NO. BK91-80845  
A91-8119

CH. 11

Filing No.

JOURNAL ENTRY

DATE: June 21, 1996

HEARING DATE: February  
6, 7 and 8, 1996

Before a United States Bankruptcy Judge for the District of  
Nebraska regarding Adversary Proceeding.

APPEARANCES

Janice Woolley, Attorney for debtor  
Neil Danberg, Attorney for Patrician Mortgage Company  
Scott Rasmussen and Doug Lash, Attorney for Andersen Construction  
Co. of Council Bluffs, Inc.

IT IS ORDERED:

Judgment is entered in favor of Patrician and against  
Andersen on Counts III and IV of Andersen's cross petition. See  
memorandum entered this date.

BY THE COURT:

Timothy J. Mahoney  
Timothy J. Mahoney  
Chief Judge

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