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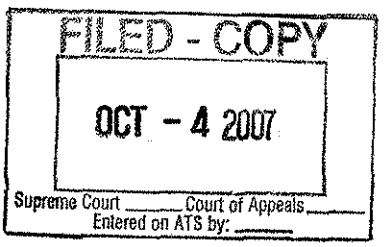
Chandler v. Hayden Appellant's Brief Dckt. 33695

No. 33695 Consolidated Under No. 33659

In the Supreme Court of the State of Idaho



First American Title Insurance Co.,
Plaintiff and Respondent/Cross-Appellant

vs.

Michael L. Chandler, individually and doing business as
Loomis Construction Company,
Defendant and Appellant/Respondent.

APPELLANT MICHAEL CHANDLER'S BRIEF

From an Appeal of a Judgment of the
Fifth Judicial District of the State of Idaho, in and for the County of Blaine
No. CV04-1119, The Honorable Robert J. Elgee, District Judge

Edward A. Lawson (ISB No. 2440), Erin F. Clark (ISB No. 6504), LAWSON & LASKI, PLLC, 675 Sun Valley Road, Suite A, P.O. Box 3310, Ketchum, ID 83340, Telephone: 208-725-0055, Facsimile: 208-725-0076

Attorneys for Defendant and Appellant, Michael L. Chandler, individually and doing business as Loomis Construction

Gary Slette (ISB No. 3198), ROBERTSON & SLETTE, PLLC, P.O. Box 1906, Twin Falls, ID 83303-1906.

Attorneys for Plaintiff and Respondent/Cross-Appellant, First American Title Insurance Company

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STATEMENT OF THE CASE

I. NATURE OF THE CASE.

If ever there was a case that exemplifies the need for equitable defenses, this case is it. In this case, Appellant Michael Chandler ("Chandler"), an individual doing business as Loomis Construction, was required to sign an oppressive indemnity agreement as part of his continuing employment to construct a home in Sun Valley, Idaho. The indemnity agreement at issue was signed by both Chandler and David and Storey Hayden, the owners of a property in Sun Valley, Idaho who had previously engaged Chandler to work as the general contractor on the construction of their new home. The indemnity agreement was demanded by Respondent First American Title Insurance Company ("First American") after the Haydens sought a $5 million construction loan from Bank of America ("BofA") to pay for the continuing construction of a residence on Lot 1 of their Sun Valley Property. As a condition of the loan, BofA demanded that it have a first lien position on Lots 1 and 2 of the Sun Valley Property and, therefore, purchased a policy of title insurance from First American. First American subsequently sought an indemnity agreement from the Haydens and Chandler that would protect First American from suffering any loss due to mechanic's liens recorded against the Sun Valley Property.

Chandler justifiably understood that the indemnity agreement required him to use the construction loan proceeds paid to him by the Haydens to pay off the subcontractors and materialmen, thereby preventing the recordation of a mechanic's lien against the property. Chandler had no idea that First American would later take the position that the indemnity agreement eliminated his own statutorily protected mechanic's lien rights. Chandler also did not know that, prior to issuing the insurance policy, First American had not obtained current financial information from the Haydens, or that the stale information First American had received from the Haydens showed that their net worth was declining at an appalling rate.

Finally, Chandler was unaware that BofA intended to pay out $4.5 million of the $5 million loan to the financially strapped Haydens immediately so that they could pay off other debts, even though most construction loans are paid out over time in accordance with the value of the work performed on the property.

All of this necessary information was kept from Chandler when he was asked to sign the indemnity agreement. Chandler simply understood that the Haydens needed a construction loan to pay him for work already completed and to continue with the construction. First American and BofA took advantage of Chandler's tenuous position. BofA knew that the Haydens were a severe financial risk but instead of denying the loan, it placed the risk of the Haydens' inability to pay on First American, who then placed the risk on Chandler, an individual who simply earns a living by constructing homes for people. Notably, BofA profited from the loan and First American profited from the insurance. Chandler, on the other hand, received nothing from the indemnity agreement other than payment for his past work and the expectation that the loan proceeds would be used to pay him for his continued work to increase the value of the property.

Unfortunately, Chandler was not paid for his hard work. The Haydens' ability to pay Chandler came to a crashing halt in November 2003 when the Haydens lost an arbitration proceeding against Robertson Stephens, Inc., a brokerage firm that claimed that the Haydens owed it over $23 million for stock market losses. As a result of the nonpayment, Chandler recorded a mechanic's lien, which was later amended. He then filed a foreclosure action against the Haydens and the other lien holders, including BofA and Robertson Stephens. That action is the subject of the consolidated appeal in Supreme Court No. 33959. In the foreclosure action, Chandler admitted that he has no lien rights against Lot 2 of the Sun Valley Property. Instead, while BofA has lien rights against both Lots 1 and 2, Chandler has lien rights only against Lot 1.

Following Chandler's filing of the foreclosure action, First American filed this lawsuit against Chandler in November 2004. Despite the unconscionability of the indemnity agreement, and the lack of any actual injury to BofA, First American sought specific performance of a provision in the agreement that purportedly required Chandler to remove his mechanic's lien from the Haydens' property. First American sought this unjust remedy because BofA instructed it to insist on the removal of Chandler's lien. BofA pushed First American to seek to destroy Chandler's ability to obtain any compensation for his work because, after Chandler signed the Indemnity Agreement, BofA acquired Robertson Stevens, a junior lien holder on the Sun Valley Property. As a result, BofA wanted the money that would come from a foreclosure sale to go to Robertson Stevens instead of the contractor whose time, effort and money went into improving the value of the property.

First American then filed two motions for summary judgment on its specific performance claim. The district court denied these motions because enforcement of that provision would be unfair in that it would deny all recovery to Chandler.

First American then filed a third motion for summary judgment, requesting that the district court determine Chandler's mechanic's lien was subordinate to the BofA deed of trust. The indemnity agreement, however, does not provide that the BofA deed of trust has priority over a mechanic's lien recorded by Chandler; it only provides that the Indemnitors agree to insure against loss caused by the recordation of a mechanic's lien. Furthermore, this relief was not requested in the Complaint filed by First American. To the contrary, First American sought nothing other than specific performance of one provision in the indemnity agreement which purported to require Chandler to remove his lien. Despite these legal deficiencies, the district court granted First American's third motion for summary judgment. It did so with the express acknowledgment that it was not addressing the equitable arguments raised by Chandler, which it

believed it need not address in order to interpret the meaning of the indemnity agreement. Thus, after unilaterally undertaking to reform the indemnity agreement, the district court entered a judgment declaring that BofA has a first lien position on both lots that make up the Haydens' property and Chander has a second lien position on Lot 1 only. The district court also awarded attorneys' fees to First American.

Chandler seeks reversal of the district court's finding that Chandler's statutorily preferred mechanic's lien rights should be trumped by the BofA deed of trust as a result of the indemnity agreement. The reasons for this reversal include the following: (1) First American did not seek in its Complaint a reformation of the indemnity agreement such that it would provide BofA with a first lien position; (2) First American did not present evidence to support a reformation of the Indemnity Agreement, and (3) there are questions of fact regarding the enforceability of the indemnity agreement, which can be resolved only after a trial on the merits is completed. Chandler also objects to the award of attorneys' fees and costs to First American because it should not have been adjudged the prevailing party.

II. STATEMENT OF FACTS AND COURSE OF THE PROCEEDINGS.

A. The Haydens' Hired Chandler to Improve Their Property.

Chandler is an individual that has done business as a general contractor in Blaine County, Idaho for the past 25 years, the last nine of which have been conducted under the tradename "Loomis Construction." (Chandler v. Hayden Record[1] "Hayden R.", p.185, ¶2.) David and Storey Hayden are the title owners of a piece of property located at Lots 1 and 2 of Back Pay Way in Sun Valley, Idaho (the "Sun Valley Property"). (Hayden R., Ex. 11 at Ex. M, pp. 16:3-

[1] This case has been consolidated with the appeal before this Court case entitled *Chandler v. Hayden*, Case. No. 33659. Therefore, there are citations to both records in this appeal. Citations to Chandler v. Hayden Record refer to the record in the Case No. 33659 appeal and citations to Record refer to the record in this appeal.

13.) When the Haydens purchased the Sun Valley Property in early 1999, Lot 1 contained a main house and Lot 2 contained a guesthouse. (Hayden R., p. 185, ¶3.) In August 1999, the Haydens met with Chandler and decided to hire him to begin immediately remodeling the main house that currently existed on Lot 1. (Hayden R, p. 185, ¶3.) The Haydens also engaged Chandler to perform some improvement work on the guesthouse that existed on Lot 2. (Hayden R., Ex. 11 at Ex. M. p. 48.) This improvement work on the Lot 2 guesthouse was *fully* paid for by the Haydens. (*Id.* at p. 48:19-22.)

The agreement between the Haydens and Chandler was an oral contract under which Chandler agreed to perform work on the Sun Valley Property for cost plus eight percent. (Hayden R, p. 185, ¶3.) In accordance with this agreement, Chandler sent the Haydens monthly invoices that included all of the subcontractor and materialmen invoices, the time spent by Loomis Construction and the general contractor markup. (Hayden R, p. 185, ¶4; R., Ex. 11 at Ex. M, p. 31.) Chandler began working on the remodel in early September 1999. (*Id.*) In a change of plans, however, the Haydens decided to demolish the existing house in December 1999 and the construction of a new home, called The Ark, began in earnest in the Spring of 2000. (Hayden R, p. 185, ¶5.)

B. The Bank of America Deed of Trust.

By early November 2000, Chandler and the Haydens expected the Project to cost an additional $7,000,000 to complete. (Hayden R, p. 185, ¶5.) In order to pay for the past and future construction, the Haydens informed Chandler that they were taking out a $5,000,000 construction loan from Bank of America ("BofA") and that they would use the Sun Valley Property as the security for the loan. (*Id.*) The Haydens did not, however, reveal to Chandler that they were using $3.5 million of the funds immediately to pay off existing debt.

As a condition of the construction loan, BofA insisted that there be title insurance insuring that its construction deed of trust was a first lien on the Sun Valley Property. BofA sought this title insurance from First American Title Company. First American inspected the Sun Valley Property on November 3, 2000 and determined that substantial work by Chandler had already begun. (Hayden R., Ex. 11 at Ex. N, p. 44.) Thus, under Idaho's mechanic's lien law, Chandler's inchoate lien right had priority over the construction deed of trust that BofA intended to record against the Sun Valley Property to secure its construction loan. See I.C. §45-506. Under the regulations of the Idaho Department of Insurance and First American's own policies and procedures, due to what is referred to as a "broken priority issue," First American could not insure that BofA's construction deed of trust would be in a first lien position unless it obtained an adequate indemnity from a responsible person and determined from current verified financial statements that the risk of insuring over the inchoate lien was acceptable. (Hayden R., Ex. 11 at Ex. N, p. 49:18-50:13.)

On November 3, 2000, First American issued its commitment to BofA for an ALTA lender's policy of title insurance insuring that BofA's construction deed of trust would be in a first lien position on the Sun Valley Property notwithstanding the broken priority issue it had identified ("Commitment"). (Hayden R., Ex. 11 at Ex. A; R., Ex. 11 at Ex. N, p. 49:18-51:1.) First American issued its Commitment to BofA on the condition that it obtain an acceptable indemnity agreement from the owner and/or general contractor. (Hayden R., Ex. 11 at Ex. N, p. 38:16-19.)

Concurrent with issuance of the Commitment, First American's local Ketchum agent submitted a Mechanic's Lien Risk Addendum form to its underwriter in Blackfoot, Idaho and requested authority to issue the policy of title insurance requested by BofA. (Hayden R., Ex. 11 at Ex. N, p. 71:2-72:2.) In the Mechanic's Lien Risk Addendum form, the general contractor

was described as a corporation named "Loomis Construction." (*Id.*, at 72:4-11.) Chandler, the individual, does not appear anywhere on the form used to evaluate the risk of issuing the requested title insurance policy. (Hayden R., Ex. 11 at Ex. B.)

In November 2000, to get around the "broken priority issue," First American presented an indemnity agreement to Chandler and the Haydens for their signatures. (Hayden R., Ex. 11 at Ex. C; R., Ex. 11 at Ex. N, p. 64.) The Indemnity Agreement provided, in part, the following: (1) the Haydens agreed to pay Chandler for labor and material supplied to the Hayden Property, (2) Chandler agreed to pay subcontractors and materialmen, and (3) each agreed to indemnify First American against any loss arising from the imposition of a mechanic's lien on the Sun Valley Property. (*Id.*) Based on his reading of the Indemnity Agreement and what he was told by David Hayden, Chandler understood that the Haydens were obligating themselves to First American to pay him and he was obligating himself to pay subcontractors and materialmen who provide labor or supplies to the Sun Valley Property. (R., p. 66.)

Notably, paragraph 8 of the Indemnity Agreement provides that "Indemnitor shall . . . submit to First American an audited financial statement or if no audited statement is available and if First American elects to accept an unaudited statement from Indemnitor, which statement shall accurately represent the financial condition of Indemnitor." (*Id.*) The regulations of the Department of Insurance and First American's own policies and procedures also required First American to obtain current verified balance sheets for both Chandler and the Haydens. Despite this requirement, First American failed to request or obtain this necessary information from Chandler or "Loomis Construction" prior to November 6, 2000 when it approved the issuance of the lender's policy of title insurance requested by BofA and described in the Commitment. Moreover, it was not until November 16, 2000, *ten days* after authorizing the issuance of the title insurance policy, that First American received the Haydens' financial information. (Hayden R,

Ex. 11 at Ex. 0, p. 41:2-24.) At this time, the Haydens provided First American with a "Weekly Statement of Financial Condition" dated May 22, 2000. (*Id.*; R., Ex. 11 at Ex. D.) Notably, this Weekly Statement of Financial Condition was neither verified nor current. (Hayden R., Ex. 11 at Ex. 0, p. 42:15-22.) To the contrary, it was *twenty-five weeks old* at the time presented. Furthermore, although the stale-dated and unverified Weekly Statement of Financial Condition showed Haydens had a net worth of more than $146,000,000.00, it also showed that the Haydens were experiencing a decline in their net worth at the appalling rate of $10,000,000.00 to $20,000,000.00 *per week.* (*Id.,* at 43:8-25.) There is also no evidence that anyone within First American actually reviewed the Haydens' stale-dated unverified Weekly Statement of Financial Condition to assess the risk of relying on them as indemnitors. (*Id.,* at 41:9-25; 42:1-20.)

Chandler, as a party to the Indemnity Agreement, understood from paragraph 8 thereof that First American had received and reviewed the Haydens' Financial Statement and concluded they had a net worth sufficient to rely upon in issuing the title insurance policy without an exception for inchoate mechanic's liens. (R., p. 66.) First American never asked for nor did it ever review any financial statement of Chandler. (*Id.*, at p. 67.) Chandler, therefore, believed First American was relying only on the Haydens' financial condition. (*Id.*, at p. 66.) Based on this belief, and the need to be paid for his past work on the Project, Chandler signed the Indemnity Agreement.

After First American obtained the Indemnity Agreement, BofA agreed to provide the Haydens with the construction loan. On November 27, 2000, BofA recorded a Deed of Trust against the Property in the amount of $5,000,000. (Hayden R., Ex. 11 at Ex. E; R, Ex. 11 at Ex. M, p. 61:11-62:12.) Years later, in February 2003, Robertson Stephens purchased the BofA Deed of Trust on the Sun Valley Property, giving it two separate encumbrances on that Property. (Hayden R., Ex. 9 at Ex. 11.)

C. The Deterioration of the Haydens' Financial Condition.

Unbeknownst to Chandler, however, the construction loan was not paid out over time to the Haydens. Instead, BofA paid $4,500,000 of the $5,000,000 loan in November 2000. (Hayden R., Ex. 11 at Ex. M, p. 35.)[2] Not knowing that the majority of the loan proceeds had been disbursed to the Haydens or for their benefit, and believing that the Hayden's financial condition was strong, Chandler continued to work on the Sun Valley Property and supply all of the labor and material used to improve it. (Hayden R., p. 186, ¶9.) Chandler's work resulted in the addition of significant value to the Hayden Property and the collateral position of BofA.

Meanwhile, the Haydens' financial condition started to deteriorate to the point where, beginning about September 1, 2001, they began having trouble paying Chandler for his work and that of the subcontractors and suppliers. (*Id.*, at ¶10.) In order to induce Chandler to continue working on the Project, the Haydens repeatedly informed Chandler that he would get paid and, in fact, they made partial payments on the outstanding invoices. (*Id.*) Therefore, he continued to work on the Project. (*Id.*)

D. Chandler's Mechanic's Lien.

In approximately May or June of 2003, Mr. Hayden informed Chandler that the Haydens were involved in a lawsuit with Robertson Stephens, which had tied up his cash flow. (*Id.*, at ¶11.) Mr. Hayden told Chandler that he believed the case would settle soon or result in a favorable award and that he would then be able to pay Chandler the past amount due. Chandler, therefore, continued to work on the Sun Valley Property. (*Id.*)

In early November 2003, however, Mr. Hayden informed Chandler that he and his wife had lost the arbitration. (*Id.*, at ¶12.) At that time, the Haydens and Chandler discussed stopping any further work on the Project. (*Id.*; Hayden R., Ex. 11 at Ex. M, pp. 39-40.) Chandler

thereafter performed only that work that was necessary to protect the improvements made to date and finish tasks that could not be left uncompleted. (*Id.*) Chandler's last day of work on the Project was during the week of November 20, 2003. (*Id.*) In an effort to protect all the subcontractors that worked on the Hayden Property, Chandler borrowed approximately $400,000.00 to pay the suppliers and materialmen. (*Id.*, at ¶13.)

Due to the Haydens failure to pay the outstanding invoices, Chandler recorded a mechanics' lien on the Sun Valley Property on December 30, 2003. (*Id.*, Ex. A.) This lien, in the amount of $1,491,020.33, was amended on January 29, 2004 and recorded as Instrument No. 498496 (the "Amended Lien"). (*Id.*, Ex. B.) Chandler then filed and recorded a Second Amended Notice of Lien on April 28, 2004 in the amount of $1,708,151.39, which was later abandoned by Chandler.

E. The Resulting Litigation.

In May 2004, Chandler filed a Complaint against the Haydens, Bank of America, Robertson Stephens and the other lien holders, seeking to establish and foreclose on the debt owed to him by the Haydens. (Hayden R., pp. 1-9, 57-66.) Robertson Stephens and BofA then counterclaimed against all of the defendants and sought to foreclose on their liens. (Hayden R., pp. 67-133.)

In November 2004, after Chandler filed his foreclosure action, First American filed its Complaint for Specific Performance against Chandler in this action. (R., pp. 1-23.) In its Complaint, First American set forth one claim, which was for specific performance of paragraph 6 of the Indemnity Agreement. This paragraph provides, in part, the following: "In the event that any Mechanics' Lien of Liens are filed against the Property, Indemnitor shall within twenty

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[2] Approximately $3.5 million of the loan proceeds were disbursed to First Republican Bank to retire Haydens' indebtedness incurred before Chandler's indemnity of First American.

(20) days of such filing: A. Cause a release of the Mechanics' Lien of Liens to be filed of record in the County Recorder's Office; or . . ." (R., p. 6) Based on this language, First American sought solely an order requiring Chandler to remove his mechanic's lien from the Sun Valley Property.

First American then filed two summary judgment motions in January and June of 2005, both times seeking an order compelling Chandler to release his mechanic's lien. (R., pp. 40-41 and 72-73) Chandler argued against these motions on the following grounds: (1) the indemnity agreement was ambiguous on its face as to what Chandler's obligations were with respect to his own liens versus his subcontractors' liens, and (2) specific performance is an equitable remedy that should be granted only if monetary damages are inadequate and performance would not result in an unjust or oppressive consequence to the other party. (Transcript "TR", pp. 36-48). The district court properly rejected both of First American's motions that sought specific performance, finding that it would be "inequitable to compel Chandler to release his liens in their entirely consistent with the terms of the Indemnity Agreement, since the position of other lien creditors would be enhanced at the expense of Chandler." (Hayden R., p. 247)

In August 2005, First American filed a third summary judgment motion. (R., pp. 100-102.) Although its complaint contained no claim other than a request for specific performance of paragraph 6 of the Indemnity Agreement, and the Indemnity Agreement does not provide for the subordination of a mechanic's lien to the BofA deed of trust, First American sought an order declaring Chandler's lien to be junior to the BofA deed of trust. (*Id.*) On October 26, 2005, before hearing this third motion for summary judgment, the district court consolidated the *Chandler v. Hayden* action with this action. (Hayden R., pp. 242-45.) In November 2005, without addressing any of the equitable arguments raised by Chandler, or the fact that First American failed to present facts sufficient to grant a reformation of the Indemnity Agreement,

the district court granted First American's third motion for summary judgment. (Hayden R., pp. 246-249.)

Meanwhile, in the consolidated *Chandler v. Hayden* action, both Chandler and Robertson Stephens filed motions for summary judgment motions establish their lien priorities. (Hayden R., pp 181-183 and R, Ex. 10.) In December 2005, the district court granted Chandler's summary judgment motion, finding that Chandler's lien on Lot 1 of the Sun Valley Property has priority over Robertson Stephen's lien. (Hayden R., pp. 277-290).

Subsequently, on October 2, 2006, the district court entered a comprehensive judgment in the two consolidated cases. (Hayden R., pp. 396-403.) In relevant part, the judgment provides the following:

- BofA's $5 million deed of trust is a valid lien and in first position on Lots 1 and 2;
- First American is awarded judgment on its Complaint and fees and costs in the total amount of $17,143;
- Chandler's lien is valid against only Lot 1 and is subordinate to the BofA deed of trust;
- Chandler is awarded judgment against the Haydens in the total amount of $1,944,030.22;
- Robertson Stephens is awarded judgment against the Haydens in the total amount of $28,733,810.25.
- Robertson Stephens' deed of trust is valid against Lots 1 and 2, but is subordinate to the BofA deed of trust on both lots and Chandler's lien on Lot 1.

ISSUES PRESENTED ON APPEAL

1. Whether the District Court erred in granting relief that was not sought in First American's Complaint against Chandler?

2. Whether the District Court erred by reforming the Indemnity Agreement without any factual or legal support for the contractual remedy of reformation?

3. Whether the District Court erred in failing to address Chandler's equitable defenses, which raise material issues of fact regarding the enforceability of the Indemnity Agreement against Chandler?

4. Whether the District Court erred in awarding attorneys' fees to First American?

ARGUMENT

I. STANDARD OF REVIEW.

In this case, the district court found as a matter of law that Chandler's mechanic's lien is inferior to the BofA deed of trust as a result of the Indemnity Agreement. This finding was a conclusion of law, of which the Court also exercises free review to determine whether the district court correctly stated the applicable law and whether the legal conclusions are sustained by the facts found. *Bumgarner v. Bumgarner*, 124 Idaho 629, 637, 862 P.2d 321, 329 (Ct. App. 1993). As set forth below, the district court failed to state the applicable law when it found (1) that First American could seek relief not pleaded in its complaint, and (2) that it need not address the equitable arguments raised by Chandler because the district court was interpreting the meaning of a contract between parties.

Furthermore, when faced with an appeal from a lower court's grant of a summary judgment motion, the Court reviews the ruling by employing the same standard properly applied by the district court. *Featherston v. Allstate Ins. Co.*, 125 Idaho 840, 842, 875 P.2d 937, 939 (1994). Summary judgment should be rendered only if the pleadings, depositions and admissions, together with the affidavits, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law. I.R.C.P. 56(c). In this case, the district court's conclusion that a reformation of the Indemnity Agreement was appropriate was not supported by the facts introduced into evidence by First American. Nor was the determination in accordance with the court's equitable powers.

Therefore, as set forth in detail below, the court's judgment subordinating Chandler's lien on Lot 1 to the BofA deed of trust should be reversed. Instead, First American's complaint should either be dismissed without prejudice or remanded back to the district court for a determination of whether a reformation of the contract is factually supported and, if so, whether enforcement should be denied as a result of Chandler's defenses.

II. FIRST AMERICAN'S MOTION SHOULD HAVE BEEN DENIED BECAUSE ITS COMPLAINT DID NOT SEEK DECLARATORY RELIEF.

In its Complaint, First American included only one claim – a claim for specific performance of paragraph 6(A) of the Indemnity Agreement. (R., pp. 1-3.) In fact, with the exception of the general "other and further relief" statement, First American expressly stated in its prayer for relief that it sought only a judgment "requiring Chandler to specifically perform the terms of the Indemnity Agreement by filing a release of the Liens relative to the Real Property." (*Id.*, at p. 3.) First American then brought two separate motions for summary judgment seeking to have Chandler forced to remove his mechanic's lien. It brought these two motions even though it had not suffered any damage due to the Chandler lien.[3] Indeed, First American is injured only if the BofA deed of trust is not fully paid by either the Haydens or through a foreclosure sale. Therefore, even if Chandler records a mechanic's lien against the property, First American is not injured unless there are insufficient funds to pay off the BofA deed of trust. This truism was obviously recognized by First American since the stated purpose of the

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[3] As of the date First American filed its complaint against Chandler, it had only been tendered the defense of this foreclosure action by BofA. Significantly, BofA never ascertained any facts giving rise to any loss or damage of which it made First American aware. (R., Ex. 1 at Ex. A, p. 114.) Inexplicably, First American also admits it filed its action for specific performance without investigating the potential loss to BofA and that it did nothing to ascertain the value of the Hayden Property to determine whether there was even a risk to it being paid off from a sale of the property. (*Id.* at 120:1-4.)

Indemnity Agreement, which is recited in paragraph 3 of the agreement, was to protect First American from suffering any "loss" from the filing of a mechanic's lien. (R., p. 5.)

The district court, however, understood that this request would have resulted in a highly inequitable result and, therefore, denied both motions. (Hayden R., p. 247.) It came to this conclusion for two reasons: (1) First American's only valid interest in whether Chandler's lien is recorded against the Sun Valley Property is a monetary, not property, interest; and (2) First American sought specific performance in order to provide an improper windfall to its insured, BofA, whose subsidiary has a third lien position on Lot 1 of the Property.

The district court's denial of these two motions was proper because First American failed to establish a right to specific performance. Specific performance is an appropriate remedy only if money damages cannot fully compensate the aggrieved party. *Meikle v. Watson*, 138 Idaho 680, 69 P.3d 100 (2003); *see also Suchan v. Rutherford*, 90 Idaho 288, 410 P.2d 434 (1966) (equity will not intervene where the aggrieved party has a plain, adequate and complete remedy at law). In fact, in *Meikle*, the Court upheld the district court's finding that specific performance was unavailable in an action to enforce a land sale contract – which is typically enforceable since land is unique – because the purchaser intended to resell the property and, thus, did not need it for any specific purpose. *Id.*, at 103. The Court agreed with the district court's finding that specific performance would not bring the party seeking performance any greater relief than would damages. Notably, since the party seeking performance had not sought damages for the alleged breach of contract, the Court upheld the lower court's dismissal of his counterclaim against the sellers. *Id.*

Similarly, requiring Chandler to remove his mechanic's lien from the Sun Valley Property would not provide First American with any greater relief than would damages if and when BofA actually suffers injury due to Chandler's lien. In fact, as set forth below, First

American admitted that it could be made whole as a result of Chandler's alleged breach of the Indemnity Agreement by way of damages. First American's own policy and procedure is to accept indemnity agreements only when the issue is one that can be solved by the payment of money. (R., Ex. 1 at Ex. A.) Specifically, First American's Policy Memo 96-1 states: "Our standard procedure is to accept an indemnity when the issue could ultimately be solved by providing money." This policy was confirmed by Michael Ferrin, First American's Regional Counsel and Underwriter, who testified as follows:

> Q. And it's also fair to say, isn't it, Mike, that with respect to Indemnity Agreement Number I where you've got a broken priority issue that those issues generally can be resolved by providing money; correct?
> A. That's correct.
> Q. So it would be fair to say that the Indemnity Agreement No. 1 would be one that would fit within the standard procedure to accept it when the issue could ultimately be solved by providing money?
> A. Well obviously it's fair to say that the construction-mechanic's lien issue can be resolved by the payment of money.
> Q. So taking the indemnity agreement in that context would be consistent with your standard procedure?
> A. . . . If the issue could not be solved with the payment of money, we probably would not take the indemnity.
> Q. In a mechanic's lien broken priority?
> A. In a mechanic's lien broken priority issue.

(*Id.*, at 31:19-32:19.)

At the hearing on its motions for summary judgment, First American argued that it was injured only by way of the attorneys' fees it had incurred in prosecuting the specific performance claim. (Tr. at 22:10-23:16.) These fees, however, do not relate to the alleged breach of the Indemnity Agreement; instead, they relate to First American's unsuccessful attempt to enforce an oppressive contract provision despite the fact that money would be a perfectly acceptable remedy. *See Meikle, supra*, at 102 (court rejected proposition that costs incurred in unsuccessfully pursuing specific performance of a contract were damages relating to the breach

of the contract). Therefore, First American did not allege any damages in its complaint sufficient to support a breach of contract theory.

Furthermore, the district court's refusal to grant specific performance was proper because a party who seeks equity must enter the court with clean hands. *Curtis v. Becker*, 130 Idaho 378, 383, 941 P.2d 350, 355 (Ct. App. 1997); *see also Suchan v. Rutherford*, 9 Idaho 288, 410 P.2d 434 (1966) ("To come within the equitable rule [a party] must stand before the court prepared to meet its scrutiny, relying upon the fairness and equitable character of the contract. This must not only be his own position, but he must also show that it is not unjust or oppressive to the defendant to compel him to perform specifically.").

In this case, notwithstanding its implied obligation to act in good faith and to deal fairly with Chandler, First American insisted that Chandler release his mechanic's lien only because BofA demanded that it do so. In fact, prior to making its demand for a release of his mechanic's lien, First American and Chandler were negotiating a potential settlement under which Chandler would dismiss BofA from the foreclosure action, which would have satisfied First American's obligation to BofA and preserved Chandler's mechanic's lien priority in relation to all other lienholders, including Robertson Stephens. (R., Ex. 1 at ¶¶2-4.) While this settlement was being discussed, Chandler was also negotiating with BofA to foreclose on the Property in a cooperative manner. (*Id.*) Then, without warning, First American withdrew its offer of settlement and instead insisted that Chandler release his lien within five days. (*Id.*, at ¶5 and Ex. A, pp. 135 and 138-144.) First American's counsel explained that BofA had insisted that it make this demand on Chandler. (*Id.*) Thus, First American colluded with its insured, BofA to try to eliminate Chandler's mechanic's lien on the Sun Valley Property in order to enhance the priority of the junior lien position of BofA's subsidiary, Robertson Stephens.

In fact, First American's representative, Mr. Ferrin, candidly admitted the influence of BofA on his decision when he testified regarding the letter his counsel wrote on November 8, 2004 to Chandler's counsel, as follows:

Q. In the second sentence counsel is telling me, "First American's insured, Bank of America had demanded that this matter be resolved immediately." That's what Bank of America was demanding in the Deposition Exhibit 22; right?
A. Um-hum.
Q. And counsel goes on to say, "and that the lien of your client on the Hayden property be released pursuant to the terms of the indemnity agreement." Do you see that?
A. Yes.
Q. And then he says, "As such, demand is hereby made upon you and/or your client pursuant to paragraph 6a to release any and all notice of liens filed by Michael Chandler and/or Loomis Construction company as set forth in the complaint on file in this action." Do you see that?
A. Yes.
Q. And then he goes on to say you've got five days to do that and this is a revocation of any authority to undertake the action discussed in the October 20 letter. Do you see that?
A. Yes.
Q. Okay. Now, I assume that the communication to me and the content of this letter was approved by First American Title Company.
A. Yes.
Q. And that the letter or the decisions reflected in the letter to make demand upon Mr. Chandler to release his lien and to take away or revoke the opportunity to dismiss B of A was done in response to Bank of America's demand.
A. The letter says it was, and it perhaps was, but we're not obligated to accede to Bank of America's demands.
Q. Okay. But nevertheless you did.
A. It might have been relevant, yes.

(R., Ex. 1 at Ex. A, pp. 142:11-143:22.)

Later, Mr. Ferrin offered an explanation for the relevance of the demand of BofA on his decision:

Q. Okay. Does your company do a significant amount of business with Bank of America?
* * *
A. I don't know the extent of our business with First American – or with Bank of America.
Q. Is it ongoing business?

A. Yes.
Q. Okay. For years you've been issuing insurance policies and closing loan transactions for Bank of America?
A. Yeah, I think that's fair to say.
Q. And is it also fair to say, Mike, that you'd like to continue to do that in the future?
A. Of course.
Q. And that you get paid -- your company gets paid for issuing policies and performing those services.
A. Yes.
Q. And you'd like to continue to make that money.
A. Yes.

(*Id.*, at 158:3-23.) Since First American was pursuing its claim for specific performance in order to benefit BofA's subsidiary, the district court correctly noted that First American's claim was an attempt to give its insured an improper windfall for the amount of Chandler's labor and efforts on the Property. (Tr., p. 51:16-53:3.) As such, First American was not entitled to ask for specific performance.

Instead of dismissing the complaint for specific performance, however, the district court allowed First American to seek a different form of relief. Although First American's prayer for relief seeks nothing other than an order requiring Chandler to specifically perform the terms of the Indemnity Agreement by filing a release of his lien, its third motion for summary judgment suddenly requested a declaration that the BofA deed of trust has priority over Chandler's mechanic's lien. The district court entertained – and ultimately granted – this motion without requiring any amendment of the Complaint. This decision, however, was not authorized under Idaho law. Idaho law clearly provides that "issues considered on summary judgment are those raised by the pleadings." *Cafferty v. State of Idaho*, 144 Idaho 324, 160 P.3d 763, 767 (2007), *citing Gardner v. Evans*, 110 Idaho 925, 939, 719 P.2d 1185 (1986). Furthermore, although courts are permitted under I.R.C.P. 15(b) to amend a pleading to conform to the proof offered at trial, "a cause of action not raised in a party's pleadings may not be considered on summary judgment." *Id., citing O'Guin v. Bingham County*, 139 Idaho 9, 15, 72 P.3d 849, 855 (2003).

In *O'Guin*, *supra*, the Court unequivocally upheld the district court's determination that the plaintiffs could not survive summary judgment on an unpled theory of liability. 139 Idaho at 15. In *O'Guin*, the parents of children who died in a County-owned landfill filed a wrongful death action against the County alleging a claim of attractive nuisance. The County sought a dismissal of that claim because its only duty to trespassers was to refrain from willful and wanton conduct, which the plaintiffs had failed to plead. The Court acknowledged that the pleadings must give adequate notice of the claim being asserted. Thus, a cause of action not raised in the pleadings may not be considered on summary judgment. *Id.* Notably, under I.R.C.P. 7(a) "pleadings" do not include motions. *Id.*, *citing O'Neil v. Schuckardt*, 116 Idaho 507, 777 P.2d 729 (1989). In upholding the granting of summary judgment to the County, the Court also rejected the plaintiffs' argument that the theory of liability was litigated at the summary judgment hearing and, therefore, they should be permitted to amend their complaint under I.R.C.P. 15(b). Instead, the Court reaffirmed that this rule applies only to unpled theories that are litigated at a trial on the merits and not to factual issues raised in a motion for summary judgment. *Id.* Furthermore, although the plaintiffs' could have sought to amend their complaint, upon their failure to do so, the County was entitled to judgment in its favor. *Id.*

In this case, First American's Complaint does not contain a claim for declaratory relief or contract reformation. The only document that even raises the issue is First American's third motion for summary judgment, which is not a "pleading" sufficient to satisfy Rule 7(a). First American also could have sought to amend its Complaint, but it chose not to do so. As a result, it was not entitled to seek judgment through a summary judgment motion. Instead, its request for declaratory relief should have been dismissed along with its complaint for specific performance.

III. FIRST AMERICAN'S MOTION SHOULD HAVE BEEN DENIED BECAUSE IT DID NOT PRESENT EVIDENCE TO SUPPORT A CLAIM FOR CONTRACT REFORMATION.

In making its decision to grant First American's motion seeking declaratory relief, the district court reformed the Indemnity Agreement between the parties. Specifically, the district court found that the Indemnity Agreement subordinated Chandler's lien on Lot 1 to BofA's deed of trust, which covers both Lots 1 and 2. A review of the Indemnity Agreement, however, evidences that there is no provision by which Chandler agreed to subordinate his lien rights to BofA. There is a provision that purports to obligate Chandler to remove or cause the release of any mechanic's lien from the Property, but this provision is not specifically enforceable against Chandler for the reasons set forth above. (R., p. 6.) There is also a provision that purports to obligate Chandler "to hold and save First American harmless, and to protect and indemnify First American from and against any and all liabilities or claims of liability, losses, costs, charges, expenses and damages of any kind or character whatsoever . . . by reason of or arising out of any Mechanics' Lien or Liens . . ." (R., pp. 7-8.) These are the only relevant obligations set forth in the Indemnity Agreement that could be alleged against Chandler with regard to his lien.

Therefore, in coming to its decision to interpret the Indemnity Agreement such that it subordinated Chandler's lien to the BofA deed of trust, the district court had to have reformed the Indemnity Agreement to include such an obligation. Contract reformation, however, is proper only when the instrument does not reflect the intentions of the parties and that such failure is the product of a mutual mistake of the parties. *Uptick Corp. v. Ahlin*, 103 Idaho 364, 371, 647 P.2d 1236, 1243 (1982). The mistake must also be "material or, in other words, so substantial and fundamental as to defeat the object of the parties." *Bailey v. Ewing*, 105 Idaho 636, 639, 671 P.2d 1099, 1102 (Ct. App. 1983). Importantly, by reforming a contract, the court is not making a new contract. Instead, "the court gives effect to the contract which the parties did in fact make,

but which by reason of mistake was not expressed in the writing executed by them." *Uptick, supra,* at p. 372, *citing Bilbao v. Krettinger*, 91 Idaho 69, 415 P.2d 712 (1966).

Therefore, to support a claim of contract reformation, First American was required to introduce into evidence undisputed facts that established that both Chandler and First American intended to obligate Chandler to subordinate his lien rights to BofA's deed of trust. First American, however, did not sustain this burden. First, Chandler expressly stated that he did not believe that he had agreed to subordinate his mechanic's lien rights when he signed the Indemnity Agreement. Instead, he stated that it was his understanding that the Haydens were obligating themselves to First American to pay him, and that he was obligating himself only to use the funds provided to him by the Haydens to pay the subcontractors and materialmen who provided labor or supplies to the Sun Valley Property. (R., p. 66.) Given that it makes no sense to construe the Indemnity Agreement as requiring him to pay himself so as to avoid the recordation of a mechanic's lien, his interpretation is wholly reasonable.

Second, First American presented no evidence by way of affidavit to support a reformation claim. There is no evidence whatsoever that First American mistakenly understood that the Indemnity Agreement obligated Chandler to subordinate his mechanic's lien rights to BofA. In fact, First American did not even submit any affidavits with its third motion for summary judgment. Instead, without providing case law support, First American simply argued that it was entitled to a declaration of subordination under the district court's equitable powers. But even if the district court is permitted to reform a contract under its equitable powers, First American presented no evidence to support its claim that an inequitable result would occur unless Chandler's lien was subordinated to the BofA deed of trust. As set forth above, BofA has not yet suffered any actual loss as a result of Chandler's lien because its deed of trust has not yet been foreclosed on. Moreover, First American can be made whole through monetary damages

when and if BofA ultimately suffers any loss, which is unlikely to occur since the Property is worth more than $8 million. (R., Ex. 2.)

On the other hand, it is highly inequitable *to Chandler* to require him to subordinate his lien to the BofA deed of trust. Inequity occurs because Chandler's lien is attached only to Lot 1 of the Sun Valley Property whereas the BofA deed of trust covers both Lots 1 and 2. As a result, BofA could presumably foreclose on Lot 1 first and apply all of the proceeds to its $5 million deed of trust. Chandler would then be left with little to no remaining sale proceeds to compensate him for the money and effort he put into improving the value of the Property. Nor would Chandler have any other assets to attach because Robertson Stephens already attached all of the Haydens' remaining assets. This foreclosure strategy would directly benefit BofA's subsidiary, Robertson Stephens, because it is in second position on Lot 2 and would, therefore, receive more proceeds from a foreclosure sale of that lot since the BofA deed of trust would likely be extinguished from a foreclosure on Lot 1. Given BofA's insistence that First American seek an order requiring Chandler to remove his lien from the Sun Valley Property, this scenario is more than likely should Chandler's lien be subordinated to the BofA deed of trust.

Therefore, the only way to obtain an equitable result in this case is to allow Chandler to retain his lien rights in the priority that the Legislature intended when it enacted Idaho's mechanic's lien laws. Then, should BofA not obtain everything it is entitled to receive under its deed of trust, and First American is thereby damaged, First American can seek indemnity from Chandler under the Indemnity Agreement, if the agreement is determined to be enforceable. Therefore, the district court's granting of the third motion for summary judgment should be reversed and First American's complaint should be dismissed without prejudice.

IV. FIRST AMERICAN'S MOTION SHOULD HAVE BEEN DENIED BECAUSE THE DISTRICT COURT FAILED TO ADDRESS CHANDLER'S DEFENSES TO CONTRACT ENFORCEMENT.

In addition to arguing that First American was not entitled to specific performance, Chandler also argued that the Indemnity Agreement should not be enforced in any manner as a result of several asserted defenses. These defenses included defenses to the formation of the Indemnity Agreement and defenses to its enforcement. In coming to its conclusion that it could reform the Indemnity Agreement so that it subordinated Chandler's lien to the BofA deed of trust, the district court found that it need not address Chandler's equitable defenses to the formation or enforcement of the contract. It determined that it need not address these defenses because it was interpreting the meaning of a contract between the parties as a matter of law. (Hayden R., p. 247.) As set forth below, this ruling was erroneous.

In its third motion for summary judgment, First American essentially morphed its claim into a claim for a declaration that Chandler's lien was subordinate to the BofA deed of trust. Notably, this declaratory relief consists of both contract interpretation and contract enforcement because it has a direct affect on Chandler's statutory lien rights. Therefore, in order to obtain this relief, First American was required to present evidence establishing that the parties to the Indemnity Agreement intended for such a subordination at the time of contracting. Then, Chandler was entitled to show that declaratory relief was not appropriate because he has viable defenses that preclude the enforcement of the Indemnity Agreement. *See Schiewe v. Farwell*, 125 Idaho 46, 867 P2d 920 (1993) (Court addressed equitable claims in determining whether tenant was entitled to a declaration that she had a right to remain on the land under a Conservation Reserve Program contract); *see also Idaho Power Co. v. Cogeneration, Inc.*, 134 Idaho 738, 746, 9 P.3d 1204, 1212 (2000) (Court held that burden of proving existence of a contract and its breach is on the plaintiff and defendant has the burden of proving affirmative

defenses that excuse performance). Indeed, it simply would not make sense to provide the declaratory relief sought by First American without even addressing whether it is actually entitled to receive that relief.

Instead, the district court should have reviewed the evidence and determined if Chandler had raised an issue of fact sufficient to survive a motion for summary judgment. *See Jordan v. Beeks*, 135 Idaho 586, 590, 21 P.3d 908 (2001) (all facts and inferences are to be construed most favorably toward the party against whom judgment is sought, and summary judgment is appropriate only if the uncontroverted facts lead to a definite disposition as a matter of law). A review of the evidence presented would have established that Chandler met his burden. In fact, Chandler presented evidence to support several defenses to the formation and enforcement of the Indemnity Agreement.

A. Chandler Presented Evidence Establishing Fraud And Mutual Mistake.

First, with regard to contract formation, Chandler presented evidence to support two defenses: fraud in the inducement and mutual mistake. That is, Chandler claimed that First American either (1) fraudulently induced Chandler to sign the Indemnity Agreement by intentionally not disclosing that it had failed to receive and analyze the financial ability of the Haydens to pay him the proceeds of the construction loan, or (2) shared Chandler's mistaken belief that the Haydens would be financially capable of paying him for the work he performed on the Property.

To establish a prima facie case of fraud, Chandler needs to prove at trial the following elements: (1) a statement or representation of fact; (2) its falsity; (3) materiality; (4) knowledge of the falsity; (5) intent for reliance; (6) the hearer's ignorance of the falsity; (7) justifiable reliance; and (8) resultant injury. *Hines v. Hines,* 129 Idaho, 847, 851 (1997). Silence may constitute fraud when a duty to disclose exists. *Sowards v. Rathbun*, 134 Idaho 702, 707 (2000).

A duty to disclose exists "if a fact known by one party and not the other is so vital that if the mistake were mutual the contract would be voidable, and the party knowing the fact also knows that the other does not know it." *Id.* Notably, the clear and convincing standard of proof relating to a fraud claim is not required to withstand a motion for summary judgment. *Hines,* at 852.

With regard to his claim for mutual mistake, such a claim arises when both parties, at the time of contracting, share a misconception regarding a basic assumption or vital fact upon which the bargain is based. *Hines*, at 853. Therefore, to establish this defense to the formation of the Indemnity Agreement, Chandler must show that both he and First American held a mistaken belief about a fact that was so substantial and fundamental that it defeats the object of the parties. *Leydet v. City of Mountain Home*, 119 Idaho 1041, 1044 (Ct. App. 1991).

Chandler presented evidence supporting both of these defenses. Paragraph 8 of the Indemnity Agreement required First American to obtain an accurate representation of the financial strength of the Haydens and Chandler prior to entering into the Indemnity Agreement. Indeed, the regulations of the Department of Insurance and First American's own policies and procedures required First American to obtain current verified balance sheets for both Chandler and the Haydens. (Hayden R., Ex. 11 at Ex. N, p. 49:18-50:13.) Chandler understandably relied on this requirement in the Indemnity Agreement when he agreed to sign it. Indeed, he reasonably believed that by signing the Indemnity Agreement, he was only agreeing to use the proceeds of the BofA construction loan disbursed to him by the Haydens to his subcontractors to insure that mechanics' liens would not be recorded against the Property. Since Chandler also understood that the Haydens were the ones that were primarily obligating themselves to pay off the BofA deed of trust, he reasonably believed that First American would have investigated the financial wherewithal of the Haydens. Certainly, he did not believe that he – an individual working hard to make a living – would ever be the Haydens' underwriter on the construction of

their multi-million dollar home, or be subordinate to the Haydens' pre-existing indebtedness or be First American's guarantor.

Despite this requirement, however, First American failed to inform Chandler that it was not intending to obtain this necessary information from the Haydens or Chandler prior to November 6, 2000, the date it approved the issuance of the lender's policy of title insurance requested by BofA and described in the Commitment. In fact, it was not until November 16, 2000, *ten days* after authorizing the issuance of the title insurance policy, that First American received the Haydens' financial information. Moreover, the statement that First American received from the Haydens was twenty-five weeks old at the time presented and showed that the Haydens were experiencing a decline in their net worth at the rate of $10,000,000.00 to $20,000,000.00 *per week* – a fact that was never disclosed to Chandler despite his obvious need for such information.

Therefore, due to First American's failure to comply with its own regulations and the contractual provisions of the Indemnity Agreement, Chandler was falsely led to believe that the Haydens were financially solvent and his purported indemnity of them was nothing more than an agreement to pay his subcontractors in a timely manner from the money paid to him by the Haydens. Given this belief, and his need to be paid for the work he had already completed on the Property, Chandler signed the Indemnity Agreement. This agreement to sign the Indemnity Agreement, however, was either fraudulently obtained (if First American knew or had reason to know that the Haydens' financial condition was weak), or was obtained as a result of the mutual mistake of First American and Chandler that the Haydens were solvent. Due to these issues of fact, it cannot be held that the Indemnity Agreement was validly formed as a matter of law.

B. Chandler Presented Evidence Supporting Equitable Defenses.

In addition to the defenses against contract formation, Chandler presented evidence supporting at least three separate equitable defenses. As set forth below, each of these defenses should have been allowed to be presented at trial.

a. First American is not Entitled to a Declaration of Priorities Due to its Own Failure to Follow the Law.

There is a principle of equity that bears on the enforceability of the Indemnity Agreement. This principle is that equity aids the vigilant and diligent and, thus, involves the question of whether the litigant seeking the Court's assistance is entitled to it. As a general rule, where a litigant has not acted in accordance with this maxim, relief is denied. 27 Am Jur 2d Equity §129. Thus, where the result complained of is induced by one's own conduct, equity will generally refuse relief. *Id.*, §130. As set forth below, the undisputed facts of this case are that First American breached the law and failed to follow its own policies and procedures, or exercise due care, in issuing the title insurance policy to BofA.

The Idaho Department of Insurance regulates title insurance companies such as First American pursuant to authority granted in Idaho Code §41-2708. Toward that end, the Department has adopted rules and regulations establishing standards of insurability and the issuance of policies of title insurance. (Hayden R., Ex. 13 at Ex. A.) Part 05 of the regulations prohibit insuring against the risk of unrecorded mechanic's liens, unless the secured mortgage has been recorded before any work of improvement commenced; or the construction work is completed and the time for filing liens has expired; or a "sufficient indemnity" from someone other than the maker of the note has been delivered to and accepted by the insurer. A sufficient indemnity is defined to mean a direct obligation to pay such liens made by a financial institution or other "responsible person". A responsible person is defined as " . . . one (1) or more than one

(1) if they are jointly and severally liable, each of whose current verified balance sheet upon examination is determined by the insurer to be sufficient for the purpose of the indemnity given."

In order to comply with the IDAPA requirements, Plaintiff adopted and promulgated its policy memo 96-1 and its Underwriting Memo 97-3. (Hayden R., Ex. 13 at Exs. A and C.) In general, First American's policies and procedures require an indemnity from the owner and general contractor on its standard form of Indemnity Agreement, together with a " . . . financial statement evidencing that the indemnitor can meet the obligation of the indemnity." (*Id.*, at Ex. B at 22:5-27:20.) Indeed, First American even observed in its own Underwriting Memo 97-3 that:

> The developers, builders, subcontractors, suppliers, lenders, and realtors are relying on us to protect the consumer from inchoate labor or materialmen's liens. Therefore, we must be more careful and aware of our risks and responsibilities and act accordingly.

(*Id.*, at Ex. C.) Despite this statement of policy, First American mistakenly identified the Haydens' general contractor as a corporation named "Loomis Construction Company" and did not learn it was actually a trade name for Mike Chandler's proprietorship until he filed his mechanic's lien. (*Id.*, at Ex. B at 49:1-14.) Furthermore, First American never requested nor was it provided with any financial statements on Loomis Construction Company or Mike Chandler, individually. (*Id.* at 49:11-20.) In fact, First American made the decision to issue the Policy on November 6, 2000, even though it did not at the time have financial statements from either Chandler *or* the Haydens. First American admits this was a breach of its policy and the law. (*Id.* at 42:15-10.) In fact, the only financial information First American received was the Haydens' Weekly Statement of Financial Condition as of May 22, 2000 on November 16, 2000. The Haydens did not, however, verify the statement. Importantly, there is no evidence that anyone at First American evaluated the Haydens' financial statement. (*Id.* at 46:8-11.) If it had, First American admits it would have discovered the statement provided was not "current." (*Id.*

at 43:17-25.) First American admits that in not getting a current verified balance sheet, it did not comply with the law, or act reasonably. (*Id.* at 45:8-46:7.)

Even more egregious, the Loomis Construction indemnity is the one mandated by law, and even though First American believed its indemnitor to be a corporate entity, it made no inquiry of Chandler's authority to sign and failed to obtain the required verified current balance sheet. As such, First American never met its regulatory obligation to obtain an indemnity from a "responsible person." Accordingly, the Policy was unlawfully issued.

First American's actions and omissions were unlawful and inconsistent with its policies and procedures. As such First American was negligent *per se*. First American now argues that it should be able to avoid the consequences of its negligence by foisting it on Chandler through a demand that he subordinate his mechanic's lien to the BofA Lien. Had First American complied with the law and its own policies, however, First American likely would have declined to issue the Policy. If Chandler had been asked for a corporate resolution and a current verified balance sheet when he signed the Indemnity Agreement, the transaction would have taken on greater significance to him, and possibly led to his refusal to indemnify First American, or his insistence on limitations on his obligation (for example, Chandler could have insisted that First American first proceed against the Haydens).

Therefore, there are material issues of fact regarding whether the Indemnity Agreement is an enforceable agreement against Chandler. As such, the district court erred in finding that the BofA Lien has priority over the Chandler Lien as a matter of law.

b. The Indemnity Agreement is Unenforceable because it is Unconscionable.

Idaho law recognizes that some contracts should never be enforced because it would be unconscionable to do so. In order to void a contract as unconscionable, the contract or the provision in the contract must be both procedurally and substantively unconscionable. *Lovey v.*

Regence Blueshield of Idaho, 139 Idaho 37, 42, 72 P.3d 877, 882 (2003). As set forth below, Chandler introduced evidence establishing both elements of unconscionability.

Procedural unconscionability arises when the bargaining process leading to the agreement was unfair. *Id.* Indicators of such unconscionability generally fall into two categories: lack of voluntariness and lack of knowledge. *Id.*; *see also Hershey v. Simpson*, 111 Idaho 491, 494, 725 P.2d 196, 199 (1986) (procedural unconscionability is characterized by circumstances that taint the bargaining process). As the *Lovey* Court noted, lack of voluntariness can be shown by high-pressure tactics or by a "great imbalance on the parties' bargaining power with the stronger party's terms being nonnegotiable and the weaker party being prevented by market factors, timing, or other pressures from being able to contract with another party of more favorable terms or to refrain from contracting at all." *Id.* As for the lack of knowledge prong, it is shown by lack of understanding regarding the contract terms arising from the use of ambiguous or complex legalistic language, the lack of opportunity to study the contract or a disparity in the sophistication, knowledge or experience of the parties. *Id.*

In this case, Chandler presented more than sufficient evidence of procedural unconscionability to survive a summary judgment motion. Specifically, Chandler presented evidence that he is a sole proprietor. (Hayden R., p. 185.) On the other hand, First American is a large corporation who presented Chandler with a form indemnity agreement that First American prescribes be used by its local agents without any modification. (R., Ex. 1 at Ex. A at 61:8-25 and 66:7-23.) Chandler also presented evidence that David Hayden informed Chandler he had to sign the Indemnity Agreement in order for the Haydens to get their construction loan and pay Chandler for work already started. (Hayden R., at p. 186, ¶¶ 7-8.) Thus, Chandler understood that he had to sign the Indemnity Agreement in order to be paid for work he had already performed on the Property. (*Id.*) As for the lack of knowledge, Chandler presented evidence

that he had no idea that First American would later contend that the Indemnity Agreement obligated him to remove his mechanic's lien or subordinate his lien rights. (R. at p. 66.) To the contrary, he reasonably believed that the construction loan proceeds would be paid out to the Haydens in accordance with the value of the work he completed, that those proceeds would be paid to him by the Haydens and that he was obligated to use those proceeds to pay subcontractors and materialmen. (*Id.*) Furthermore, and perhaps most importantly, First American withheld necessary information from Chandler to enable him to fully understand the Indemnity Agreement. Specifically, First American did not tell Chandler that it had not received a current financial statement from the Haydens. Nor did it tell Chandler that the Hayden's stale financial statement showed that the Haydens' net worth was declining approximately $10-20 million a week. First American allowed Chandler to believe that it had performed a credit check on the Haydens and that they were determined to be credit worthy. Instead, First American had information that showed that the Haydens were a severe credit risk and it placed that risk on an uninformed individual. Such evidence is more than sufficient to support a finding of procedural unconscionability.

Substantive unconscionability relates to the terms of the contract. An agreement is unconscionable if it contains a bargain that "no man in his senses and not under delusion would make on the one hand, and [that] no honest and fair man would accept on the other." *Hershey, supra*, at 199. In determining whether a contract is substantively unconscionable, the court must consider the purpose and effect of the contract, the needs of both parties and the commercial setting in which it was executed, and the reasonableness of the terms at the time of contracting. *Lovey, supra*, at 43.

The evidence presented in this case epitomizes the definition of substantive unconscionability. BofA sought to give a loan to a credit risky couple, who – with BofA's

knowledge – intended to use a "construction" loan to immediately pay off other debt. Instead of keeping that risk, however, BofA passed it on to First American by paying for a title insurance policy that would ensure that it could not be injured by any mechanics' lien that may be recorded against the property. That is, BofA knew that the loan proceeds were not going to be used to improve the value of the property so it made sure that it would always have the value of the underlying land to protect against the Haydens' nonpayment of the loan. Though it was paid to do so, First American did not want to retain the risk that the Haydens would fail to pay for the construction on their property. It, therefore, passed the risk to Michael Chandler – an individual looking to earn a living – without providing him with any compensation for that risk. More egregiously, First American did not even inform Chandler that he was taking on a huge personal liability because the Haydens' net worth was declining at an extremely rapid pace. Nor did it inform Chandler that $4.5 million of the loan was being distributed to the Haydens immediately instead of over time and in accordance with the value of the construction. No situation could be more egregious that this one.

The unconscionability is further evidenced by the fact that First American is attempting to bypass Idaho's strong preference for mechanic's liens by requiring the general contractor to sign an overreaching agreement. Idaho Code §45-506, expressly provides that mechanic's liens "are preferred to any lien, mortgage or other encumbrance, . . ." Thus, they are preferred over any deed of trust. In fact, this Court has held that the lien statutes are to be liberally construed so as to effect their objects and promote justice. *Pierson v. Sewell*, 97 Idaho 38, 41, 539P.2d 590, 593 (1975). The object of the lien statutes is to "compensate persons who perform labor upon or furnish material to be used in the construction, alteration or repair of a building or structure." *Id.* For that reason, Idaho courts do not insist upon strict compliance with the lien statutes. Instead,

to ensure that justice is served, only substantial compliance is required. *Barber v. Honorof*, 116 Idaho 767, 769, 780 P.2d 89, 91 (1989).

By providing Chandler with an ambiguous agreement that purportedly eliminates his lien rights, First American is essentially rejecting the Idaho Legislature's desire to protect those individuals that add value to real property. It believes that it should be able to contract around the Legislature's express goal of serving justice. It should not be permitted to violate Idaho's public policy in this manner. *See National Union Fire Ins. Co. v. Dixon*, 141 Idaho 537, 541, 112 P.3d 825, 829 (2005) ("Unambiguous contracts that violate public policy are illegal and unenforceable.") At the very least, it should not be permitted to eliminate a contractor's lien rights without providing sufficient information to the contractor to enable him to analyze the risk of waiving his rights.

Chandler presented more than enough evidence to survive a summary judgment motion on this defense. The district court's ruling that his lien rights are subordinate to the BofA deed of trust, therefore, should be overturned.

c. The Indemnity Agreement Should Not be Enforced Due to Changed Circumstances.

Where events subsequent to making a contract work unexpected hardship, equity may refuse specific performance of the contract. 71 Am Jur 2d Specific Performance §82. Moreover, where the change in circumstance is accompanied by negligence or fault of the party seeking the relief, equity will not intervene. *Id.* Therefore, if a change in circumstance is due to the party seeking to enforce the contract, equity will excuse the other party's performance.

In this case, more than three years elapsed from the date of the Indemnity Agreement to the commencement of this action. During the interim, a litany of unanticipated changes occurred which are harmful to Chandler. These changes include the following:

- First American did not comply with the law or its policies in issuing the insurance policy to BofA;
- BofA did not comply with its construction loan terms and disbursed $4.5 million to Haydens in a lump sum;
- Haydens' financial condition deteriorated;
- More than $25 million in third party liens were imposed on the Sun Valley Property;
- Haydens defaulted on their construction contract with Chandler;
- Haydens defaulted on their construction loan with BofA on November 20, 2001;
- Chandler added over $1 million in value to the Hayden Property;
- Chandler paid subcontractors and materialmen approximately $400,000 out of his own pocket;
- BofA sold the Haydens' debt to Robertson Stephens, which purchased with knowledge of Chandler's inchoate lien; and
- Haydens' debt to BofA was collateralized by Robertson Stephens with other Hayden assets.

In analyzing the changes that have occurred since the Indemnity Agreement was signed by Chandler, it is critical to recognize that the Indemnity Agreement in this case arose in the context of a transaction involving what amounts to a joint enterprise between Chandler, the Haydens, First American and BofA. The enterprise was the funding of a construction loan, the proceeds of which were to be used by the Haydens to pay Chandler for improving the Hayden Property. As such, the Indemnity Agreement must be viewed in the context of the joint enterprise and the other documents attending it. These other documents include the BofA construction loan agreement and deed of trust and the title insurance policy. Simply put, the Indemnity Agreement cannot be analyzed in a vacuum because it was not entered in a vacuum. Indeed, the only reason Chandler signed the agreement was to enable the Haydens to obtain a construction loan from BofA – a fact that BofA was well aware of.

Since BofA had knowledge of Chandler's inchoate lien rights and of the Indemnity Agreement he made with First American, it was obligated to refrain from engaging in conduct that would impair Chandler's inchoate lien rights or his obligations under the Indemnity Agreement. *Fikes vs. First Federal Savings & Loan Assoc,* 533 P. 2d 251 (1975 Alaska) (court held that subordinated lien holder had reasonable expectation construction lender would conform to its customary loan monitoring practices and, therefore, lender should not be allowed to charge to a lien loan advancements it knows may not be used to increase the value of the property while diminishing the value of the subordinated interest); *Middlebrook Anderson Co v. Southwest Sav. & Loan Ass'n,* 18 Cal.App.3d 1023, 96 Cal.Rptr. 338 (1971) (the holder of a construction loan deed of trust owes to the holder of a subordinated purchase money mortgage, an implied duty to protect the interests of the subordinated purchase money mortgagee based on strong public policy considerations including the lender being in a superior position to supervise the use of the loan proceeds, absorb and provide for any losses, make provision for various contingencies, require documented evidence of expenditures and conduct on-site inspections); *Campanella v Rainier National Bank,* 26 Wash.App.418, 612 P.2d 460 (1980) (subordinated property owner is like a quasi-surety who has pledged property to secure a construction loan where it is expected that the loan proceeds will be used to enhance the value of the property, thereby protecting both parties).

First American argued, and the district court agreed, that Chandler essentially agreed to subordinate his lien rights to the construction loan BofA was making to the Haydens. As such, Chandler would be in the identical position as a subordinated purchase money mortgagee. He, therefore, was entitled to expect that BofA would not prejudice his lien rights by advancing loan amounts that it knew were not going to be used to pay Chandler for his work to enhance the value of the Haydens' property. Indeed, BofA should be held to such duty because Chandler's

mechanic's lien rights are founded upon stronger public policy considerations than those applicable to purchase money mortgagees. Neither BofA nor First American should be allowed to prejudice Chandler's lien rights as a result of BofA's decision not to fund the Haydens' construction loan in a manner that insured that it was being used to pay for the construction on the Sun Valley Property.

Furthermore, BofA's duty not to prejudice Chandler's lien rights should be imparted to First American because of the joint enterprise between all of the parties. In fact, in actions involving title insurance companies, courts have held that information contained in documents in their possession is imputed to the lender and, therefore, precludes subordination of a purchase money deed of trust. *Burkons vs. Ticor Title Ins. Co.,* 168 Ariz. 345, 813 P.2d 710 (1991) (subordination was only for the purpose of constructing improvements on the property and deciding issue was title company's knowledge and fact that if the subordination were for a purpose other than the common enterprise it would have to be expressly stated); *Dickens vs. First American Title Ins. Co.,* 162 Ariz. 511, 784 P.2d 717 (1989) (title company lacked authority to subordinate purchase money deed of trust where purpose was limited to improving property with construction loan proceeds because the court reasoned that the knowledge of the title company based on documents in its possession is imputed to the lender). Since First American was the escrow agent for the funding of the construction loan and would have had copies of the construction loan documents in its possession at closing, knowledge of those facts must be imputed to First American.

Under the construction loan agreement between the Haydens and BofA, BofA agreed to disburse money to pay off an existing debt the Haydens owed to First Republic Bank. No other money was to be disbursed by BofA until it received an executed construction contract, a construction budget, a policy of Builder's General Liability Insurance, a policy of Builder's Risk

Insurance, and proof of Workman's Compensation Insurance. Then, disbursements were only to be made based on a written requisition specifying all labor and materials furnished in connection with the construction of the improvements after the date of the loan agreement. (Hayden R., at Ex. 13 at Ex. D at 74.)

The Haydens represented to Chandler that the construction loan was needed and would be disbursed as described in the loan agreement. (Hayden R., at p. 186, ¶7.) BofA, however, disbursed $4.5 million of the $5 million loan without the construction contract, budget or proof of Chandler's liability and workman's compensation insurance. (*Id.*, ¶ 9.) BofA did not pay the Haydens based on paid invoices for work performed after the construction loan was closed by First American. (Hayden R. at Ex. 13, at Ex. M at 34:27-35:20, 74:6-22.) In view of the foregoing authority, Chandler's Lien would have priority over any amounts disbursed by BofA to the Haydens that did not comply with the terms of the construction loan. *Fikes, supra.*

Also prejudicial to Chandler was BofA's lack of timely enforcement of its deed of trust after the loan secured thereby matured on November 20, 2001. Chandler performed considerable work between November 2001 and November 2003. (Hayden R., at p. 185 and 187 at ¶¶ 6, 12.) If BofA had enforced its deed of trust in a timely manner, Chandler would not have continued work, thereby adding value to the Hayden Property.

The foregoing changes in circumstances were not foreseen by either First American or Chandler as of the date of the Indemnity Agreement. These changes in circumstance will likely preclude Chandler from ever being paid for his work if this Court orders him to subordinate his lien to the BofA Lien. These changes in circumstances combined with First American's violation of law and negligence, together with the breach of duty by BofA to protect Chandler's subordinated lien rights, preclude specific performance of Chandler's purported obligation to subordinate his mechanic's lien.

V. FIRST AMERICAN SHOULD NOT HAVE BEEN AWARDED ATTORNEYS' FEES AS THE PREVAILING PARTY.

On February 9, 2006, the district court issued a Memorandum Decision and Order on First American's request for attorneys' fees. First American based its request for fees on its assertion that "the final result of the litigation was entirely favorable from First American's standpoint." (R., at p. 125.) Thus, it asserted, it was the prevailing party. The district court agreed that First American was the prevailing party under I.R.C.P. 54(d)(1)(B) as to its third motion for summary judgment and, thus, was the prevailing party considering the result of the action in relation to the relief sought. (Hayden R., p. 328E.) The district court refused, however, to award any fees incurred in conjunction with First American's first two unsuccessful motions for summary judgment. (*Id.*) Based on those findings, the district court awarded $17,143 in fees and costs to First American. (*Id.*, at p. 328H.)

Chandler seeks to have this award of fees reversed because First American should not have prevailed on its third motion for summary judgment. Instead, as set forth above, First American was the recipient of a gift of relief that it requested only after it was invited to do so by the district court. "In determining which party to an action is a prevailing party and entitled to costs, the trial court shall in its sound discretion consider the final judgment or result of the action *in relation to the relief sought by the respective parties.*" I.R.C.P. Rule 54(d)(1)(B) (emphasis added). Although Rule 54(d)(1)(B) speaks only of costs, "Rule 54(e)(1), pertaining to attorney fees, incorporates the Rule 54(d)(1)(B) definition of prevailing party." *Eighteen Mile Ranch, LLC v. Nord Excavating & Paving, Inc.*, 141 Idaho 716, 117 P.3d 130, 133 n. 1 (2005). Thus, this Court has broad discretion to determine who is the prevailing party in awarding costs and attorney's fees, or to determine that there is no prevailing party at all. *Adams v. Krueger*, 124 Idaho 74, 77-78, 856 P.2d 864, 867-68 (1993) (trial court did not abuse discretion in finding no clearly prevailing party); *Farm Credit Bank of Spokane v. Wissel*, 122 Idaho 565, 836 P.2d

511 (1992) (upholding trial court's discretionary determination that there was no prevailing party).

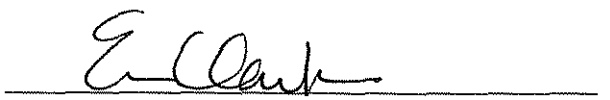
First American's complaint did not ask for the relief it was ultimately granted by the district court. Instead, its complaint sought an order requiring Chandler to release his lien – relief that was never granted to First American. In fact, until the district court invited First American to file its Third Motion for Summary Judgment, First American never asked the district court to subordinate Chandler's lien to Bank of America's ("BofA") deed of trust. In other words, First American never asked for the relief the district court gave it. Thus, First American did not prevail on its claim for specific performance when it received a totally different result – subordination of Chandler's lien to BofA's deed of trust.

Furthermore, for the reasons set forth above, First American should not have prevailed on its Third Motion for Summary Judgment. Instead, the motion should have been denied and its Complaint for Specific Performance dismissed and Chandler should have been declared the prevailing party. Therefore, Chandler respectfully requests that the Court reverse the award of fees and costs granted by the district court.

CONCLUSION

For the reasons set forth above, Chandler respectfully requests that the Court grant this appeal and either dismiss First American's Complaint for Specific Performance or remand the case back to the district court for a trial on the merits.

RESPECTFULLY SUBMITTED this 3 day of October, 2007.



Erin Farrell Clark

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 3 day of October 2007, I caused to be served a true copy of the foregoing document by the method indicated below, and addressed to each of the following:

Gary Slette, Esq.
ROBERTSON & SLETTE, PLLC
P.O. Box 1906
Twin Falls, ID 83303-1906

✓ U.S. Mail, Postage Prepaid
____ Hand Delivered
____ Overnight Mail
____ Telecopy

Erin Farrell Clark