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Priority between Mortgages and Mechanics Liens

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interests, and this is equally true to all federal property, real or personal, held or used by private individuals for their own gain.[60]

Congress can, however, if and when it desires under its sovereign powers immunize any federal agency or activity from state taxation and thereby prevent even the taxation of private interests in federal property used or held under government contract, and thus could have changed in advance the outcome of the *Alabama* and *Dravo* cases.

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PRIORITY BETWEEN MORTGAGES AND MECHANICS LIENS

In the Colorado decision of *Darien v. Hudson*,[1] the issue of priority arose between a purchase money mortgage and a mechanic's lien. The mortgagee had given the mortgagor additional funds to repair the house on the property and had the mortgage recorded immediately. The mortgagor failed to apply these funds for the improvements, and as a result mechanics liens were filed by the materialmen. The court held that the mortgage did not take priority over the lien claimants, even though recorded first. Before discussing the cases that are relevant to this problem, the Wyoming lien law and its interpretation should be considered.

Our Wyoming lien law was taken from Missouri. The three sections which are pertinent to this problem say in substance that a mechanic's lien shall attach to a building or improvement in preference to any prior lien or incumbrance upon the land; that such building can be sold and removed by the purchaser;[2] that a mechanic's lien shall be preferred to liens that attach subsequent to the commencement of the building or improvement;[3] and that a mechanic's lien shall not affect any lien, incumbrance or mortgage upon the land that was in existence at the inception of the mechanic's lien.[4]

These three sections were discussed in *Prugh v. Imhoff*.[5] The rule seems to be that a separate and distinct building or erection is required for the lien to have preference over an earlier mortgagee and where the lien results only from repairs or improvements, the mechanic's lien is not prior. As the court said in interpreting these sections, since a mortgage covers the building as well as the land, the lien for repairs, or improvements which are put upon such existing building, will be subject to the prior lien of the mortgage or deed of trust; otherwise, one's principal

60. Carson v. Roan-Anderson Co. et al., 342 U.S. 232, 72 S.Ct. 257, 96 L.Ed. 257 (1952).

1. Darien v. Judson, 134 Colo. 213, 302 P.2d 519 (1956).
2. Wyo. Comp. Stat. § 55-203 (1945).
3. Wyo. Comp. Stat. § 55-207 (1945).
4. Wyo. Comp. Stat. § 55-403 (1945).
5. 44 Wyo. 143, 9 P.2d 152 (1932).

security might be repaired or improved out from under him. But if the building, erection or improvement is an independent affair, not in existence when the mortgage was taken, it will be subject to the mechanic's lien in preference to the mortgage and it may be sold and removed as provided by statute.

Three problems will be discussed in this note. The first arises where the mortgagor makes improvements on the mortgaged premises without any financial assistance from the mortgagee. The second involves the mortgagee advancing the mortgagor money with which to repair or build, such as a construction money mortgage. The third deals with severance and pro rata distribution. There must be two assumptions before any analysis can be made. One is that the mortgage was given and recorded prior to any contract to build or actual work begun. The other is that the mechanic's lienor has filed and given notice of his lien within the statutory period.

Generally, where a purchase money mortgage is given and the mortgagee has no knowledge that improvements are being made, has not advanced any money for building or repair, and there is no requirement in the contract of purchase to build, the mortgagee will be prior.[6] In one case the priority was not lost even though the vendor and holder of the purchase money mortgage required the vendee to build.[7] Also it has been held that mere co-operation by the holder of a mortgage in the plans of the grantor for improvements was not sufficient to give the mechanic's lienor a priority. New York has held it immaterial that the mortgagee reap the benefits of the work without having to pay for it, since the building contract was between the lienor and mortgagor who alone was liable to the lienor.[8] As the Georgia court said, before the mortgagee will lose his priority, there must be some definite and affirmative act by the lender, communicated to the materialmen, that could have led materialmen to believe that the lender consented to his selling material to borrower on credit.[9]

Some courts recognizing the general rule as to mortgages, deny priority upon some equitable principle or other theory. Such was the case of *Carew v. Stubbs*,[10] in which a purchase money mortgage was given after the construction contract. The court said that the vendee had "authority" before the delivery of the deed to create liens on the land for labor and materials.[11] The Missouri court, under similar facts, denied priority to the mortgagee because they said that equity could hardly sanction a method whereby the mortgagor entered into a contract to build and then after part

6. Reed & Sherwood Mfg. Co. v. Jones, 202 Minn. 274, 278 N.W. 30 (1938).
7. Chicago Lbr. Co. v. Schweitzer, 45 Kan. 255, 25 Pac. 592 (1891).
8. Ga. State Bank & Savings Ass'n. v. Wilson, 189 Ga. 21, 5 S.E.2d 14 (1939).
9. Ausable Chasm Co. v. Hotel Chasm & Country Club, 263 App. Div. 486, 33 N.Y.2d 427 (1937).
10. 155 Mass. 549, 30 N.E. 219 (1892).
11. Jones v. Osborn, 108 Iowa 409, 70 N.W. 143 (1899).

of the building was completed, executed a purchase money mortgage to the true owner, the materialmen thinking all the time that he was dealing with the true owner, when in fact he was not.[12] This may be authority for the same proposition shouldn't occur in Wyoming.

To draw a rule from the foregoing cases seems a little difficult, but it may be said that if the mortgagee has no knowledge that his mortgagor is making repairs, he probably will not lose his priority absent statutory provisions. But if a mortgagee negligently stands by and allows a materialman to contract on the basis of some misunderstanding, when in all fairness the mortgagee should have told the lienors the true facts, the mortgagee will probably be estopped from repudiating his own implied misrepresentations.

The next problem deals with either a purchase money mortgage with additional sums to build or a construction money mortgage. Looking solely to the Wyoming statutes, if the money is for repairs then no priority will be given to the lienors. If it is for new construction then the lienors have priority as to the building and may sever it from the land and remove it within a reasonable time.[13] The issue could arise in Wyoming as it did in Colorado where the money advanced was for repairs, and the mortgagor did not apply the funds given under the mortgage to pay the materialmen. Our court could say that the mortgagee has a duty to see that these funds are applied for the purpose given, and to the extent that they weren't, the mortgagee's priority may be lost.

The general rule of mortgage law, absent any statutory provision, is that if the amount for which the mortgage shall stand is wholly optional with the mortgagee, he cannot after he receives notice that a subsequent lien has attached, have priority as to sums forwarded after notice of the lien. If the sums are obligatory the mortgage is prior as to all amounts advanced.[14] Some statutes, such as Oregon's, disregard the distinction between optional future advances and obligatory, and just say that they are subordinate to mechanics liens.[15] Also, in Alabama, construction loans, whether optional or obligatory, are by statute held to be inferior to mechanics liens.[16] However, in Arkansas if the advances are obligatory, the construction money mortgage has priority.[17]

Many statutes or judicial decisions are based upon some duty. They either place a duty on the mortgagee to see to it that his mortgagor applies the funds properly or they place the burden on the lienors to in-

12. Jefferson County Lbr. Co. v. Robinson, 121 S.W.2d 209 (1938).
13. Prugh v. Imhoff, 44 Wyo. 143, 9 P.2d 152 (1932); Schulenbery v. Hayden, 146 Mo. 583, 48 S.W. 472 (1898); Wilson v. Lubke, 176 Mo. 210, 75 S.W. 602 (1903).
14. Superior Lumber Co. v. Nat'l. Bank of Commerce, 176 Ark. 300, 2 S.W.2d 1093 (1928).
15. Drake v. Pagett Mortgage Co., 203 Ore. 66, 274 P.2d 804 (1954).
16. Baker Sand & Gravel Co. v. Rogers Plumbing & Heating Co., 228 Ala. 612, 154 So. 591 (1934).
17. Ark. Stat. § 51-605 (1947).

quire into the records to see if there are any existing liens on the building or land for which they are furnishing materials or labor. As the Arkansas court so aptly put it, laborers and materialmen can learn the purpose for which the money was raised by examining the records, and if they do not believe the borrower will use it for the purpose they can refuse to furnish materials without some further security for payment. The court said that the sole test of superiority of liens upon the lands before improvements are made is the purpose for which the money is raised or borrowed, and not the use made of it.[18]

Some courts approach this problem, not by talking in terms of optional or obligatory advances, nor in terms of duty, but rather to the problem as a whole and limit the mortgagee's prior lien, to the extent of the funds actually used in the project. As the Mississippi court[19] said, where the mortgagee did nothing to see that the construction was being paid for and merely turned over money to the contractor as he asked for it, the mortgagee's lien was superior to liens of materialmen only to the extent that its funds actually went into the project. The court went on to say that the mortagee should advance the proceeds with reasonable diligence in order that the holders of statutory liens may not be unjustly defeated in their claims. Where the whole amount for which the mortgage was given was advanced and applied in construction of the building, the construction money mortgage has priority.[20] The Colorado court[21] has said that when the lienors have notice of the existence of a mortgage which is given expressly for the purpose of securing funds to construct an improvement, and know that the funds thus obtained are being applied in that way, the lienors will have a subordinate claim. The court still limited the mortgagee's priority to the proceeds of the loan that were actually applied in the improvement of the property.

It might be interesting to note that the Colorado court did not mention this *Journalman* case[22] in their opinion in the *Darien*[23] case. The two cases may be distinguished on their facts. In the *Journalman* case the lienors had knowledge that a prior mortgage existed and the mortgagor applied at least some of the money advanced by the mortgagee to the improvements of the property. In the *Darien* case it doesn't appear that either of these facts were present. The rule in Colorado appears to be that a mortgagee must give the lienors actual notice of his mortgage, that he has a duty to see that these funds are applied to the improvement and that the mortgagee's lien will be prior as to those funds actually used in the repair or construction of the mortgaged premises.

18. Ashdown Hardware Co. v. Hughes, 223 Ark. 541, 267 S.W.2d 294 (1954).
19. 1st Nat'l. Bank of Greenville v. Virden, 208 Miss. 679, 45 So.2d 268 (1950); Weiss v. Nachetz Co., 166 Miss. 253, 140 So. 736 (1932).
20. Brush v. Bohan, 102 Cal. 457, 283 Pac. 126 (1929); Community Lbr. Co. of Baldwin v. Calif. Publ. Co., 215 Cal. 274, 10 P.2d 60 (1932).
21. Journalman v. McPhee, 31 Colo. 26, 71 Pac. 419 (1903).
22. Ibid.
23. Supra note 1.

The last problem is that of severance which arises under the Wyoming statutes providing that the mortgagee has priority as to the land, but that the mechanics lienors have priority as to the building, with the right to remove within a reasonable time.[24] If the building is a brick or concrete structure then it cannot be removed without substantial injury to the land or to the building. Sale of the entire property and pro rata distribution of the proceeds would seem to be a possible solution, but this has been expressly disapproved in Missouri, at least where the mortgage indebtedness is not yet due and payable.[25] The court there indicated that there is no procedure at all in Missouri even though the mortgage was due and payable. When courts find that the property is not feasibly separable, and won't apply the pro rata doctrine, they say in effect that the lien priority is gone.[26]

In Alabama, the court held that in case of repairs, the lienor could come into equity and have sale of the property ordered, even though the prior mortgage on the property was not yet due, the mortgagee sharing in the proceeds upon a pro rata basis.[27] Also, in a later decision of the same jurisdiction,[28] the court said where there was a mortgage on the land, equity courts in a suit to enforce mechanics liens, could, where removal of the building would in a large measure operate to destroy the security, adjust priorities in the proceeds on equitable principles. This may be authority in Wyoming that a pro rata distribution can be made, contrary to the Missouri decisions.

Some states by statute have incorporated the pro rata distribution into their law.[29] This seems to be the more sensible solution regardless of whether the building is separable or not. North Dakota has a different rule. It changed from the severance rule and the statute of that state in effect provides that where the mortgagee has a prior recorded mortgage on the land, he is prior to the land and the building. When the lienors have a prior lien on the building, they have a priority as to the building and the land.[30]

In conclusion, it seems that a revision of our mechanics lien law would be in order. As to the first problem discussed, where the mortgagee has not advanced funds for construction, but has knowledge that his mortgagor is making repairs or additions, a statute similar to Minnesota,[31] requiring the mortgagee to give actual notice to the lienors to maintain his priority, would equitably take care of the problem.

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24. Supra note 13.
25. Gold Lbr. Co. v. Baker, 225 Mo.App. 849, 36 S.W.2d 130 (1931).
26. Hammann v. McMullen, 122 Tex. 476, 62 S.W.2d 59 (1933); Grand Opera House Co. v. McGuire, 14 Mont. 558, 37 Pac. 607 (1894).
27. Wimberly v. Mayberry, 94 Ala. 240, 10 So. 157 (1891).
28. Supra note 16.
29. Green v. Sexton, 196 Iowa 1086, 196 N.W. 27 (1923).
30. Woolridge v. Torgrinson, 59 N.D. 307, 229 N.W. 805 (1930).
31. Minn. Stat. § 514.05 (1953).

As to the second situation discussed, where the mortgagee has given funds for construction, a state similar to Ohio's[32] would seem better than our present statute. This type of statute would give priority to the building loan mortgage but would make that priority depend on the rightful application of the building loan installments. Also a posting of notice on the lot or land could be required so that the lienors have actual notice of the existing mortgage.

As to the last proposition, the severance type statute[33] seems to be outdated and impractical. It seems that if the entire property was sold and each claimant given his pro rata share of the proceeds the additional expense of removing the building would be eliminated, the building would not be partially destroyed by the moving, a purchaser would pay more for the building as it was on the land, and thus neither party would be hurt to any appreciable extent.

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CREATION OF ROYALTIES PRIOR TO LEASING

A recent Colorado case has again raised questions as to the use of the expression "oil and gas royalty."[1] Some of the questions are: (1) what is it, (2) how do you create it, and (3) can it be created prior to the execution of an oil and gas lease. This note will be limited primarily to a consideration of the third question, although something must be said about the others before there can be any clear discussion of the selected question.

Ordinarily, the term "oil and gas royalty" refers to an expense-free share of the oil and gas.[2] It is expense free in the sense that it does not

32. Code of Ohio § 1311.14.
33. Ill. Rev. Stat. c. 82, § 16 (1949).
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1. Carlett v. Cox, ... Colo. ...., 333 P.2d 619 (1958).
2. U.S.: Mabee Oil and Gas Co. v. Hudson, 156 F.2d 450 (1946); Shinn v. Buxton, 154 F.2d 629 (1946); Patterson v. Texas Co., 131 F.2d 998, certiorari denied, 319 U.S. 761, 63 S.Ct. 1318, 87 L.Ed. 1712, rehearing denied, 320 U.S. 214, 63 S.Ct. 1455, 87 L.Ed. 1851 (1942); Wright v. Brush, 115 F.2d 265 (1940); Ark.: Hunson v. Ware, 224 Ark. 430, 274 S.W.2d 359 (1955); Longiro v. Machen, 217 Ark. 641, 232 S.W.2d 826 (1950); Cal.: Depuy v. McColgan, 122 Cal.App.2d 237, 246 P.2d 155 (1952); La Laguna Ranch Co. v. Dodge, 18 Cal.2d 132, 114 P.2d 315, 135 A.L.R. 546 (1941); Kan.: Randolph's Estate, 175 Kan. 685, 266 P.2d 315 (1954); Tegarden v. Beers, 175 Kan. 610, 265 P.2d 845 (1954); Robinson v. Robinson, 165 Kan. 494, 196 P.2d 159 (1948); Holland v. Shaffer, 162 Kan. 474, 178 P.2d 235, 173 A.L.R. 845 (1947); Skelly Oil Co. v. Cities Service Oil Co., 160 Kan. 226, 160 P.2d 246 (1945); Ky.: Maynard v. Ratliff, 297 Ky. 127, 179 S.W.2d 200 (1944); La.: Vincent v. Bullock, 192 La. 1, 187 So. 35 (1935); Mich.: People v. Blankenship, 305 Mich. 79, 8 N.W.2d 919 (1943); Mont.: Stokes v. Tutnet, ... Mont. ...., 328 P.2d 1096 (1958); New Silver Bell Mining Co. v. County, 129 Mont. 269, 284 P.2d 1012 (1955); Marias River Syndicate v. Big West Oil Co., 98 Mont. 254, 38 P.2d 599 (1934); Homestake Exploration Corp. v. Schoregge, 81 Mont. 604, 264 Pac. 388 (1928); Hinerman v. Baldwin, 67 Mont. 417, 215 Pac. 1103 (1923); N.M.: Duvall v. Stone, 54 N.M .27, 213 P.2d 212 (1949); Ohio: Pure Oil Co. v. Kindall, 116 Ohio St. 188, 156 N.E. 119 (1927); Okla.: Hinkle v. Gauntt, 210 Okla. 432, 206 P.2d 1001