

No. A06-851

STATE OF MINNESOTA

IN COURT OF APPEALS

DALE M. STONE,

Respondent,

v.

SELWIN ORTEGA,

Appellant,

and

JETMAR PROPERTIES,
KEITH M. HAMMOND,

Defendants.

RESPONDENT'S BRIEF

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STATEMENT OF ISSUES

I. IS A DEED WHICH PURPORTS TO CONVEY LAND TO A NONEXISTENT ENTITY LEGALLY VOID?

The trial court held in the affirmative.

Most Apposite Statutes:

Minn. Stat. §§ 302A.153; 322B.175

Most Apposite Cases:

Warthan v. Midwest Consol. Ins. Agencies, 450 N.W.2d 145 (Minn. App. 1990);

Kiamesha Devel. Corp. v. Guild Properties, 4 N.Y.2d 63, 175 N.Y.S.2d 62 (1958);

Sullivan v. Buckhorn Ranch Partnership, 119 P.3d 192 (Okla. 2005);

Mabel First Luth. Church v. Cadwallader, 172 Minn. 471, 215 N.W. 845 (1927)

II. DID THE TRIAL COURT ERR IN FINDING THAT THE APPELLANT WAS NOT A “GOOD FAITH PURCHASER?”

The trial court held in the negative.

Most Apposite Statute:

Minn. Stat. § 507.34

Most Apposite Cases:

West Concord Conservation Club, Inc. v. Chilson, 306 N.W.2d 892 (Minn. 1981)

Claflin v. Commercial State Bank, 487 N.W.2d 242 (Minn. App. 1992)

Miller v. Hennen, 438 N.W.2d 366 (Minn. 1989)

**III. DID THE TRIAL COURT ERR IN DENYING THE APPELLANT
RELIEF ON EQUITABLE GROUNDS?**

The trial court held in the negative.

Most Apposite Cases:

West Concord Conservation Club, Inc. v. Chilson, 306 N.W.2d 892 (Minn. 1981)

Froslee v. Sonju, 209 Minn. 522, 297 N.W. 1 (1941)

STATEMENT OF THE CASE

Plaintiff Dale Stone sued Defendants Keith Hammond and Jetmar Properties, LLC, for fraud. He also sought declaratory judgment against them and against the third Defendant, Selwin Ortega. Plaintiff contended that his deed to Jetmar, Jetmar's mortgage to Ortega, and Ortega's subsequent foreclosure all should be declared legally void. (Appellant's Appendix, A-35)

Hammond and Jetmar failed to answer. Ortega answered (A-29), and Plaintiff's motion for summary judgment was denied. (A-19) The case proceeded to trial in the Fourth Judicial District, Hennepin County, before the Hon. George F. McGunnigle.

The court awarded damages against Hammond and Jetmar for consumer fraud. (A-3) It declared the deed, the mortgage, and the foreclosure by Ortega to be void. (A-4 to 5) Ortega perfected this appeal.

STATEMENT OF FACTS

Overview

The parties to this appeal both were swindled by a ruthless confidence man. Unfortunately, one of the parties must bear the loss of the property at issue. The evidence supports the trial court's decision to place the loss on Selwin Ortega rather than on Dale Stone.

As will be shown below, Ortega is an experienced businessman who has handled many real estate transactions. In dealing with the swindler, he failed to

exercise due diligence, failed to heed his attorney's warnings, and ignored plain facts which should have led a reasonable businessperson to inquire.

The record shows Stone to be an extraordinarily naïve and gullible novice. He uses solecisms and malapropisms in speaking of business affairs. The swindler deluded him with an elaborate charade and quickly stripped him of his life's savings and of his property.

Appellant's Brief seeks to paint Stone as a colleague and a confidante of the swindler. For instance, Appellant states that "the one time [Stone] met Ortega, [he] was introduced as a member of the board of Jetmar Properties, LLC." (App. Br., p. 4) Appellant gives no citation for this statement, and there is no support for it in the record. (See Tr., pp. 93-94, 158 (Ortega and Stone both state that the first time they met was at their depositions)) Appellant's contention that Stone worked on "many, many projects" for Jetmar (App. Br., p. 4) is likewise unfounded, as will be shown below.

Keith Hammond and Jetmar

The swindles at issue in this matter were perpetrated by Keith Hammond. Hammond's criminal career was described for the court by Detective Cory Cardenas of the Bloomington Police Department. (Tr., pp. 98-108)

Hammond is a convicted felon. (Tr., p. 106) During the events in issue here, he was on probation after having been convicted of theft by swindle. The probation order forbade him to partake in "activities ... dealing with real estate where he would obtain funds." (Tr., p. 103)

Despite this order, Hammond was soon involved in a real estate deal that sparked an investigative television report. (Id.) Thereafter, Cardenas received complaints from an unpaid employee of Hammond's and from "eleven or twelve other victims," who included Dale Stone. (Tr., pp. 99-101)

A probation revocation hearing was held in the spring of 2005. Hammond's probation was revoked (in part through the testimony of Stone), and he was sent to prison in St. Cloud. (Tr., p. 105)

During his probation, Hammond perpetrated swindles through a company, Jetmar Properties, LLC. Jetmar's Articles of Organization are dated Nov. 13, 2002. (Ex. 300, Tr., p. 52) The Articles state that "this company shall exist ... from and after the date these Articles of Organization are filed with the Minnesota Secretary of State." (Ex. 300, Art. 4; Tr., p. 53)

Jetmar's Articles were not filed for some fifteen months, until March 11, 2004. (Ex. 300; Tr., pp. 53-54) A Certificate of Organization for Jetmar then was issued by the Secretary of State. (Ex. 301; Tr., pp. 51-52) In the meantime, most of the events at issue in this matter had transpired.

Dale Stone

Dale Stone is 63 years old, a widower on Social Security. As a young man, he attended a Bible institute and a seminary. He did mission work on world hunger. Eventually, he earned a bachelor's degree in speech and music and a master's degree in education. (Tr., pp. 29-31, 41)

Stone had owned a duplex in Brooklyn Park since about 1980. He leased it to tenants, and relied on it to provide for his retirement. Apart from his own home, this duplex was all the property he owned. (Tr., pp. 31-2, 58)

In 2003, Stone was working part-time at various humble occupations. He delivered newspapers, marketed a nutritional aid, and “demonstrat[ed] a shoe product called Leatherette.” (Tr., pp. 31, 33)

In April 2003, Stone sold Leatherette at the Minneapolis auto show. Keith Hammond purchased a bottle, and the men exchanged their business cards. A few days later, Hammond invited Stone “to discuss an investment opportunity where I could double thirty thousand dollars in two months.” (Tr., p. 33)

Hammond ushered Stone into “a spacious luxurious office on Normandale Boulevard in a prestigious area of town.” (Tr., p. 36) He then took him to visit a second office at his home in a gated community. (Tr., pp. 36-37) Hammond showed him a brochure of his purported real estate projects (which Stone referred to as “the Performa” [sic]) and “drew charts as to the positive cash flow he would get for the sale of each property.” (Tr., pp. 34, 38, 63, 65)

Hammond then drove Stone around the Twin Cities, showing off properties which he claimed to be developing for Jetmar. He claimed to be an architect (“architecture is my passion”) and showed a half-built house displaying a Jetmar sign. (Tr., pp. 36-37)

Hammond's Swindling of Stone

In the next few weeks, Hammond mulcted Stone out of his life's savings.

In summary:

- (1) Hammond said that he wanted to develop a piece of land in Maple Grove and "needed 30 thousand dollars to complete the deal." He told Stone that if he invested, he "would double my money in 60 days." Stone gave him a cashier's check for \$30,000 on April 24, 2003, and ultimately lost the whole sum. (Tr., pp. 60-62)
- (2) On May 14, Hammond swindled Stone out of his duplex, as will be described below.
- (3) Shortly afterward, Stone gave Hammond another \$10,000 to invest in "a Minnetonka property which is photographed in the Performa." Again, he lost the whole sum. (Tr., pp. 63-64)
- (4) A few days later, Stone gave Hammond an additional \$8,500 to "help lay utilities from the street" to three lots along the Mississippi River. (pp. 65-66) One of these lots had the half-constructed house displaying the Jetmar sign, and another was "projected in the Performa." (Tr., pp. 37, 65)
- (5) On July 21, Stone gave Hammond another \$1,000 for "ongoing expenses." (Tr., p. 67)
- (6) In the first week of October, Stone gave Hammond yet another \$1,000. (Id.)

(7) Later in October, Stone gave Hammond \$120. (Id.) By this time, Stone says, “I had no more money.” (Tr., pp. 88)

Toward the end of this wretched process, late in the summer of 2003, Stone supposedly went to work for Hammond as an “independent contractor.” (Tr., p. 82) The gist of this “contracting” was that Stone “gave [Hammond] some ideas” on property development and “helped him with some ongoing expenses.” (Tr., p. 83)

Among other matters, Hammond and Stone discussed a “Vikings stadium” proposal which Hammond supposedly was preparing on behalf of the City of Hastings. (Tr., p. 84) Hammond promised to pay Stone \$6,000 a month for these consulting services, and also promised to “take care of him” from the proceeds of the Vikings stadium. (Tr., pp. 68, 84)

Stone expressly denied that he was an officer or an employee of Jetmar, or that he had a formal connection to the company. (Tr., pp. 68, 95) He had no contact of any sort with Selwin Ortega on Jetmar’s behalf. (See Tr., p. 94) Ortega acknowledged that he had never met Stone until the time of their depositions. (Tr., p. 158)

The Quitclaim Deed to the Duplex

The key transaction at issue is Stone’s deed to Jetmar of his duplex in Brooklyn Park. The deed was executed on May 14, 2003 – some 10 months prior to the date when a Certificate of Organization was issued to give Jetmar corporate existence. (See Ex. 301, 304) Here is the story of that transaction.

In May of 2003, when Hammond had just begun to manipulate Stone, Hammond told him that he was “really excited” about a project on West Lake Street. (Tr., p. 38) This “project” involved a strip of commercial property owned by Selwin Ortega – eight business spaces, including restaurants, coffee shops, and retail stores. (Tr., pp. 38, 151)

Hammond’s “project” involved obtaining this property and transforming it into a 50-unit condominium with four commercial businesses on ground floor and two levels of underground parking. (Tr., pp. 39, 153) Hammond told Stone that he needed some money to put the project together, and that Stone could have “about a 15 percent position in the whole project.” for an investment of \$20,000 or \$30,000. (Tr., pp. 39, 75-76)

Hammond then presented “another alternative” whereby Stone might participate in the project “without putting out any money.” (Tr., pp. 39, 76) He said, “[L]et me borrow your building [the Brooklyn Park duplex] for two months,” and “absolutely guaranteed there would be no risk to me.” (Tr., p. 76) Hammond said that he “[j]ust needed the building to put in his portfolio” and that its presence there “would move all of his business forward.” (Tr., pp. 45, 76-77)

Hammond promised “all kinds of good things” for Stone from this transaction. (Tr., p. 76) Besides an interest in the Lake Street project, “he said that I had been so helpful to him the [sic] he was also going to buy me a 40 acre hobby farm in Delano.” (Tr., pp. 39-40) Hammond had one of his employees

drive Stone to Delano to see the farm. (Tr., p. 40) He also promised Stone “a new car of my choice.” (Id.)

Hammond gave Stone elaborate assurances that he would be protected in the transaction. Stone recalled:

Basically the stipulations were that he knew I was a widower on social security. So he knew I was concerned to be able to provide for my monthly income. So the first stipulation was that I would continue to get the rents.

The second was that he would pay expenses, which included insurance, Service Plus, which is – Service Plus is for the appliances if they had a problem. Also that I would continue to manage the building. Also that the terms of it would be he would return it to me totally unencumbered, that’s the key one. That I would get it back totally unencumbered in 60 days or less.

(Tr., p. 41 (emphasis added))

After all these blandishments, Stone agreed “to exercise [sic] the quitclaim deed” to Jetmar. (Tr., p. 42) Hammond prepared the deed for Stone (“which I had never seen a quitclaim deed before”) and told him that “this will do the trick.”

(Id.) Hammond told Stone to meet him “at the photocopying place in the IDS” to sign the deed and have it notarized. (Id.)

Stone went to the photocopy shop. He was surprised to find that Hammond had put none of his promises in writing. (Tr., p. 44) Hammond knew that Stone had promised to sing at a funeral that day and that he was late for the engagement. (Tr., pp. 42-44) When Stone asked about their stipulations, Hammond replied, “We don’t need it to be written out because it’s only going to be for 60 days.”

(Tr., p. 44) Stone obediently signed the deed to Jetmar and rushed off to sing at the funeral. (Id.)

The quitclaim deed was signed and recorded on May 14, 2003. (Ex. 304) On the very next day, Hammond granted a mortgage on the property from Jetmar to Ortega, in defiance of his promise to Stone. (Ex. 303) Jetmar's Articles, meanwhile, were unfiled, and would not be filed for some ten months. (See Ex. 300, 301)

Hammond's Swindling of Ortega

Selwin Ortega is an experienced businessman and buyer and seller of real property. At one time, he owned twelve grocery stores. (Tr., pp. 174-75) Later, he owned the property with eight commercial spaces on West Lake Street. (Tr., pp. 150-51) He has a corporation, S and J Properties, and serves as one of its officers. (Tr., p. 185)

Near the end of 2002, Hammond appeared at Ortega's office and offered to buy his property on Lake Street. (Tr., p. 151) Hammond told Ortega much the same story that he later told to Stone: that he would transform the property into a mixed condominium and retail development. (Tr., p. 153)

Hammond prepared a purchase agreement. It stated a purchase price of some \$1,800,000 or \$2,000,000. (Tr., p. 152) The agreement was signed, but the sale never closed, because "Mr. Hammond did not have the money." (Tr., pp. 120, 152)

Audaciously, Hammond asked Ortega to lend him \$200,000 (one-tenth or more of the total purchase price), without offering any security. (Tr., pp. 153-54) Hammond said that “he needed to hire an architect and he needed to hire people to put a package together to go to the city to acquire all the permits and all the approvals.” (Tr., p. 154)

Ortega’s attorney cautioned him that “you really should have collateral for that before you do that.” (Tr., pp. 131-32) But Ortega was “trying to do a deal,” and went ahead with the unsecured loan. (Tr., p. 132) Ortega loaned \$200,000 to Jetmar by wire transfer on January 28, 2003. (Tr., p. 154, Ex. 204)

Hammond promised Ortega that he would pay the \$200,000 back in three days. (Tr., p. 155) He told Ortega that he would “get money from other developments” to fund the repayment. (Tr., p. 177) Ortega didn’t ask him why he couldn’t simply wait for three days and use this “money from other developments” to pay his expenses, rather than asking for the loan. (Tr., pp. 176-77)

Three days passed, and the money was not repaid. Ortega agreed to extend the loan, but now belatedly asked for collateral. (Tr., p. 155) Ortega’s attorney held several meetings with Jetmar’s attorney, “trying to get security on this loan in any way we could.” (Tr., p. 128)

Hammond offered Ortega and his attorney three successive forms of security: (1) a mortgage on three lots in Bloomington (but Hammond had only a contract for deed on these lots, so the mortgage obviously was worthless); (2) a \$200,000 deposit in his attorney’s escrow account (Hammond wrote the attorney a

check, but it bounced); and (3) a mortgage on Dale Stone's duplex. (Tr., pp. 122-24) Ortega accepted the latter mortgage on May 15, 2003, nearly five months after making the loan to Jetmar. (See Ex. 303)

Neither Ortega nor his attorney checked with the Secretary of State to verify Jetmar's legal existence or good standing. (Tr., pp. 145-46, 185-86) The attorney agreed that a commercial lender taking a mortgage "absolutely" would insist on a title policy, but he and his client never sought one. (Tr., pp. 128-30) Nor did they do a judgment search, secure a credit report, or get a Dunn & Bradstreet report on Jetmar. (Tr., pp. 138-39, 169)

The Foreclosure of the Mortgage

Hammond had promised to return the duplex to Stone in 60 days. Hammond missed the deadline, but he assured Stone, "I almost have it done, just be patient." (Tr., p. 46) Stone still was receiving rent from the tenants in the duplex, so he was not suspicious. (Id.)

Hammond never told Stone about the mortgage. (Tr., p. 50) Stone learned about it some seven months later, in December 2003, when the tenants in the duplex received a letter from Ortega's attorney. (Tr., pp. 85-86) This letter advised them to "put [the rent] in a separate account and don't pay either of them." (tr., p. 147)

Stone confronted Hammond, who assured him that "there was a grace period and I would be able to redeem before it was up." (Tr., pp. 50-51) Hammond also assured him that he would arrange matters so that Stone continued

to get the rent from the duplex (Tr., pp. 55, 87) Stone did receive the rent for eight more months, through August of 2004. (Id.)

Meanwhile, Ortega's attorney commenced foreclosure proceedings. (See Ex. 305) The foreclosure apparently was accomplished by advertisement pursuant to a power of sale, rather than by judicial action. (See id.) Stone was given no notice of the foreclosure proceedings or of the sheriff's sale. (Tr., pp. 54, 141-42)

ARGUMENT

I. THE DEED WAS VOID BECAUSE JETMAR, THE GRANTEE, DID NOT EXIST.

Standard of Review

An appellate court need not give deference to a trial court's decision on a legal issue. *Frost-Benco Electric v. Minnesota Public Utilities*, 358 N.W.2d 639, 642 (Minn. 1984). Statutory construction is reviewed under a de novo standard. *In re Welfare of A.A.K.*, 590 Minn. 773, 776 (Minn. 1999)

Argument

The trial court held that “[t]he deed purporting to convey Stone’s interest to Jetmar was legally void.” It based this holding on the fact that Jetmar’s Articles were not filed at the time that the deed was signed and recorded. The court held

that Jetmar “had no corporate existence” and thus was incapable of taking title to land. (See Conclusions of Law 1, 2 (A-4))

Ortega disputes the trial court’s analysis. He argues that (1) the “de facto corporation” doctrine still is viable in Minnesota; (2) even if the doctrine has been abolished for corporations, it is available to limited liability companies (LLCs); and (3) even if the deed was void when signed, it became retroactively effective on the date Jetmar’s organization. (See App. Br., pp. 11-14)

These contentions have no merit. Minnesota law demonstrably bars the concept of “de facto LLCs.” As a matter of law, Stone’s deed to Jetmar was void at the time that it was signed, delivered, and recorded..

A. Minnesota Has Abolished the De Facto Corporation Doctrine.

As Appellant contends, Minnesota common law recognized de facto corporations. Many older cases applied the well-established common law test. That test required (1) some law under which a corporation with the powers assumed might lawfully have been created; (2) a colorable and bona fide attempt to perfect an organization under such a law; and (3) user of the rights claimed to have been conferred by the law. See, e.g., Evens v. Anderson, 132 Minn. 59, 155 N.W. 1040, 1041 (1916).

The de facto corporation doctrine, however, was “roundly criticized” for many years. See American Vending Services, Inc. v. Morse, 881 P.2d 917, 921 (Utah App. 1994). That criticism helped give rise to the Model Business

Corporation Act (MBCA), which sought “to provide some clarity and bright-line tests to previously cloudy areas.” Id.

The MBCA’s official Comment made absolutely clear its intent to abolish de facto corporations. The Comment stated, in part;

Abolition of the concept of de facto incorporation, which at best was fuzzy, is a sound result. No reason exists for its continuance under general corporation laws, where the process of acquiring de jure incorporation is both simple and clear. The vestigial appendage should be removed.

Model Business Corporation Act, § 146 cmt., at 908-09 (1971); *American Vending*, 881 p.2d at 921 (emphasis added).

The Minnesota Business Corporation Act, Minn. Stats. Chap. 302A, was derived in part from the MBCA. Specifically, Minn. Stat. § 302A.153 was drawn from MBCA §§ 53 and 54. The Minnesota statute (enacted in 1981) provides, in pertinent part:

302A.153. Effective date of articles

Articles of incorporation are effective and corporate existence begins when the articles of incorporation are filed with the secretary of state accompanied by a fee of \$135, which includes a \$100 incorporation fee in addition to the \$35 filing fee required by section 302A.011, subdivision 11. ...

Minn. Stat. § 302A.153 (2003)(emphasis added).

The 1981 Reporter’s Note to this statute states expressly that de facto corporate status has been abolished. The Note provides, in pertinent part;

[T]he effective date should coincide with filing so that there can be no doubt that all subsequent corporate acts are the acts of a de jure corporation. This is important because the doctrine of de facto

corporations is inapplicable in this state after the enactment of the act. The simplicity of the procedure set forth for incorporation makes the continuation of the doctrine inappropriate; no publication or other filing with any other official is necessary under this act, only the barest notice, by filing with the secretary of state, is required, and failure to comply with this requirement is inadequate to meet the standard of compliance formerly required under that doctrine.

Minn. Stat. § 302A.153, Reporter's Note (West 2004), pp. 274-75 (emphasis added). The Advisory Task Force Report to the 1981 Act likewise declares "the end of de facto corporations." See Minn. Stat. § 302A.001, Advisory Task Force Report (West 2004), p. 189.

The Minnesota Court of Appeals thereafter unequivocally held that the Act had abolished de facto corporations. In *Warthan v. Midwest Consolidated Insurance Agencies*, 450 N.W.2d 145 (Minn. App. 1990), the Court quoted the Reporter's Note ("the doctrine of de facto corporations is inapplicable in this state") and also cited the Advisory Task Force Report ("noting the end of de facto corporations"). See id. at 147-48. *Warthan* then explained the significance of the Note and of the Report:

The use of advisory committee reports is recognized in this state as a tool for ascertaining legislative intent. [Citation omitted.] The reporter's notes to these sections were written in conjunction with enactment of the MBCA and the advisory committee expressly recognized that "all the provisions of the proposed new business corporation act * * * is analyzed in our Reporter's section-by-section analysis." Advisory Committee Report, at XXI.

450 N.W.2d at 148, n. 2 (emphasis added).

As Appellant points out, two Minnesota cases have referred to de facto corporations as if the doctrine still were viable after 1981. See *Almac, Inc. v. JRH*

Development Inc., 391 N.W.2d 919, 924-25 (Minn. App. 1986); *Ross v. Briggs and Morgan*, 520 N.W.2d 432, 436-37 (Minn. App. 1994) (App. Br., p. 12).

However, these opinions do not mention the Reporter's Note or the Task Force Report. It does not appear that the issue of abolishment of de facto corporations ever was called to the Court's attention by the litigants in these cases.

Other Minnesota cases squarely follow *Warthan* in holding that de facto corporations have been abolished. See *Shapiro v. Stern*, 2004 WL 2223064 (Minn. App. Dec. 22, 2004), *11 ("the doctrine of de facto corporations is inapplicable in Minnesota")(Respondent's Appendix, R-1, R-14); *Field v. Fiberich Technologies*, 51 W.C.D: 325, 333-34 (W.C.C.A. 1994)("The doctrine of *de facto* corporations has been inapplicable in this state since the enactment of the Minnesota Business Corporation Act").

Case law in other states with statutes derived from the Model Act overwhelmingly takes the same position. See, e.g., *American Vending*, 881 P.2d at 922-23; *Pharmaceutical Sales and Consulting Corp. v. J.W.S. Delavau*, 59 F. Supp. 2d 408, 413-415 (D.N.J. 1999); 8 *Fletcher Cyclopedia of the Law of Private Corporations* (2001), § 3762.10 (MBCA-based legislation "eliminate[s] the common law concepts of de facto corporations, de jure corporations, and corporations by estoppel").

In sum, the trial court was clearly correct in holding that Jetmar could not be a de facto corporation. This Court should reaffirm that de facto corporation status no longer is available in this state.

B. The Abolition of De Facto Corporations Also Applies to LLCs.

Appellant argues that “Jetmar is a LLC under Chapter 322B which does not have any Reporter notes undoing ‘de facto corporations.’” (App. Br., p. 12) This contention is mistaken.

The Minnesota Limited Liability Company Act, Minn. Stat. Chap. 322B, is to be construed according to pertinent Reporter’s Notes from the Business Corporation Act. The Reporter’s Notes for Chapter 322B summarize recommendations of a Joint Committee of the Minnesota State Bar Association which drafted the Act. The Notes state, in pertinent part:

Relevance of Chapter 302A to Interpreting and Applying Chapter 322B

Most of the governance and management provisions of chapter 322B are drawn from chapter 302A, even though chapter 322B provisions differ from chapter 302A provisions in terminology. ... To the extent a chapter 322B provision resembles a chapter 302A provision in substance, the case law and Reporter’s Notes of chapter 302A should be used to interpret and apply the chapter 322B provisions.

Minn. Stat. § 322B.01, Reporter’s Notes (West 2004), p. 314 (emphasis added); see also pp. 306-08 (describing the work of the Joint Committee).

The LLC Act’s section on the creation of LLCs is drawn directly from the Business Corporation Act. Minn. Stat. § 322B.175 (2003) provides, in pertinent part:

322B.175. Effective date of articles of organization

Articles of organization are effective and limited liability company existence begins when the articles of organization are filed with the secretary of state accompanied by a payment of \$135, which includes a \$100 organization fee in addition to the \$35 filing fee required by section 322B.03, subdivision 18. ...

(emphasis added)

This language is virtually identical to the language of Minn. Stat. § 302A.153. Thus, the Reporter's Note to § 153 (recognizing the abolishment of de facto corporations) and the *Warthan* case apply to LLCs.

In short, Minnesota law clearly excludes the concept of "de facto LLCs." Moreover, Jetmar's Articles state that "this company shall exist ... from and after the date these Articles of Organization are filed with the Minnesota Secretary of State." (Ex. 300, Art. 4; Tr., p. 53) The trial court correctly held that Jetmar was nonexistent at the time of the attempted execution of the deed.

C. A Deed to a Nonexistent Entity is Void.

The trial court held that, since Jetmar was nonexistent, Stone's quitclaim deed purporting to convey the duplex to Jetmar was legally void. (Conclusions of Law no. 1, 2 (A-4)) This holding clearly was correct.

The court cited *Mabel First Lutheran Church v. Cadwallader*, 172 Minn. 471, 215 N.W. 845, 847 (1927), which appears to be the Minnesota case most closely on point. In *Mabel*, a deed was given to trustees of an incipient corporation whose corporate articles had not been filed. The Court stated: "[A]s the brick church organization was not a corporation either de jure or de facto, it

could not take title to real estate nor acquire title thereto by adverse possession.”

(emphasis added)

A valid deed requires a grantee in existence, legally capable of taking and holding property at the time of the conveyance. See 23 Am. Jur. 2d *Deeds*, § 24; e.g., *Allman v. Gatschet*, 437 S.W.2d 70 (Mo. 1969). A deed to a nonexistent grantee therefore is inoperative and void. See 23 Am. Jur. 2d *Deeds*, § 21; e.g., *State of Oregon v. Bureau of Land Management*, 876 F.2d 1419, 1425 (9th Cir. 1989).

The foregoing principles have been applied to fact situations very closely in point for the present case. In *Kiamesha Development Corp. v. Guild Properties, Inc.*, 4 N.Y.2d 63, 175 N.Y.Supp. 63 (1958), an incipient corporation sought to obtain tax-forfeited property. It purchased a tax certificate a few days before its own corporate articles were filed. The court held:

The tax certificate was thus made to a nonexistent entity incapable of taking thereunder, and accordingly could transfer no rights whatsoever – it was void. [Citations omitted.] Here we are dealing with neither a corporation *de jure* nor one *de facto*, but with a purported entity which “cannot take title to real or personal property, * * * acquire rights by contract or otherwise, incur debts or other liabilities either in contract or tort, sue or be sued” {Citations omitted.]

175 N.Y.S.2d at 70-71 (emphasis added).

In *Sullivan v. Buckhorn Ranch Partnership*, 119 P.3d 192 (Okla. 2005), as here, a grantor sued to invalidate a deed. As here, he argued that the deed was

void because the grantee was nonexistent. The Oklahoma court agreed (while reserving questions of fact as to estoppel and other equitable issues). It stated:

Sullivan argues that because the disputed deed attempted to convey property to a non-existing legal entity, it is void and he is entitled to the property.

* * *

We agree with Sullivan, that there must be a grantor and a grantee to be a valid deed, and that the grantee must have a legal existence. An attempted conveyance to a non-existing legal entity may, like an attempted conveyance to a fictitious person, be of no effect and void – passing no title and conveying no interest whatsoever.

Id. at 199 (emphasis added). See also, e.g., Borough of Elizabeth v. Aim Sher Corp., 316 Pa. Super. 97, 462 A.2d 811, 812-13 (1983)(“A deed that purports to convey real estate to a nonexistent corporation is of no effect”); Zulver Realty Co. v. Snyder, 191 Md. 374, 62 A.2d 276, 279 (1948)(“a deed to a supposed corporation which has not been duly incorporated ... does not pass any title”); Harwood v. Masquelette, 95 Ind. App. 338, 181 N.E. 380, 381 (1932)(citing “the almost universally accepted rule that a deed to ... a corporation not yet organized, or having a valid existence, is a nullity and passes no title to anyone”).

This Court should follow the foregoing cases and affirm the trial court. Since Jetmar did not exist at the time of the attempted conveyance, the deed at issue in this matter was void.

D. Appellant’s Counterarguments Have No Merit.

1. Cases Holding that Deed Passes Title at Time of Incorporation

Ortega cites two cases where deeds to incipient corporations were deemed effective when their articles were filed. See *Community Credit Union Services, Inc. v. Federal Express Services Corp.*, 534 A.2d 331 (D.C. App. 1987); *White Oak Grove Benevolent Society v. Murray*, 145 Mo. 622, 47 S.W. 501 (1898)(App. Br., p. 13).

The foregoing cases embody an exception to the “almost universally accepted rule” that deeds to nonexistent entities are void. See *Harwood*, 181 N.E. at 381; *Kiamesha*, 175 N.Y.S.2d at 70-71 (conveyance to incipient corporation held void, although filing was accomplished within a few days); *Borough of Elizabeth*, 462 A.2d at 812-13 (deed to incipient corporation held invalid, where filing was accomplished many months later).

The exception applies to equitable claims, which almost invariably are framed in terms of an estoppel against the grantor. Thus, the *Allman* decision states:

It is the general rule that a valid deed of conveyance requires a grantee in esse who is capable of taking and holding title to the property at the time of the conveyance[citations omitted], although equitable rights may result in favor of a subsequently formed corporation named as a grantee.

437 S.W.2d at 74 (emphasis added). See also *White Oak Grove*, 47 S.W. at 502-03 (invoking estoppel against the grantors “in equity and good conscience”); *Community Credit Union*, 534 A.2d at 334, 335-36 (citing “principles of equity” and estoppel).

In the present case, the trial court rejected Ortega's arguments for estoppel. The trial court's finding that Ortega was not a "good faith purchaser" resolved the balance of equities against him. This will be explained below. (See pp. 28-42, *infra*)

Thus, the exception to the void-deed rule does not apply to this case. This Court should follow the general rule that deeds to nonexistent entities are void.

2. "Collateral Attack" on the Foreclosure

Ortega contends that Stone cannot "collaterally attack" the mortgage foreclosure after the redemption period. (App. Br., pp. 24-25) Ortega did not raise this theory below, and should not be allowed to raise it here. See *Thiele v. Stich*, 425 N.W.2d 580, 582 (Minn. 1988)(appellate court generally will not consider matters not argued and considered in the trial court).

The theory, moreover, is misconceived. "Collateral attack" is a concept applicable to judgments and judicial orders. In *Nelson v. Nelson*, 111 Minn. 183, 126 N.W. 731, 734 (1910), the court states:

The doctrine against collateral attack applies almost exclusively to judgments of duly constituted courts, or the proceedings and decisions of judicial or quasi judicial officers in matters within their jurisdiction. It has no application to contracts, or to stipulations or agreements in actions or proceedings not followed by judicial confirmation.

(emphasis added)

Likewise, 55 Am. Jur.2d *Mortgages*, §716 (cited in App. Br., at p. 24)

provides:

The general rule that a judgment or decree is not subject to collateral attack if the court had jurisdiction of the parties and of the subject matter is applicable to decrees of foreclosure. In such respect, a decree of a court of competent jurisdiction is conclusive, notwithstanding the court may have proceeded irregularly or erred in its application of the law ... its decree of foreclosure and the sale thereunder are not subject to collateral attack for any errors committed by the court in the course of the proceedings.

(emphasis added)

The foreclosure at issue in the present case apparently did not involve a judgment or decree. It seems to have been a foreclosure by advertisement pursuant to a power of sale. (See Ex. 305) The record gives minimal information as to how the foreclosure took place, and there is no proof of the entry of any judgment or judicial decree. (When Stone's attorney sought testimony about the foreclosure, Ortega's attorney successfully objected "to this whole line of inquiry here as irrelevant" (Tr., p. 142)!)

For the foregoing reasons, "collateral attack" analysis should be held inapplicable here. Even if the analysis were relevant, the Court should hold that this lawsuit is a proper direct attack on the foreclosure-by-advertisement, not a collateral attack. See, e.g., *Stumer v. Howard*, 242 Minn. 371, 65 N.W.2d 609 (1954) ("A direct attack on a judgment is an attempt to annul, amend, reverse, or vacate a judgment or declare it void in an appropriate proceeding instituted initially and primarily for that purpose").

Many cases recognize the viability of lawsuits attacking foreclosure proceedings after the redemption period. See, e.g., Amresco Residential Mortgage Corp. v. Stange, 631 N.W.2d 444, 444-45 (Minn. App. 2001) (“after expiration of the statutory period for redeeming property,” mortgagors could bring an action “to set aside respondent’s foreclosure”).

Respondent’s counsel feel ethically bound to point out a case that did apply the concept of “collateral attack” to foreclosure-by-advertisement. See Prior Lake State Bank v. Mahoney, 216 N.W.2d 681, 682 (Minn. 1974) (“the claimed irregularity, asserted only after the expiration of the period of redemption, constituted an impermissible collateral attack”). However, this reference is dictum and completely unanalytic, and should be limited to its facts.

The *Mahoney* Court seems unaware of the issue whether “collateral attack” applies to extrajudicial proceedings. The holding is extremely brief and cites, without explanation, to a typical case applying collateral attack analysis to a judicial decree. See id.; In re Petition of Fidelity & Deposit Co. of Maryland, 216 N.W.2d 674 (Minn. 1974).

Mahoney, moreover, involved a post-redemption-period challenge to foreclosure by the mortgagor, who had full notice of the proceedings. In the present case, Stone was not the mortgagor, was not given notice, and “didn’t know anything about the Sheriff’s sale.” (See Tr., pp. 54, 141-42)

This Court, accordingly, should hold that *Mahoney* does not govern the present case. The Court should reject Ortega’s “collateral attack” contention

because (1) the theory was not raised below; (2) Ortega's attorney successfully objected to pertinent evidence as "irrelevant"; (3) the theory does not apply to attacks on extrajudicial proceedings; and (3) even if it did apply, the present attack is direct rather than collateral. Thus, the trial court's holding that the deed was void should be affirmed.

II. THE TRIAL COURT DID NOT ERR IN DENYING ORTEGA THE STATUS OF A "GOOD FAITH PURCHASER."

Standard of Review

The findings of fact in a bench trial "shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge the credibility of witnesses." See Minn. R. Civ. P. 52.01; *Rogers v. Moore*, 707 N.W.2d 650, 656 (Minn. 1999). In applying this rule, the appellate court should "view the record in the light most favorable to the judgment of the district court." *Rogers*, 707 N.W.2d at 656. The findings of fact must be "manifestly contrary to the weight of the evidence or not reasonably supported by the evidence as a whole" to warrant reversal. *Id.*

Argument

Ortega contends that he is a "good faith purchaser" under Minnesota's Recording Act. The Act, Minn. Stat. § 507.34, provides, in pertinent part:

507.34 Unrecorded conveyances void in certain cases

Every conveyance of real estate shall be recorded in the office of the county recorder of the county where such real estate is situated; and every such conveyance not so recorded shall be void as against any subsequent purchaser in good faith and for a valuable consideration of the same real estate, or any part thereof, whose conveyance is first duly recorded ...

(emphasis added)

The Recording Act does not control the analysis in this matter, because no unrecorded conveyance is at issue. Appellant's Brief gropes to explain the pertinence of the statutory language. (See App. Br., pp. 15-18)

The trial court, however, did make a finding of fact on the "good faith purchaser" issue. It held:

Ortega has failed to meet his burden of proving by a fair preponderance of the evidence that he is a "purchaser" within the meaning of the statute, or that he otherwise should be treated as a good faith purchaser for value.

(Finding of Fact 15 (A-4))

As will be shown below, the evidence firmly supports the trial court's finding. Insofar as the finding is relevant (e.g., for the issue of estoppel), it should clearly be affirmed.

A. Ortega Was Not a "Purchaser ... For a Valuable Consideration."

The trial court correctly found that Ortega failed to prove himself a "purchaser" for purposes of the statute. A party invoking the Recording Act to defeat another party's title has the burden of proof. See *Miller v. Hennen*, 438 N.W.2d 366, 369 (Minn. 1989).

The evidence of record fails to show that Ortega “purchased” Jetmar’s mortgage. Ortega’s \$200,000 loan to Jetmar had been made four months before the mortgage, with no collateral whatsoever.

Ortega contends that this loan was “extended” in reliance on the mortgage. By his own account, however, the loan fell into default after three days, and had been in default for four months. Ortega and his attorney belatedly tried to get security “in any way we could,” and repeatedly were offered worthless collateral. (See Tr., pp. 122-24, 128)

There is no evidence to suggest that Ortega could have taken any sort of effective collection action against either Hammond or Jetmar. Ortega thus failed to show that he either paid consideration or incurred a detriment in return for the mortgage. The trial court’s finding that he failed to prove “purchaser” status should be affirmed.

B. Ortega Was Not a “Good Faith Purchaser”

Even if Ortega was a “purchaser ... for a valuable consideration,” he failed to show that he was a “good faith purchaser” under the Recording Act. The trial court clearly could find that Ortega did not meet his burden of proof on this point.

The meaning of “good faith purchaser” (or “bona fide purchaser”) under the Act is well settled. A purchaser in good faith is “one who gives consideration

without actual, implied, or constructive notice of the inconsistent outstanding rights of others.” *Miller*, 438 N.W.2d at 369.

The question presented here is whether Ortega received implied notice that the mortgage from Jetmar was invalid. Specifically, the question is whether Ortega should be charged with notice (1) that Jetmar had no legal existence or (2) that Hammond had issued the mortgage by fraud.

“Implied notice” means that one has “actual knowledge of facts which would put one on further inquiry.” *Miller*, 438 N.W.2d at 370. The Minnesota Supreme Court explains:

For example, if a subsequent purchaser was aware that someone other than the vendor was living on the land, the purchaser would have a duty to inquire concerning the rights of the inhabitant of the property and would be charged with notice of all facts which such an inquiry would have disclosed. [Citation omitted.] This court adopted the following rule for implied notice cases:

One is not a bona fide purchaser and entitled to the protection of the recording act, though he paid a valuable consideration and did not have actual notice of a prior unrecorded conveyance from the same grantor, if he had knowledge of facts which ought to have put him on an inquiry that would have led to a knowledge of such conveyance.

Id. (emphasis added)

The requirements of reasonable inquiry are further explained in 1 Patton and Palomar, *Land Titles* (3rd Ed. 2002), § 12, pp. 72-75:

If other circumstances exist that ought to put a person exercising common sense and prudence on inquiry, a purchaser will be presumed to have made that inquiry and will be charged with notice of every fact that would have resulted from it.

* * *

A reasonable inquiry must be diligent. Lack of diligence in the prosecution of a required inquiry creates a conclusive presumption of knowledge of those facts that a reasonable inquiry would have revealed.

(emphasis added)

The foregoing principles have been applied in Minnesota case law closely in point for the facts of this case. In *Clafin v. Commercial State Bank of Two Harbors*, 487 N.W.2d 242 (Minn. App. 1992), as in the present case, a swindler induced a grantor to convey a deed by fraud. As here, the swindler then promptly mortgaged the property without the grantor's knowledge.

In *Clafin*, as in the present case, the defrauded grantor remained in possession of the land. As here, the mortgagee knew that the grantor was still in possession but made no attempt to inquire with her about her rights. The Court of Appeals held that the mortgagee was not a good faith purchaser:

The fact that Margaret was a grantor-in-possession gave rise to a duty that the Bank inquire of *her* as to her rights. ... The Bank had a duty to inquire of Margaret and is charged with notice of all facts which such inquiry would have disclosed; thus, it is not a bona fide purchaser in good faith for value without notice.

Id. at 249 (emphasis added; italics in original)

Another case closely in point is *West Concord Conservation Club, Inc. v. Chilson*, 306 N.W.2d 892 (Minn. 1981). In that case, as in the present one, a grantor sought to have a deed declared void. The deed had been executed through

fraud. The signer of the deed, a member of the Conservation Club, had falsely purported to be the president of the Club, with authority to make the sale.

As in the present case, the *West Concord* defendants argued that they were unsuspecting purchasers of the land. As here, the trial court held that the deed was void. The Supreme Court affirmed, observing:

The [purchaser] is bound by what a reasonable investigation would have revealed. ... Prior to closing, the [purchaser's] officers and attorney had in their possession the Conservation Club's corporate records. These records would have indicated that there had not been a meeting of the members of the board authorizing the conveyance. An examination would have also revealed that Plevke was not the president and did not have the power to sell the club property. The Coon Club was thus placed on inquiry notice as to the claims of the Conservation Club.

Id. at 896-97 (emphasis added)

This court should follow *West Concord* and *Claflin* in affirming the finding here. As in *Claflin*, Ortega made no inquiry with Stone, the grantor in possession. As in *West Concord*, Ortega did not investigate Jetmar's legal status. Ortega's obligation to do so will be explained in more detail below.

C. Minnesota's Title Standards Required Ortega to Investigate Jetmar's Status.

Where a purchaser has "implied notice" of facts into which it should inquire, the court assesses the reasonableness of the purchaser's inquiry. See *Miller v. Hennen*, 438 N.W.2d at 370-71; 1 Patton and Palomar, § 12, p. 75. The

Minnesota Supreme Court expressly has held that a reasonable inquiry includes adherence to Minnesota Title Standards.

In *Miller*, as in the present case, an argument was raised that the party on notice “had no duty to investigate outside the tract index.” See Miller, 438 N.W.2d at 371. Our Supreme Court disagreed. It stated:

We support Minnesota State Bar Association Title Standard No. 16, which provides:

STRAY DEEDS – STRANGER TO STRANGER. A deed, contract, lease or mortgage from a stranger to the record title (including a prior owner of record) to another stranger to the record title does not make the title unmarketable but, if such instrument has not been of record for more than 15 years, inquiry should be made to ascertain the interest claimed.

Miller was required under this standard to investigate the various mortgages, including the one he contemplated purchasing, in order to determine which party had legitimate title. It is common practice among title-examining attorneys to advise prospective purchasers to inquire regarding claimed interest of strangers to title.

Id. (emphasis added)

In the present case, Appellant’s Brief contends that the Minnesota Title Standards do not require any inquiry into the status of an LLC. (See App. Br., p. 9) This contention is incorrect.

Appellant relies on Standard no. 33, which states in part:

***FILING ARTICLES OF INCORPORATION –
CORPORATE EXISTENCE –
CONTINUANCE OF CORPORATE EXISTENCE***

- (a) It is not necessary to require the recording of Articles of Incorporation in the office of the County Recorder or Registrar of Titles to show legal corporate existence, except for religious corporations governed by Minn. Stat. Chapter 315.

* * *

(b) A title shall not be unmarketable because the continued legal corporate existence of a corporation in the chain of title does not appear of record.

Minnesota Standards for Title Examinations (Section of Real Property Law of Minnesota State Bar Association 2005)(emphasis added) This standard does not speak to the reasonableness of “investigat[ing] outside the tract index” in transactions like the one at issue. Cf. Miller, 438 N.W.2d at 371.

A section from the “White Pages” which accompany the Title Standards directly addresses the situation here. The purpose of the White Pages is as follows:

THE “WHITE PAGES”

The following article, commonly referred to as the “White Pages”, is a supplement to the Minnesota Title Standards. It is intended to inform and be a guide to the real estate lawyer in the transactional context.

* * *

3. The primary focus of the “White Pages” is representing parties in current transactions. This is distinguished from the focus of the “Minnesota Title Standards” which is examining the record title of past transactions.

Minnesota Standards for Title Representations, Preface to the “White Pages” (emphasis added).

The “White Pages” section which deals with LLCs provides, in pertinent part:

In accepting a conveyance from the LLC determine:

- (a) That the LLC is in good standing with the office of the Minnesota Secretary of State (need not be recorded).
- (b) That the LLC is authorized or is not prohibited from making the conveyance, by examining such documentation as the articles of organization, member control agreement, bylaws, operating agreement or resolution (need not be recorded).
- (c) That an authorized manager (sometimes referred to as an officer) executed the conveyance, by examining such documentation as the articles of organization, member control agreement, bylaws, operating agreement or resolution. (See Minn. Stat. §322B.673.)(need not be recorded).

See id., White Pages, Chapter I, § D9, p. I-D-13 (emphasis added).

Ortega and his attorney made no such investigation when taking a mortgage from Hammond's purported LLC. Thus, under *Miller*, the trial court clearly could find that Ortega had not made a reasonable inquiry so as to qualify for "good faith purchaser" status.

In making this finding, the trial court also could take account of many facts shown by the evidence of record -- Ortega's experience in dealing with real estate, Hammond's blatant failures to keep his commitments, the bounced check that Hammond had written as "collateral." These matters all should have caused Ortega to be particularly wary. This Court should affirm the trial court's holding that Ortega failed to prove himself entitled to "good faith purchaser" status.

III. THE TRIAL COURT'S DECISION SHOULD NOT BE REVERSED ON EQUITABLE GROUNDS.

Standard of Review

The granting of equitable relief is within the sound discretion of the trial court, and only a clear abuse of that discretion will result in reversal. *Nadeau v. County of Ramsey*, 277 N.W.2d 520, 524 (Minn. 1979).

Estoppel and waiver both ordinarily are questions of fact. *See Pollard v. Southdale Gardens of Edina*, 698 N.W.2d 449, 453, 454 (Minn. App. 2003). Accordingly, the standard of review is clear error. *See* Minn. R. Civ. P. 52.01.

A. Overview: Balancing the Equities

Appellant's many arguments to this Court almost all are, in essence, an appeal for reversal on equitable grounds. Appellant's Brief invokes the concepts of "equity," "estoppel," or "fairness" more than fifty times in the course of its argument.

Appellant's Brief cites a torrent of cases. Most involve equitable estoppel, a key element of which is reliance by the injured party. Most also expressly or implicitly turn on a finding that the injured party was a "good faith purchaser."

In the present case, the trial court found that Ortega had not proven "good faith purchaser" status. (Finding No. 15; A-4) As argued above, the court was eminently justified in that finding. Among other matters, the record shows:

- (1) Ortega is an experienced businessman who has handled numerous transactions involving commercial real estate. (Tr., pp. 150-51, 174-76)

- (2) Ortega, as seller, loaned Hammond, the buyer, one-tenth or more of the purchase price, in a transaction his own attorney called “unusual.” (Tr., pp. 133-35)
- (3) Ortega, eager to “do a deal,” disregarded his own attorney’s caution to get collateral before he made the loan. (Tr., p. 131)
- (4) Hammond told Ortega that he would pay back the loan in three days because he was going to “get money from other developments.” (Tr., p. 177) Ortega didn’t demand an explanation of why the loan was necessary, in light of these pending payments. (Tr., pp. 176-77)
- (5) When Hammond failed to repay the loan, Ortega and his lawyer belatedly sought collateral. Hammond offered them a transparently worthless mortgage, and then escrowed a check, which immediately bounced. (Tr., pp. 122-24, 128)
- (6) All the foregoing matters occurred before the purported mortgage of Stone’s duplex. Despite their experience with Hammond, Ortega and his attorney accepted the mortgage without any research on Jetmar. They not only failed to check its legal status, but failed to do a judgment search, get a credit report, get a Dunn & Bradstreet report, or get a title policy. (Tr., pp. 138-39, 145-46, 169, 185-86)

Given this evidence, the trial court was eminently justified in finding Ortega not to be a “good faith purchaser.” The trial court also clearly was entitled to weigh the equities against Ortega in favor of Stone.

The court could find, on the evidence of record, that Stone was far less sophisticated than Ortega and far less capable of protecting himself from manipulation by Hammond. Appellant contends (with minimal citation to the record) that Stone “kn[e]w about the foreclosure action,” “kn[e]w about the [sheriff’s] sale,” allowed the sale to go forward by “watching and being silent about any claim that he really owned the property,” and otherwise acted inequitably. (See App. Br., pp. 22-25) In fact, the record shows:

- (1) Stone let Hammond “borrow my building” on condition that he would not mortgage it and that he “[j]ust needed the building to put in his portfolio.” (Tr., pp. 41, 45, 76-7) Thus, Stone did not foresee the deed inducing reliance of the sort claimed by Ortega.
- (2) Stone learned of the mortgage some seven months after it was issued, confronted Hammond, and was assured by him that “there was a grace period” and that he would be able to redeem before the period was up. (Tr., pp. 47-50; 85-87)
- (3) Hammond also told Stone “that he would intercede for me to Mr. Ortega” so that Stone would get rent from the duplex. (Tr., pp. 55, 87) Stone continued to receive the rent for nine more months, through August 2004 (the very eve of this lawsuit). (Id.)
- (4) Ortega and his attorney never contacted Stone directly about the property. They gave him no notice of the foreclosure proceedings. (Tr.,

pp. 141-42) Stone stated that he “didn’t know anything about the Sheriff’s sale.” (Tr., p. 54)

Given all this evidence, the trial court clearly could balance the equities in favor of Stone. This court should be mindful of the trial court’s opportunity to judge the credibility of the witnesses. See Minn. R. Civ. P. 52.01. Appellant has shown no basis for reversing on equitable grounds. This will be further explained below.

B. Equitable Estoppel

Ortega argues that it was clear error for the court not to find equitable estoppel against Stone. Ortega had the burden of proof on this issue. It is well settled that:

Parties seeking to invoke the doctrine of equitable estoppel must prove (1) that promises or inducements were made; (2) that they reasonably relied upon the promises; and (3) that they will be harmed if estoppel is not applied.

Pollard v. Southdale Gardens of Edina, 698 N.W.2d 449, 455 (Minn. App. 2005)(emphasis added).

The key point at issue here is whether Ortega “reasonably relied” on the validity of the deed. The trial court’s finding that Ortega was not a “good faith purchaser” effectively resolved this issue against Ortega. (See Finding No. 15, A-4) As will be shown below, that finding is amply supported by estoppel case law.

Reliance must be reasonable under the circumstances of the case. A party cannot invoke estoppel when he “could have discovered the true facts upon exercising reasonable prudence.” *Farmers Security State Bank of Zumbrota v. Voegele*, 386 N.W.2d 760, 763 (Minn. App. 1986)(emphasis added).

In *Froslee v. Sonju*, 209 Minn. 522, 297 N.W. 1 (1941), as in the present case, the plaintiff argued that a deed was void. As in the present case, the defendant argued equitable estoppel. The trial court decided for the plaintiff, and the Supreme Court affirmed. It stated:

To be estopped from asserting title, one must have led another by words or conduct to believe that the former had no interest in the property, and the other must have relied upon the misleading words or conduct in such a manner as to change his position for the worse. Estoppel cannot be invoked by a party who knew the facts or was negligent in not knowing them.

* * *

There can be no estoppel as to facts equally known to both parties or as to facts which the party invoking the estoppel ought, in the exercise of reasonable prudence, to know. ... He cannot claim ignorance when the law charges him with knowledge.

* * *

We are of the view that the evidence of estoppel was not so strong as to require a finding on that issue in defendant’s favor. A contrary finding was permissible.

Id. at 3, 4 (emphasis added)

More recently, the court affirmed a similar finding under circumstances very closely in point for this case. In *West Concord Conservation Club, Inc. v.*

Chilson, as noted above, a swindler purported to convey a deed on behalf of his organization. The organization sued successfully to have the deed declared void.

The *West Concord* defendants, successive purchasers of the land, sought to invoke estoppel against the organization. They agreed that they were innocent purchasers who were unaware of the fraud. The trial court declined to apply estoppel and the Supreme Court affirmed. It stated, in part:

Defendant Lorraine Chilson discovered the utility box and was thus placed on notice of the Conservation Club's interest. She was also informed directly by her attorney that the club had paid the utility bills for the property. She and the other purchasers chose to proceed with the closing despite the risk. Consequently, the Chilsons and Jackson cannot invoke estoppel, since they were negligent in ascertaining the rights of the Conservation Club and they took with knowledge of the defect in the title.

The Coon Club is bound by what a reasonable investigation would have revealed. ... Prior to closing, the Coon Club's officers and attorney had in their possession the Conservation Club's corporate records. These records would have indicated that there had not been a meeting of the members of the board authorizing the conveyance. An examination would have also revealed that Plevke was not the president and did not have the power to sell the club property. The Coon Club was thus placed on inquiry notice as to the claims of the Conservation Club.

Id., 306 N.W.2d at 896-97 (emphasis added).

Like the defendants in *West Concord*, Ortega disregarded his attorney's advice, failed to check Jetmar's records, and otherwise failed to carry out "a reasonable investigation." As in *West Concord* and in *Froslee*, the trial court clearly could find that there was no showing of reasonable reliance sufficient to warrant an estoppel.

The host of estoppel cases cited in Appellant's Brief are readily distinguishable on this basis. Those case expressly or implicitly find reasonable reliance. They often explicitly couch these findings in terms of "good faith purchaser" status.

In *Proulx v. Hirsch Bros. Inc.*, 279 Minn. 157, 155 N.W.2d 907 (1968)

(App. Br., pp. 16, 19), for example, the Court states:

We think it clear that under the evidence herein both plaintiffs and the other defendants are estopped from asserting any claims in opposition to rights acquired by defendants Thorpe and Gesme through their good-faith purchase of this property.

155 N.W.2d at 912 (emphasis added). See also, e.g., *Esty v. Cummings*, 80 Minn.

516, 83 N W. 420, 421 (1900)(App. Br., pp. 19-20)(estoppel granted in favor of mortgagee who "loaned the money ... taking the mortgage in question in good faith, and in the belief that [the individual] owned the property").

In sum, the trial court properly denied Ortega "good faith purchaser" status because of his lack of reasonable inquiry. The trial court's finding defeats Ortega's claim of equitable estoppel. Thus, the decision should be affirmed.

C. Other Equitable Defenses

Ortega perfunctorily raises other equitable defenses, including the theories of laches and waiver. (See App. Br., p. 25) These defenses have no merit.

Waiver is a voluntary relinquishment of a known right. *Pollard v. Southdale Gardens of Edina*, 698 N.W.2d at 453. The proponent has the burden of proof. Thus:

The party alleging waiver must provide evidence that the party that is alleged to have waived the right possessed both knowledge of the right in question and the intent to waive that right

Id. (emphasis added)

Waiver ordinarily is a question of fact, and intent to relinquish a known right is “rarely to be inferred as a matter of law.” *Fedie v. Mid-Century Ins. Co.*, 631 N.W.2d 815, 819 (Minn. App. 2001). A finding that there was no waiver will not be disturbed if reasonable evidence supports the trial court. See id.; Minn. R. Civ. P. 52.01.

In the present case, the trial court clearly could find that Stone did not intend to relinquish a known right. Stone stated that he didn’t understand the significance of the redemption period and “didn’t know anything about the Sheriff’s sale.” (Tr., pp. 54-55) He continued to collect rent from the disputed duplex until the very eve of this litigation. (Tr., p. 55)

The same facts support a finding that Stone was not guilty of laches. Laches is “an unreasonable delay in asserting a known right.” *Jackel v. Brower*, 668 N.W.2d 685, 691 (Minn. App. 2003). This assessment lies within the trial court’s equitable discretion. See id. at 691 (“A party seeking laches must come with clean hands in order to obtain the benefit of the balancing of the equities”).

In the present case, the trial court clearly had discretion to balance the equities in favor of Stone. Stone was far less experienced than Ortega, and Ortega manifestly failed to exercise due diligence. The trial court assessed the credibility of the witnesses, and properly struck the balance in Stone's favor.

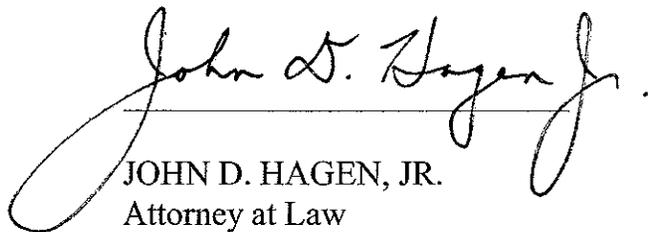
CONCLUSION

The trial court correctly held that the quitclaim deed from Stone to Jetmar was void. Jetmar did not exist at the time the deed was signed, delivered, and recorded. Thus, Jetmar never held title and could not mortgage the property to Ortega.

The central issue is whether Ortega nevertheless should be granted relief on grounds of equity and estoppel. The trial court's refusal to grant such relief was well within the bounds of its discretion. The evidence amply supports the key finding that Ortega was not a "good faith purchaser."

The trial court observed the witnesses, and clearly was entitled to find that Ortega failed to exercise due diligence in making a reasonable inquiry. This Court should affirm the trial court's award of the property to Stone.

Respectfully submitted,



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The appendix to this brief is not available for online viewing as specified in the *Minnesota Rules of Public Access to the Records of the Judicial Branch*, Rule 8, Subd. 2(e)(2) (with amendments effective July 1, 2007).