



Rainey • Kizer • Reviere & Bell plc

105 South Highland Avenue
Post Office Box 1147
Jackson, Tennessee 38302-1147
731.423.2414
Fax: 731.426.8111

BANKING LAW ALERT NEWSLETTER

BANK NOT SUCCESSFUL IN EQUITABLE SUBROGATION CLAIM

There have been several Appellate Court decisions in Tennessee over the last couple of years dealing with equitable subrogation as it relates to lien priority. The most recent of the cases is Blalock & Sons vs. Fairteen, LLC. In the Blalock case, Fairteen obtained financing for a project from BB&T. Approximately one year later, Fairteen needed additional funds for its project and obtained a new loan from M & I Bank (which paid off BB&T). Prior to the recording of the M & I Bank trust deed, Blalock (a subcontractor) commenced work on the project. M & I Bank knew at its loan closing that Blalock had started work on the project and was owed for prior work done in the amount of approximately \$1 million. Blalock refused to sign a Subordination Agreement in favor of M & I Bank. Nevertheless, M & I Bank continued to fund the project. From the M & I Bank loan, Blalock was paid over \$1 million for work Blalock had completed through the date of the loan closing. After the closing of the M & I Bank loan, Blalock continued to perform work on the project. Blalock received progress payments from Fairteen totaling over \$2.5 million. Thereafter, Fairteen defaulted on its contract with Blalock. Blalock recorded a lien in the amount of \$264,000.00. Then Blalock filed an action to perfect its lien. M & I Bank claimed its trust deed had priority over Blalock's lien under the doctrine of equitable subrogation.

The Court ruled that Blalock achieved "visible commencement of operations", as defined in TCA §66-11-101 (17), prior to M & I Bank's deed of trust being recorded. Therefore, Blalock's contractor's lien related back to commencement of work on the project and took priority over M & I Bank's trust deed. The Court of Appeals wrote that the cases universally require a showing that the party seeking subrogation is in a junior lien position because of fraud or a mistake of fact. The rationale of equitable subrogation is to prevent unjust enrichment. Equitable subrogation rests on the maxim that one should not be enriched by another's loss. Because M & I Bank knew of Blalock's lien position and proceeded with its loan in spite of that knowledge, the Court ruled that M & I Bank was not entitled to a priority position on its trust deed over the mechanic's lien of Blalock under the equitable subrogation theory.

OUR RECOMMENDATION: Equitable subrogation is difficult to achieve, but in a case where there has been a mistake of fact or fraud by a party claiming a superior lien position, the junior lien holder possibly could be successful in getting its lien position moved up to a superior lien position under the doctrine of equitable subrogation.

William C. Bell, Jr.
wbell@raineykizer.com

Laura A. Williams
lwilliams@raineykizer.com

Charles C. Exum
cexum@raineykizer.com

Adam C. Crider
acrider@raineykizer.com