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6  
7 **UNITED STATES BANKRUPTCY COURT**  
**DISTRICT OF ARIZONA**

8 In re:

9  
10 MORTGAGES, LTD., an Arizona  
11 corporation,

12 Debtor,

13 JEFFREY C. STONE, INC., d/b/a  
14 SUMMIT BUILDERS, an Arizona  
15 corporation,

16 Plaintiff,

17  
18 v.

19 CENTRAL AND MONROE, L.L.C.,  
20 an Arizona limited liability company, et  
21 al.,

22 Defendants.

23 SUMMERS GROUP, INC., d/b/a  
24 REXEL PHOENIX ELECTRIC, a  
25 corporation,

26 Cross-Claimant/Counter-Claimant,

27  
28 v.

**CHAPTER 11 Proceedings**

**CASE NO.: 2:08-BK-07465-RJH**

**Consolidated Case:**

**ADV. NO.: 2:09-ap-00424-RJH**

**ADV. NO.: 2:09-ap-00056-RJH**

**KGM BUILDERS, INC.'S REPLY TO  
ML'S RESPONSE TO KGM'S MOTION  
FOR RECONSIDERATION AND  
SEPARATE CONTRACT  
MEMORANDUM**





1 CENTRAL AND MONROE, L.L.C.,  
2 an Arizona limited liability company,

3 Cross-Defendants, and

4 JEFFREY C. STONE, INC., d/b/a  
5 SUMMIT BUILDERS, an Arizona  
6 corporation,

7 Counter-Defendant.

8  
9 and related counterclaims and cross-  
10 claims.

11 KGM Builders, Inc., (“KGM”) by and through its undersigned counsel hereby  
12 submits its Reply to ML’s Response to KGM’s Motion for Reconsideration. This Reply  
13 is supported by the following Memorandum of Points and Authorities and the entire file  
14 in this matter. KGM joins in the legal arguments of Summit in its Reply solely as it  
15 relates to the equitable subrogation argument in Sections I and II only.  
16  
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19 **RESPECTFULLY SUBMITTED** this 30<sup>th</sup> day of September, 2011.

20 **PALECEK & PALECEK PLLC**

21  
22 /s/ Karen A. Palecek

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**MEMORADUM OF POINTS AND AUTHORITIES**

**A. Factual and legal summary.**

KGM does not dispute that on February 15, 2011, Judge Randolph Haines of the United States Bankruptcy Court entered a Memorandum Decision in the Adversary Case granting Partial Summary Judgment regarding ML’s Partial Summary Judgment on Lien Priority. In that Ruling, this Court ordered ML was entitled to be equitably subrogated to \$7.3 million as of July 1, 2005; that KGM would have a lien position of \$277,265.57 as of November 16, 2006 and that ML would come behind KGM in the amount of \$8.9 million as of May 16, 2007.

KGM does join in Summit’s Motion for Reconsideration with regard to the disclosure of documentation as it relates to the creation of a question of fact with regard to equitable subrogation. Equitable subrogation is an equitable remedy designed to prevent injustice. *Mosher* 45 Ariz. 468, 46 P.2d 112 (1935); *Lamb Excavation Inc. v. Chase Manhattan Mortgage Corporation*, 208 Ariz. 478, 480, 95 P.3d 542, 544 (App. Div. 2 2004). Subrogation is not an absolute right, but rather as a matter of grace to be granted or withheld as the equities of the case may demand. “*Compania Anonima Venezolana De Navegacion v. A.J. Perez Export Company* 303 F.2d 692, 697 (5<sup>th</sup> Cir.), (1962), cert. denied, 371, U.S. 942 (1962). Arizona’s approach to equitable subrogation is consistent with the Re-statement, the Doctrine generally applies when there is an Agreement to





1 subrogate and “when an intervening lien claimant suffers no prejudice.” *Lamb*  
2 *supra* at 482. Citing E.g., *Peterman-Donnelly Engineers & Contractors Corp. v.*  
3 *First National Bank of Arizona*, 2 Ariz. App. 321, 326, 408 P.2d 841, 846 (App.  
4 1965). Whether the doctrine of equitable subrogation may be applied in any  
5 particular instance depends on the particular facts and circumstances of each  
6 case as it arises... “*Lamb supra* 482”  
7

8  
9 A Trial Court may not be myopic but must balance the equities in view of  
10 the totality of the circumstances of the case to determine whether a party is  
11 entitled to equitable subrogation. *Murray v. Cadle Company*, 257 S.W.3d 291,  
12 299-302 (Tex. App. 2008). In conducting this balancing test, the Court may  
13 consider various factors including: whether ML breached its agreement to fund;  
14 the quality of work performed; prejudice to intervening lien holders; *Lamb*  
15 *supra*, factors that increase the risk of default; intent to subrogate; whether ML  
16 acted with the intent to prejudice lien claimants, *Mosher supra*; and whether ML  
17 can be harmed given the amount of its bid at the Trustee Sale is presumed to be  
18 a price subject to the existing mechanics liens.  
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21 In short, whether a party is entitled to subrogation depends on the  
22 particular facts and circumstances as they arise. In this case, the reason for the  
23 Motion for Reconsideration is that the facts and circumstances reveal that ML  
24 sought to unjustly prejudice the lien claimants and never intended to be  
25 subrogated to the Choice bank loan and in fact the document that was presented  
26 to KGM and/or randomly presented and not completely presented to Summit  
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1 need to be analyzed with regard to equitable subrogation, and clearly there is a  
2 fact question as to whether equitable subrogation applies to the Choice bank  
3 loan.  
4

5 It is KGM's position that it does not and KGM would be in first position.

6 **B. ML seeks to employ subrogation to prejudice lien claimants when**  
7 **there was no intention.**

8 Unfortunately, ML is not merely seeking subrogation to the priority of  
9 the Choice loan, but ML is asking this Court to exercise its equitable powers to  
10 further allow ML to prejudice the rights of the lien claimants and extinguish  
11 their claims in their entirety. Equity abhors a forfeiture. *Hillman v. Busselle*,  
12 66 Ariz., 139, 145, 185, P.2 311, 314 1947 (in denying the defendants request  
13 for retention of earnest money, the Court felt that it would be manifest and fair  
14 and equitable to constitute unjust enrichment, "to allow defendants to retain  
15 earnest money where the acts of defendants do not show entire candor or good  
16 faith")  
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19 On January 19, 2010 ML noticed a Trustees Sale on its May 16, 2007  
20 Deed of Trust. The sale notice specifically identified the Deed of Trust as the  
21 May 16, 2007 Deed of Trust, with trust or Central and Monroe, LLC recorded at  
22 instrument number 2007-0571099. Nothing in the sale notice ever referenced  
23 the prior deed of trust. The trustee's sale ultimately occurred on July 27, 2010.  
24 ML was the only bidder and submitted a \$4 million credit bid. If ML had never  
25 intended to be equitably subrogated to the Choice bank deed of trust, why didn't  
26 ML foreclose on that Deed of Trust? They never intended a two (2) step  
27  
28



1 subrogation. ML waited until after to have the trustee sale July 27, 2010, 3  
2 years later, to claim equitable subrogation. ML's credit bid placed the lien  
3 claimants in an entirely different financial situation then their position behind  
4 the relatively small Choice bank loan and constitutes prejudice per se.  
5

6 **C. Waiver and unclean hands.**

7 What ML seems to ignore in their Response to the Summary Judgment is  
8 the doctrine of waiver and unclean hands. Like other equitable remedies that  
9 claim to subrogation may be lost by waiver, unclean hands, or estoppel. See  
10 *Jack vs. Shee*, 33 Cal. App. 2d 402, 412, 92, P.2d 449, 454 (App. 1939).  
11 (causing property to be sold under a junior trust deed of higher indebtedness  
12 party waived his right of subrogation). A motion to be equitably subrogated to  
13 the priority of the prior loan, by definition, seeks to invoke the equitable powers  
14 of the Court. *Mosher supra at 486*. As an equitable doctrine, equitable  
15 subrogation may be denied based upon a claimants unclean hands. See *Tripati*  
16 *vs. Ariz. Department of Corrections*, 199 Ariz. 222, 225, 16P.3d 783, 786, (App.  
17 2000).  
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21 In this case, in the documents that were subsequently presented to  
22 Summit and never presented to KGM, it is clear that ML's notice of trustee's  
23 sale references the \$75 million dollar deed of trust, ML was attempting to be  
24 secret about the actual priority being foreclosed and now is asserting that it was  
25 the Choice loan and thus, they should be able to be equitably subrogated in front  
26 of both KGM and Summit. The facts are clear that this court should allow the  
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1 lien claimants to have their day in court that ML's unclean hands and waiver by  
2 foreclosing on the wrong "deed of trust" should not be allowed to give them any  
3 type of equitable relief, especially with regard to equitable subrogation. The  
4 Trustee Sale effectively clears the property of liens, claims or interest that have a  
5 priority subordinate to the deed of trust, but leave the property subject to all  
6 liens, claims and trusts that have a priority senior to the deed of trust. As a  
7 result, ML acquired its interest in the property subject to KGM's mechanics lien,  
8 See *Scottsdale Memorial Health Systems vs. Clark*, 157 Ariz. 461, 759 p. 7607.  
9

11 A non-judicial foreclosure strips the process of many of the protections  
12 available under judicial foreclosure. See *Mid-Kansas* 167 Ariz. 131, 804 p.2d  
13 1319. In the context of this case, the power of sale procedure seems ripe for  
14 misuse. At least one Court has found that foreclosure of an equitably subrogated  
15 lien by power of sale requires an assignment of the trust deed. See *Strike vs.*  
16 *Transwest Discount Corp.* 92 Cal. App. 3d 735, 743 (App. 1979). Subrogation  
17 in this case is barred by the doctrines of inequity, waiver, laches, estoppel and  
18 unclean hands. These are all factual issues that KGM asks this Court to give  
19 KGM the right to have its day in Court and present these factual issues such that  
20 material fact questions regarding equitable subrogation would apply requiring  
21 denial of ML's Summary Judgment Motion.  
22

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25 **D. Separate Contracts.**

26 As this Court presented in its February 15, 2011 Memorandum Decision,  
27 there is no dispute that the owner signed a separate and distinct contract with  
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1 General Contractor KGM Builders for the demolition of the interior of the  
2 building and abatement. Summit claimed that although their contract was  
3 separate and they were a general contractor that had a general contract with the  
4 owner, it was the general contract for construction of the hotel. There is a  
5 complete and separate procedure in fact, the ability to sell after KGM was  
6 complete with demolition was the owners choice. Summit had the general  
7 contract separate and apart from KGM to construct "Hotel Monroe". The mere  
8 fact that Summit's work was on the same property is not the analysis with regard  
9 to separate contracts for lien priority purposes. Just to reiterate for this Court's  
10 analysis:  
11  
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13 A.R.S. §33-992 Preference of liens over subsequent  
14 encumbrances; professional services liens (E)... A lien  
15 arising from work or labor done or materials furnished  
16 for each improvement at the site attaches to property for  
17 priority purposes at the time labor was commenced or  
18 materials were commenced to be furnished pursuant to  
19 the contract between the owner and original contractor  
20 for that improvement to the site... KGM's contract was  
21 for the demolition and abatement improvement to the  
22 site and their contract was with Central and Monroe,  
23 LLC. Summit Builders was the General Contractor for a  
24 completely different scope of work with the owner,  
25  
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1 Central and Monroe, LLC, two (2) separate  
2 improvements to the site and two (2) separate  
3 attachments to the property for lien priority purposes.  
4

5 **RESPECTFULLY SUBMITTED** this 30<sup>th</sup> day of September, 2011.  
6

7 **PALECEK & PALECEK PLLC**

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9 */s/ Karen A. Palecek*

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**CERTIFICATE OF SERVICE**

I hereby certify that on September 30, 2011, I electronically transmitted the attached document to the Clerk’s Office using the CM/ECF System for the filing and transmittal of a Notice of Electronic Filing to the following CM/ECF registrants:

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