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Winger Contracting Co. v. Cargill, Inc. is Major Change in Iowa Mechanic's Lien Rights

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Introduction

In the case of Winger Contracting Co. v. Cargill, Inc., several commercial contractors sought to foreclose their mechanic's liens based upon millions of dollars of allegedly unpaid work that such contractors had performed as part of the construction of a new chemical facility for the property lessee (the "Lessee"), who owned and operated the chemical facility on land it leased from the property owner-lessor ("Cargill"). Specifically, the lien claimants were subcontractors to one of the two design-builders who had entered into contracts with the Lessee.

In its opinion, the Iowa Supreme Court explained that they were "called upon to decide whether mechanic's liens arising from the provision of materials and labor to a lessee attach to the property of the lessor under the facts and circumstances of this case. The case also presents the question of whether a construction mortgage lien ultimately obtained by the owner of the land on the leasehold and property of the lessee has priority over later-filed mechanic's liens." Id. at *1.

In the underlying litigation, the district court ruled that (1) the mechanic's liens did *not* attach to the property of the lessor, Cargill, and instead, only attached to the Lessee's leasehold interest, and (2) Cargill's after-acquired construction mortgage lien on the Lessee's chemical facility/leasehold interest had priority over all mechanic's liens (of claimants who commenced their work after the original recordation date of such mortgage).

As a result, the district court granted Cargill's motion for summary judgment. The mechanic's lien claimants appealed, and, as described in detail below, the Iowa Supreme Court affirmed the ruling of the district court, leaving the contractors (1) with no mechanic's lien rights against the underlying property owned by Cargill and (2) with their mechanic's lien rights against the Lessee's leasehold interest being inferior and junior to Cargill's construction mortgage lien. Id. at *1.

Arguments Made by the Contractors

At the lower level and/or on appeal, Winger and the other various contractors-lien claimants asserted the following arguments:

(1) **Joint Venture and Agency Theory Arguments Based upon Prior Case Law**: The contractors argued that Cargill and the Lessee did not merely have a lessor–lessee relationship but were engaged in an "ongoing and continuing business relationship combining their property, effort, money, skill, and knowledge for their mutual benefit," amounting to a joint venture relationship, such that Cargill's underlying property should be subjected to the mechanic's liens under the prior Iowa Supreme court case of *Denniston & Partridge Co. v. Romp*, 56 N.W.2d 601 (Iowa 1953). Id. at *10.

Likewise, the contractors argued that the lease between Cargill and the Lessee conferred benefits on Cargill that could only arise from the construction of the chemical facility that was

required under the terms of the lease, thereby resulting in the Lessee being Cargill's agent for purposes of the Lessee's contracting of construction services and thereby subjecting Cargill's underlying property to the asserted mechanic's liens under the prior Iowa Supreme court cases of *Stroh Corp. v. K & S Development Corp.*, 247 N.W.2d 750, 752 (Iowa 1976) and *Romp*, 56 N.W.2d 601.

(2) **Work "Directly to the Land" / "Otherwise Improved" Arguments Based upon Section 572.2(1):** On appeal, contractors, Winger and Peterson, made two related arguments based upon the below underlined language within Iowa Code section 572.2(1), which provides as follows:

> 572.2. Persons Entitled to a Lien:
>
> (1) Every person who furnishes any material or labor for, or performs any labor upon, any building or land for improvement, alteration, or repair thereof, including those engaged in the construction or repair of any work of internal or external improvement, and those engaged in grading, sodding, installing nursery stock, landscaping, sidewalk building, fencing on any land or lot, by virtue of any contract with the owner, owner-builder, general contractor, or subcontractor shall have a lien upon such building or improvement, and land belonging to the owner on which the same is situated or upon the land or lot so graded, landscaped, fenced, or otherwise improved, altered, or repaired, to secure payment for the material or labor furnished or labor performed.
>
> Iowa Code § 572.2(1).

First, Peterson argued it had performed work "directly to the land" which entitled it to a lien on Cargill's fee interest. Peterson claimed that it "was hired, among other things, to move dirt, provide concrete paving and erosion control, strip, salvage and spread topsoil, clear and grub the land, and install storm sewers and fencing." Accordingly, Peterson asserted it was separately entitled to a lien "upon the land or lot so graded, landscaped, fenced, or otherwise improved, altered, or repaired."

Second, Winger asserted that, pursuant to the above underlined statutory language in section 572.2(1), its lien attached not simply to land "belonging to the owner," but also to land upon which the improvements were made. On appeal, the Iowa Supreme Court further explained Winger's argument as follows:

> Parsing such statutory language, Winger asserts that it has a lien for construction services rendered pursuant to its contract with [the Lessee] on 'such building or improvement'—namely, [the Lessee's] chemical facility—and 'upon the land or lot so graded, landscaped, fenced, or otherwise improved'—namely, Cargill's land.
>
> Winger indicates that the Oxford comma—the third comma in the phrase 'so graded, landscaped, fenced, or otherwise improved'—means that the term 'otherwise improved' is not limited to activities similar to grading, landscaping, or fencing, but instead, has a broader meaning that generally includes 'improvements.'

Id. at *11 (internal citations omitted).

(3) **Unjust Enrichment / Fraud Argument**: The contractors also argued that Cargill avoiding liability on the mechanic's liens would result in unjust enrichment. Related to this, the contractors likewise argued that "allowing Cargill to purchase the lease mortgage on its own property ten months after the filing of mechanic's liens and to claim that its newly acquired rights in the property were superior to the mechanic's liens would be 'the ultimate in absurdity and artifice of fraud,' [and] that equity requires substance and intent, rather than form, should govern to prevent injustice," citing the case of *Veale Lumber Co. v. Brown*, 195 N.W.2d 248 (Iowa 1923). Id. at *4. Based upon the *Veale* case, the contractors argued that "the mechanic's liens that unquestionably attached to the property of the Lessee were superior to the construction mortgage lien asserted by Cargill." Id. at *4.

(4) **Merger Argument (RE: Cargill's Construction Mortgage Lien)**: In addition, the contractors argued that Cargill's construction mortgage lien, acquired by assignment from the lender, merged with its fee simple interest in the land, such that its construction mortgage lien was not superior to the mechanic's liens held by the contractors on the facility and Lessee's leasehold interest. Id. at *15-16

Specific Facts of the Case

In asserting its successful position, Cargill emphasized the specific terms of the lease, as well as specific amendments in Iowa's mechanic's lien statute that had been made since the prior cases of *Stroh* and *Romp* had been rendered. The lease between Cargill and the Lessee included the following terms:

- It was a 50-year lease for the Lessee to construct a chemical manufacturing facility on Cargill's land.
- The Lessee was required to pay $12,000 in annual rent along with other consideration, including payment of property taxes, reimbursement for security services, and under some circumstances, insurance.
- The Lessee covenanted to Cargill that it would not use the land for anything other the chemical plant.
- Cargill would continue to own the land, while the Lessee would own the chemical facility.
- The Lessee was required to remove the facility from the land at the end of the lease, unless different arrangements are made between the parties, and the Lessee was required to return the land to substantially the same prior condition.
- The Lessee could encumber, assign, or mortgage to a secured creditor its leasehold estate in the land or its fee estate in the chemical facility.
- Per the lease's express terms, nothing in the lease should be construed "as creating a partnership, joint venture, or association" between Cargill and the Lease or "cause either party to be responsible in any way for the debts or obligations of the other party." Instead, the relationship between Cargill and the Lessee was merely "the relationship of landlord and tenant," per the terms of the Lease.
- The Lessee was required to keep the property free from any and all liens arising out of any construction of the facility.
- Cargill had no right to share in the profits made by the Lessee under the lease.
- A memorandum of lease was filed with the county recorder.

- In addition, under certain ancillary agreements to the lease, Cargill agreed to supply the Lessee with essential inputs (including water) needed for Lessee's chemical production facility, and Cargill also agreed to purchase a set amount of the chemicals produced at the Lessee's facility.
- Finally, as part of the relationship, Cargill assisted the Lessee in obtaining bond financing through the state, with a private lender issuing a letter of credit guaranteeing payment to the State bond trustee. In turn, the Lessee agreed to reimburse such private lender for any payments made under such letter of credit, which was secured by a leasehold mortgage and assignment of rents and leases, thereby giving such lender a first priority leasehold mortgage lien and security interest on the Lessee's chemical facility and leasehold estate. Related to this, under an ancillary "put" agreement, Cargill had agreed to purchase such lender's rights and obligations if the Lessee defaulted on this agreement with the lender.

Id. at *1-3.

Ultimately, numerous serious problems occurred during the construction project, including problems stemming from allegedly defective work by the Lessee's design-builders and their subcontractors, which resulted in the Lessee being unable to meet its obligations to the private lender and with various contractors claiming they had not been paid for millions of dollars of work allegedly owed to them for their work on the construction of the facility. Due to the Lessee's default, the lender paid off the State bond and then the lender exercised its "put," requiring Cargill to pay off the lender. Pursuant to the put agreement, the lender assigned Cargill its rights under the construction mortgage covering the facility and the Lessee's leasehold interest. Thus, in the litigation, Cargill argued that its construction mortgage lien took priority over all mechanics' liens of claimants who commenced their work after the recordation date of such mortgage. Id. at *3-4.

As noted, the district court ultimately ruled, on summary judgment, that (1) the mechanic's liens did *not* attach to the property of Cargill, but only attached to the Lessee's leasehold interest (i.e., the facility); and (2) Cargill's construction mortgage lien against the Lessee's leasehold interest had priority over all mechanic's liens filed for work commenced subsequent to the mortgage's original recordation date. Id. at *1. The Iowa Supreme Court affirmed the district court's opinion; its analysis is discussed below.

Supreme Court's Analysis of Prior Case Law

In its opinion, affirming the district court's ruling, the Iowa Supreme Court first explained the prior case law in this area. The Court explained, that while ordinarily lienholders contracting with lessees cannot acquire greater interest in real estate than the interests owned by the lessees, there were multiple prior Iowa Supreme Court cases in which mechanic's liens did attach to the property of the lessor when the work and services were provided under contracts with the lessee, including the *Romp* and *Stroh* cases.

However, the Iowa Supreme Court emphasized that in the 1953 *Romp* case, (1) the current definition of "owner" under the mechanic's lien statute applicable at that time was as follows: "'Owner' shall include every person for whose use or benefit any building, erection, or other improvement is made, having the capacity to contract" and (2) "the then-effective version of Iowa Code section 572.2 provided for mechanic's liens arising out of 'any building or land for improvement, alteration, or repair thereof ... by virtue of any contract with the owner, his *agent*, trustee, contractor,

or subcontractor.'" Id. at *8-9. The Iowa Supreme Court, in *Winger*, explained the *Romp* court's analysis as follows:

> [A]pplying the statutory provisions, the *Romp* court concluded that the lessees were agents of the lessor under the facts presented. The *Romp* court noted that the rental charged by the lessor contemplated improvement of the land. The lease was for a short-term period of five years with one five-year term of renewal with no provision at the end for removal of the improvements. The lessor loaned the lessee money with the expectation that a substantial part of the money would be used to construct a building or buildings.
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> The *Romp* court also considered whether the mortgage lien of the lessor was superior to the mechanic's lien. The *Romp* court concluded that it was not. The *Romp* court stated that such a result, under the facts of the case, would permit something very like a fraud upon the suppliers of materials or labor. The *Romp* court declared, the rule that one who advances money to another for the erection of improvements on land acquires a lien superior to those of materialmen or laborers has no application under the facts where the lessor was the owner and the improvements were made for her benefit. According to the *Romp* court, she cannot evade her responsibility by taking a mortgage.

Id. at *9 (internal citations and quotations omitted).

The Iowa Supreme Court then explained the court's analysis from the second prior case, the *Stroh* case:

> In *Stroh*, an unrecorded lease required the lessee to construct a car-wash/gasoline facility on the premises. Under the lease, the lessor approved plans for the facility. Upon completion of the construction, the lease provided that the lessor pay the lessee $50,000, the estimated cost of the project. The lease provided for annual rent of $16,250 for a fifteen-year term with an option for two consecutive five-year terms of renewal. Title in the property vested with the lessor upon completion of the lease. . . . The question in the case was whether Stroh's mechanic's lien attached to the real property of the owner or solely on the property of the lessee. The *Stroh* court cited Iowa Code section 572.2, which at the time provided that a mechanic's lien may arise by virtue of a contract with the owner *or his agent*.
>
> The *Stroh* court recognized that, ordinarily, mere knowledge or consent to the making of improvements did not subject the interest of the owner to a mechanic's lien. But according to *Stroh*, if the lessor has by express or implied agreement contracted for the improvement of his real property, the mechanic's lien attaches to the property of the owner. The *Stroh* court stated that such express or implied agreement particularly arose in situations where the building or improvements became the property of the lessor after a comparatively short term. In such situations, according to *Stroh*, 'the lessee is considered to be the agent of the lessor within the meaning of [Iowa Code section] 572.2.'
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> The *Stroh* court held that the mechanic's lien under the facts of the case attached to the lessor's real property. The *Stroh* court noted that the construction of the car wash

> materially added to the value of the land, with the assessed value increasing from $22,491 to $79,060 after construction of the project. *Id.* The improvements immediately became the property of the lessor. Finally, the facility was the primary reason for the rent of $16,250.

Id. at *9 (some internal citations omitted).

Supreme Court's Analysis of Recent Statutory Amendments

The Iowa Supreme Court then outlined the changes made in Iowa's mechanic's lien statute in 2007 and 2012.

First, the 2007 amendments entirely removed contracts with "the owner's agent" as giving rise to mechanic's liens on the property of the owner under Iowa Code section 572.2(1).

Second, the 2007 amendments eliminated the term "owner's agent" from various other provisions of the mechanic's lien statute.

Third, the 2012 amendments limited the scope of the term "owner." As amended in 2007, the term "owner" generally meant "the record titleholder" in the property. But the 2007 version additionally provided that owner included "every person for whose use or benefit any ... improvement is made." In 2012, the legislature eliminated the additional language, such that "owner" is now narrowly defined as "the legal or equitable titleholder of record."

Supreme Court's Conclusions RE: Each Argument and Other Holdings

The Iowa Supreme Court's decision included analysis on each of the arguments raised by the contractors.

(1) **Joint Venture and Agency Arguments**: As noted above, the contractors argued that the relationship between the Lessee and Cargill equated to more than a mere lessor-lessee relationship, but instead rose to the level of (a) the Lessee being Cargill's agent for purposes of the construction contracts and (b) the two parties otherwise being in a joint venture, thereby subjecting Cargill's underlying property to the asserted mechanic's liens under the prior *Romp* and *Stroh* case law. In response, the Iowa Supreme Court stated that its analysis of these arguments must start with analysis of the recent amendments to the mechanic's lien statute and the effect of such amendments on the matter, explaining as follows:

> A threshold issue is whether a mechanic's lien on the underlying fee interest may arise under the current version of Iowa Code section 572.2(1) where the contract is with the lessee and not the owner of the property. If the answer to this question is no, there is no need to consider whether the mechanic's liens attach under *Romp* [and] *Stroh*.
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> Based on our review of the statute, we conclude that Cargill has the better argument. A mechanic's lien is a creature of statute. **The amendments of 2007 and 2012 narrow the definition of owner and eliminate contracts with agents as a**

> **basis for a mechanic's lien against property of an owner. We conclude the language used by the legislature should be given its natural effect.**

Id. at *13 (internal citations omitted) emphasis added). The Court also went on to explain as follows:

> We do not view the legislative amendments in 2007 and 2012 as working a profound change in the law of agency. As pointed out by Cargill, an agent can still enter into a contract on behalf of a principal. When an agent acts within the scope of authority *on behalf of a principal*, a contract arises with the principal.

Id. at *14 (emphasis added).

Thus, the Iowa Supreme Court acknowledged that when a contractor and lessee enter into a construction agreement, the contractor may still have mechanic's lien rights against the underlying property owned by the lessor in the limited situation in which the lessee is legally deemed to be an agent for the principal--under general agency law and not based upon any language within the lien statute--who was acting within the scope of his or her authority and *acting on behalf of the principal, and not on behalf of the agent itself,* when entering into the construction contract with the contractor. Though, this is a very limited situation, and the Court emphasized as follows:

> **Under our interpretation of legislative action, *Romp* and *Stroh* are no longer good law. Both of these cases involved contracts with lessees who were determined to be, in essence, agents of fee owners because of the beneficial relationship between the lessors and the owners that extended well beyond the ordinary landlord–tenant relationship.** It may be that under these cases, Winger would have an argument for the attachment of mechanic's liens to Cargill's fee simple interest. **But by reworking the statute to limit mechanic's liens to property belonging to a narrowly defined owner, the legislature has adopted an approach in conflict with *Romp* and *Stroh*.** Because we find that the language of the statute precludes the attachment of mechanic's liens to the fee simple interest of Cargill, there is no occasion to consider application of our now superseded precedent.

Id. at *14 (emphasis matter).

In *Winger*, the contractors' joint venture and agency theory arguments were expressly based upon their claimed application of the pertinent facts to such prior case law established in *Romp* and *Stroh*, which the Court ruled was no longer valid. Accordingly, the Court concluded that the contractors' joint venture and agency theory arguments were without merit.

(2) **Work "Directly to the Land" / "Otherwise Improved" Arguments:** As noted above, the contractors argued that (a) because they had performed work "directly to the land," they were entitled to a lien on Cargill's fee interest under section 572.2(1), and (b) their liens attached not simply to land "belonging to the owner," but also to land upon which the improvements were made, under the "otherwise improved" language within section 572.2(1). In response, the Iowa Supreme Court found that the contractors had not properly raised and preserved the

aforementioned arguments before the district court when the motions for summary judgment were considered.

In particular, the Court held that, "[n]owhere in the summary judgment proceedings did Winger make the factual claim to have provided landscaping-type work on Cargill's land, and Winger did not make the legal argument that it was entitled to a mechanic's lien by virtue of the otherwise improved language under Iowa Code section 572.2." Id. at *14. Accordingly, the Iowa Supreme Court did not make a substantive ruling on the merits of these two arguments raised under section 572.2(1), meaning that these arguments may still be viable arguments for contractors to raise in these situations.

(3) **Unjust Enrichment / Fraud Argument (RE: Cargill's Construction Mortgage Lien):** In response to the contractors' various arguments that Cargill would be unjustly enriched and that its actions amounted to fraud, the Iowa Supreme Court disagreed.

The Court explained that: "a mechanic's lien is a creature of statute. Outside of the statute, there are no substantive rights to a mechanic's lien." Id. at *16. The Court further noted that nothing in the record suggested Cargill defrauded the contractors out of their statutory mechanic's lien rights and that there was no suggestion that "Cargill at any time misrepresented that Cargill owned the land but that the facility and the lease were owned by [the Lessee]," of which the contractors also had constructive notice. Id. at *16.

Likewise, the Court explained that "Winger and the other four parties did not claim that their contracts were in fact with Cargill and that [the Lessee] was acting as an agent to bind Cargill as principal." Id. at *16. Instead, "[t]hey knew that [the Lessee] was the party to their construction contracts. As a result of the above, Winger and the other four parties cannot be said to have been defrauded of a statutory right that they no longer had." Id. at *16.

In addition, in response to Winger's argument that "it was fraudulent for Cargill to claim a superior right over their mechanic's liens through the acquisition of the construction mortgage lien from [the lender]," the Court explained as follows:

> Prior to the assignment of [the lender's] interest, however, the liens of Winger and the other four parties were subject to its interest. The assignment of the construction mortgage lease to Cargill did not deprive them of anything. Further, the after-acquired mortgage acquired by Cargill was not on its own property, as suggested by Winger, but was on the property owned by [the Lessee], namely, the facility and the leasehold interests.
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> The case is thus distinguishable from *Veale*, 197 Iowa at 241–43, 195 N.W. at 249, where the improvements were made on the owner's land by a builder, and after the improvements were made, the property was to be sold to the builder at a price which reflected the improvements. The *Veale* court emphasized that the improvements were made on the owner's own property. *Id.* at 244, 195 N.W. at 250. Unlike in *Veale*, Cargill did not finance the construction of its own building which it was going to sell at a profit... . [instead] Cargill was the assignee of a construction mortgage that financed the building owned by [the Lessee] when

> the default occurred. We decline to find fraud under the circumstances presented.

Id. at *17.

(4) **Merger Argument (RE: Cargill's Construction Mortgage Lien):** Under this argument, the contractors sought to defeat the priority of Cargill's after-acquired construction mortgage lien by asserting that Cargill's interests as reflected in its construction mortgage lien merged with its fee simple interest in the land. The Iowa Supreme Court disagreed with this argument, ruling that no merger had occurred and explaining as follows:

> Iowa case law declares that in situations where the mortgagee purchases the equity of redemption from the mortgagor, the mortgage debt, and the mortgage, is extinguished but 'if it is to the interest of the mortgagee, and it can be done without prejudice to the rights of the mortgagor or third persons, the doctrine of merger ... will not apply.' Here, [the contractors] are not prejudiced by lack of merger as their lien position prior to Cargill obtaining the assignment of the mortgage was inferior to the construction mortgage lien of [the lender]. Thus, the position of [the contractors have] not been affected by the transfer of the mortgage interest. Further, as noted in later caselaw, if there was no expression of his intention in relation to the matter at the time he acquired the equity of redemption, it will be presumed, in the absence of circumstances indicating a contrary purpose, that he intended to do that which would prove most advantageous to himself.
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> In sum, Cargill obtained its construction mortgage interest under less than desirable circumstances.... When Cargill obtained the interest in the construction mortgage, it had no possible interest in merging the construction mortgage estate with its fee simple estate and thereby losing its superior lien position that arises from the construction mortgage.

Id. at *15-16 (internal citations omitted).

Final Comments

Based upon the above analysis, the Iowa Supreme Court affirmed the district court's summary judgment ruling that the mechanic's liens did *not* attach to the property of Cargill and that Cargill's construction mortgage lien had priority over all mechanic's liens filed for work commenced subsequent to the mortgage recordation date. Id. at *17.

As noted, this decision is significant to Iowa lien law. In particular, going forward, contractors must know that they likely will have no mechanic's lien rights against the underlying property when they perform build-out work for commercial lessee-clients or otherwise perform any type of work for a client who is merely leasing the property.

Instead, lien rights will ordinarily be limited to merely covering the lessee's leasehold interest, and the prior precedent set forth in the *Romp* and *Stroh* cases can no longer be used by contractors as a

valid basis to claim lien rights to the underlying property owned the lessor. That said, the *Winger* case does leave room for contractors to raise some potential arguments in certain, limited situations. Though overall, based upon this *Winger* decision, contractors should consider whether other protections and security are available to help secure their rights to payment under contracts with lessee-clients.

If your company performs work for lessee-clients and you have questions about this area of law, please contact JodieMcDougal@davisbrownlaw.com or 515-288-2500 to discuss your questions.