

CONTRACTOR ALERT

Contractor Alert is a joint publication by this Contractor and the Law Offices of Richard M. Sissman, Esquire, located at 1485 Chain Bridge Road, Suite 105, McLean, VA 22101. This newsletter is designed to give general information on the matters covered. Space limitation prevents exhaustive treatment or analysis of this topic. This newsletter is not intended to substitute for advice on specific legal problems. If you are interested in receiving a complimentary issue or to be placed on our mailing list, contact Richard M. Sissman, Esquire. We welcome and appreciate your suggestions for future article topics.

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REVISITING THE DOCTRINE OF EQUITABLE CONVERSION

In the State of Maryland, if a Court determines that a person is deemed to be a “bona fide purchaser for value” and/or holding “equitable title” of residential property, that person, when he becomes legal title holder to the property, will be relinquished from the burden of construction mechanic’s liens encumbrances that were in existence prior to the conveyance of legal title to the new owner.

History- In the year 1976, the Court of Appeals ruled Maryland's Mechanics' Lien Statute unconstitutional in part holding that a lien does not have priority over other previously recorded liens. That priority was ruled "null and void" in *Barry Properties*, as it operated to deprive owners of significant property interests, without notice, a prior opportunity to be heard, or other procedural safeguards compatible with the due process clauses of the Fourteenth Amendment and Article 23 of the Maryland Declaration of Rights.

In *Himmighoefer v. Medallion Industries, Inc.*, the Court of Appeals determined, under the Act, post-*Barry Properties*, the effect of a contract of sale for value of property on a subcontractor's mechanics' lien remedy against the property. There, a subcontractor performed work and furnished materials for the construction of two houses, under a contract with the builder of a residential housing development who did not own the properties. Subsequently, the owner of the properties executed contracts to sell them to two purchasers. During the executory period, the subcontractor filed petitions to establish mechanics' liens against the properties, naming the owner/seller as the defendant. The owner/seller then conveyed legal title of the properties to the purchasers, for full value. The court entered a default decree establishing mechanics' liens against the properties after the owner/seller did not respond to a show cause order.

The purchasers learned of the mechanics' liens when their properties were posted for sale. They intervened and moved to vacate the decree. The circuit court granted them relief temporarily, but ruled, ultimately, that they had been on notice that the subcontractor had not been paid, by virtue of its having

filed a petition to establish mechanics' liens **before the legal titles were conveyed**. The court directed that the liens be re-established. An appeal was noted.

In reversing the circuit court, the Court drew an analogy between mechanics' liens and judgment liens. It reasoned that, after *Barry Properties*, a mechanics' lien holder can have no greater equity in the seller's real property than a judgment creditor of the seller would have; therefore, the relative rights of a mechanics' lien holder and an equitable title holder in real property must be the same as the relative rights of a judgment creditor and an equitable title holder in real property. The equitable interest in real property of a purchaser under an executory contract of sale is superior to the equitable interest of a judgment creditor whose judgment against the legal title holder of the property was recorded after execution of the contract of sale.

A seller of real property under an executory contract has no real right in the property: rather, he has bare legal title, as security for the purchase price, which is an interest in personalty, not realty. Just as the judgment creditor has no equity that can attach the purchaser's equitable interest in the property by judgment lien, a mechanics' lien claimant has no equity in the property that can attach the purchaser's equitable interest in the property by mechanics' lien. Accordingly, the subcontractor could not place mechanics' liens against the properties, as its claims against the properties, through the legal titles of the owner/seller, could not attach the purchasers' equitable interests.

Eight years after its decision the Court in *York Roofing, Inc. v. Adcock*, further clarified the doctrine of “equitable conversion”. In *York* subcontractors performed work and furnished materials for the renovation of a building. While they were so engaged, the property owner entered into a contract to sell it, for value. The subcontractors completed their work; thereafter, the owner/seller conveyed legal title to the purchasers. A month later, the subcontractors served the purchasers with notices of their intention to establish mechanics' liens against the property. They then filed petitions in circuit court, seeking to establish and enforce mechanics' liens and naming the purchasers as defendants.

The subcontractors maintained that, under the analysis employed by the Court in *Himmighoefer*, the purchasers under the executory contract of sale became the equitable owners of the property, and, therefore,

were "owners" of the property within the meaning of the Act. By serving notices of their intentions to claim mechanics' liens on the purchasers, the subcontractors gave notice to an "owner," as required by statute. Upon timely and proper petition to the circuit court, they were entitled to mechanics' liens against the property.

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The Court disagreed, and affirmed the denial of the subcontractors' petitions. It held that, even though the purchasers acquired equitable ownership of the property upon execution of the contract of sale, this equity interest alone did not make them "owners," within the meaning of the Act. The Court explained that the definitions of "owner," "contractor," and "contract" in the Act are interrelated, so as to make plain that an "owner" must be a party to an agreement for the doing of work or the furnishing of material, or both, for or about the building that is sought to be subject to the lien. The purchasers were not parties to the contract for the renovation of the property; therefore, although they owned equitable title, they were not the "owners" of the property, for purposes of establishing a mechanics' lien:

The only contract which the subcontractors entered for furnishing labor and materials were with the general contractor and there is no evidence that it was acting as an agent of the purchasers. Consequently, the purchasers' property was not subject to a mechanics' lien under the statute.

The Court in *York Roofing* held further that the defendants were bona fide purchasers for value, who had acquired legal title to their properties free of mechanics' liens that were established after they signed their contracts of sale. It noted, moreover, that, even if the purchasers had actual knowledge of the unpaid debts owed to the subcontractors when legal title was conveyed to them, the result would not have differed. When equitable title was transferred to the purchasers, by virtue of the execution of the contract of sale, the subcontractors merely had claims against the seller, not judgment liens. Just as a contract purchaser's prior knowledge of a claim against the contract seller that is not reduced to judgment will not impair the purchaser's equitable title or interfere with his right to take legal title upon payment of the purchase money, a contract purchaser's prior knowledge of a claim against the contract seller for which a mechanics' lien is not established will not have a like effect.

In conclusion, if you are a contractor that is doing construction on a residential property where you believe that the property is under contract at the time that you are performing work, you should ask the legal title holder, if known, whether the property is under contract or soon to be under contract. If so, be very careful since your ability to lien the job at a later time may be nil against the soon to be legal title holders of the residential property.

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