

NO. A05-1178

State of Minnesota
In Supreme Court

IN THE MATTER OF THE PETITION OF JOSHUA S. COLLIER,
IN RELATION TO PROPERTY REGISTERED IN
CERTIFICATE OF TITLE NO. 1596547 FOR AN
ORDER DIRECTING ENTRY OF A NEW CERTIFICATE
AND DECLARATORY RELIEF

REPLY BRIEF

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TABLE OF CONTENTS

Table of Authorities	ii
Argument	1
The Torrens system of land title registration eliminates the doctrine of constructive notice, but not the effect of actual notice or actual knowledge of unregistered interests in land	1
Conclusion	14

TABLE OF AUTHORITIES

Cases

<i>Andrews v. Benson</i> , 476 N.W.2d 194 (Minn. Ct. App. 1991)	12
<i>Comstock v. Davis, Inc. v. G.D.S Assoc.</i> , 481 N.W.2d 82, 85 (Minn. Ct. App. 1992).....	3, 12
<i>Cook v. Luettich</i> , 191 Minn. 6, 8, 252 N.W. 649, 649 (1934).....	12
<i>Fingerhut Corp. v. Suburban Nat. Bank</i> , 460 N.W.2d 63, 65-66 (Minn. Ct. App. 1990)	2, 8
<i>GME Consultants, Inc. v. Oak Grove Development, Inc.</i> , 515 N.W.2d 74 (Minn. Ct. App 1994)	11
<i>In re Juran</i> , 178 Minn. 55, 226 N.W. 210 (1929)	passim
<i>In re Moulton's Estate</i> , 233 Minn. 286, 46 N.W. 667 (1951)	11
<i>In re Ocwen Financial Services, Inc.</i> , 649 N.W.2d 854, 857 (Minn. Ct. App. 2002).....	12
<i>In re Petition of Alchemedes/Brookwood, Ltd.</i> , 546 N.W.2d 41, 42 (Minn. Ct. App. 1996)	3, 9, 12
<i>In re Petition of Willmus</i> , 568 N.W.2d 726 (Minn. App. 1997)	12
<i>Johnson v. Chicago, Burlington & Quincy RR</i> , 243 Minn. 58, 68-9, 66 N.W.2d 763, 770-1 (1954	11
<i>U.S. v. Ryan</i> , 124 F.Supp. 1, 5 (D. Minn. 1954).....	5

Statutes

Minn. Stat. § 508.48.....	10
Minn. Stat. § 508.49.....	4
Minn. Stat. § 514.05.....	6, 7
Minn. Stat. § 580.60.....	4
Section 508.25 of the Minnesota Statutes.....	1, 2, 3, 4

Other Authorities

R.G. Patton, <i>The Torrens System of Land Title Registration</i> , 19 Minn. L. Rev. 519, 535 (1935).....	15
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ARGUMENT

The Torrens system of land title registration eliminates the doctrine of constructive notice, but not the effect of actual notice or actual knowledge of unregistered interests in land.

Section 508.25 of the Minnesota Statutes requires, as a condition precedent to its application to bar unregistered interests, that one purchases registered land “in good faith” and “for a valuable consideration”. The “good faith” required by the statute is negated when one purchases with actual notice and actual knowledge of a prior mortgage and Sheriff’s Certificate of Sale innocently recorded but not “registered” by mistake or oversight, for unconscionably less than fair market value, so that the purchaser’s interests are subject to the mortgage.

The Minnesota State District Court, Second Judicial District, Ramsey County, Minnesota (the Honorable M. Michael Monahan) ruled that the “good faith” required by MINN. STAT. § 508.25 was negated in such an instance, so that the interests of the purchaser (i.e. Respondent Joshua Collier) were subject to the mortgage of Appellant M&I Bank FSB. The Minnesota Court of Appeals (the Honorable Judges Lansing, Schumaker, and Halbrooks) ruled that the actual notice and actual knowledge of purchaser Collier was (essentially) irrelevant, because the mortgage was not properly registered.

The analysis in Respondent’s Brief is flawed and cases relied upon distinguishable, as set forth below. The decision of the Court of Appeals in this case should be reversed, and the decision of the district court upheld. In addition, this

Court's long-relied upon rule set forth in *In re Juran*, 178 Minn. 55, 226 N.W. 210 (1929) of the continued effect of actual knowledge of unrecorded interests in Torrens property should not be overturned as requested by Respondent.

I. Actual knowledge of an unregistered mortgage on Torrens property is relevant to the good faith requirement of Minn. Stat. § 508.25.

The heart of the decision of the Court of Appeals and Respondent's case is that actual knowledge of an unrecorded mortgage on Torrens property is irrelevant to the "good faith" analysis required by Minn. Stat. § 508.25, absent a finding of fraud or some type of illegality. Respondent entirely disregards the additional requirement of Minn. Stat. § 508.25 that a subsequent purchaser pay valuable consideration for a parcel of real property, which is understandable given that Respondent paid \$5,000 for his interest.¹ Respondent argues that an unregistered mortgage is ineffective against a later mortgage which is properly registered, and that registration is what creates a mortgage lien interest in Torrens property. Respondent's Brief, page 8. Respondent relies on *Fingerhut Corp. v. Suburban Nat. Bank*, 460 N.W.2d 63, 65-66 (Minn. Ct. App. 1990) for this position. Respondent states that it is irrelevant that he had actual knowledge of Appellant's prior executed and recorded mortgage and foreclosure action, arguing that "actual notice means actual knowledge of an enforceable agreement." *Id.* (emphasis in original). He cites *Comstock v. Davis, Inc. v.*

¹ Respondent makes the creative claim that the cost of "a very expensive lawsuit" should be added to the consideration for his purchase, further demonstrating his lack of good faith in the purchase of the property.

G.D.S Assoc., 481 N.W.2d 82, 85 (Minn. Ct. App. 1992) for this conclusion, as well as *In re Petition of Alchemedes/Brookwood, Ltd.*, 546 N.W.2d 41, 42 (Minn. Ct. App. 1996). The analysis of the Court of Appeals and Respondent eviscerates the “good faith” requirement of Minn. Stat. § 508.25 and prior cases addressing this issue and should not be adopted by this Court.

Respondent seeks to narrow “actual knowledge” to mean knowledge only of a mortgage which is noted on the certificate of title. Actual knowledge must include more than knowledge that the mortgage is on the certificate of title and therefore “enforceable”. Put another way, Respondent argues there can never be “actual knowledge” of any interest which is not on the certificate of title, since by this definition such interests are not “enforceable” and “actual knowledge” is limited to “enforceable” interests. To construe “in good faith” as negated exclusively by actual notice or actual knowledge of matters properly registered and set forth on the certificate of title, renders the phrase “in good faith” a nullity and entirely superfluous. This follows because these are precisely the interests the purchaser is subject to by the language set forth in the statute itself following the phrase “in good faith”. *See* MINN. STAT. § 508.25. Further, this construction also renders the phrase “in good faith” a nullity and superfluous because long standing Minnesota case law provides that a purchaser of Torrens property is subject to matters set forth on the certificates of title. *See, e.g., In re Juran*, 178 Minn. 55, 55, 226 N.W. 210, 202 (1929). There is no

dispute that a purchaser has always had actual (and constructive) notice of all interests memorialized on the certificate of title.

Respondent suggests that this Court find that “good faith” exists under Minn. Stat. § 508.25, “unless the conveyance is acquired through fraud or some type of illegality.” Respondent’s Brief, page 13. Respondent’s definition of “good faith” (which lacks any citation) is overly restrictive and should not be adopted by this Court. *Juran* and its progeny did not limit “good faith” to circumstances involving fraud or illegality. Equity does not support Respondent’s interpretation, which would reward Respondent’s inequitable (and undisputed) conduct in this case. The facts of Respondent’s conduct verge on fraud, and include the purchase from Conley of his interest for \$5,000, without disclosing that Respondent had learned that Petitioner had not registered its mortgage with the registrar. There is no reason for this Court to narrow the definition of “good faith” as requested by Respondent, which would essentially eliminate the good faith requirement of Minn. Stat. § 508.25.

Respondent’s argument that mortgages are somehow special or treated differently is incorrect. Respondent’s Brief, page 12. Minn. Stat. § 580.60 applies the rules regarding registration in regards to mortgages to leases as well. Easements are also covered by the Torrens Act, at Minn. Stat. § 508.49. This means that the decision of the Court of Appeals (and Respondent’s argument) would also be applied to actual notice of unregistered leases, easements and other interests in Torrens property. The elimination of the effect of actual notice on the good faith determination will also

necessarily affect these other interests, contrary to Respondent's insistence that mortgages are treated differently under the Torrens Act.

Respondent raises the specter of "chaos" if the law regarding actual notice is not changed as proposed by Respondent. Respondent claims that if a judgment search was run at the closing of a real estate sale and it revealed unregistered judgments, that any such judgments would create "actual notice" of the existence of the judgment and preclude a good faith purchase free of such encumbrances. Respondent's Brief, page 11, fn. 4. This is not correct. A judgment search would provide only record or constructive notice of the possible existence of such judgments. It would not be actual notice of the existence or validity of such unrecorded judgments. An unregistered judgment noted in such a search could well be invalid, based on an intervening bankruptcy discharge, applicable state and federal law requiring recording with the registrar in the instance of state or federal tax liens or other issue. *See U.S. v. Ryan*, 124 F.Supp. 1, 5 (D. Minn. 1954)(noting that federal law explicitly states that a federal tax lien is invalid unless notice recorded in compliance with applicable state law). There is no dispute that such record or constructive notice is irrelevant for purposes of Torrens property.

The present case involves much more than mere constructive or record notice. It is undisputed that Respondent had actual knowledge of the existence and validity of the mortgage and foreclosure action. Respondent had actual knowledge based on his discussions with the Ramsey County Sheriff, Conley and negotiations with Petitioner

prior to his purchase of his interest for \$5,000. If a purchaser closing on a real estate transaction had similar actual knowledge of the existence and validity of a prior interest (such as a judgment or mortgage), the purchaser would have the option of either paying off the interest or closing on the purchase potentially subject to the interest. This would be an equitable and common result, if the purchaser had actual knowledge (as in this case).

Comstock, *Fingerhut*, and *Alchemedes* are distinguishable from the instant case. *Comstock* analyzed the concept of “actual notice” in a different context. *Comstock*, a surveyor, foreclosed a mechanics’ lien. First Trust claimed its mortgage was prior to any mechanics’ lien. First Trust’s mortgage was dated November 25, 1986, but was not recorded until December 18, 1986. The first visible and actual improvements on the property—namely, *Comstock*’s survey stakes—occurred in the interim, on December 3, 1986.

The question on appeal was whether *Comstock* had actual notice of the First Trust mortgage sufficient to satisfy Minn. Stat. § 514.05.² The trial court found actual notice based strictly on circumstantial evidence. Specifically, the trial court found, based *Comstock*’s years of experience as a surveyor, that he “must have imputed

² MINN. STAT. § 514.05 provides:

All such liens, as against the owner of the land, shall attach and take effect from the time the first item of material or labor is furnished upon the premises for the beginning of the improvement, and shall be preferred to any mortgage or other encumbrance not then of record, unless the lienholder had actual notice thereof.

knowledge of some financing arrangement, since such arrangements are commonplace in projects of this size.” 481 N.W.2d at 84. The Court of Appeals rejected the trial court’s finding. It observed, “generalized knowledge of non-specific financing to be arranged at some point in the future is insufficient to satisfy the actual notice standard.” The Court of Appeals noted “the record contains no evidence showing actual knowledge by [Comstock] of a signed enforceable mortgage agreement before the field staking on December 3, 1986.” 481 N.W.2d at 85. The language quoted by Respondent was part of the Court of Appeals’ analysis distinguishing inquiry notice from actual notice. Implied or inquiry notice is defined as “where one has *actual knowledge* of facts which would put one on further inquiry”. *Id.* at 85 (emphasis in original)(citations omitted). The Court of Appeals analyzed “actual knowledge” as used in Minn. Stat. § 514.05, noting that term “actual notice” excludes enforcement of mortgages where there is only inquiry notice. *Id.* at 85. The Court of Appeals ruled for Comstock because First Trust had failed to prove Comstock had “actual notice” of its mortgage: “generalized knowledge of non-specific financing to be arranged at some point in the future is insufficient to satisfy the actual notice standard.” 481 N.W.2d at 84. The fact that the court analyzed the record to determine if Comstock had actual knowledge of the mortgage demonstrates that such actual knowledge is important and relevant. In the instant case, there is no dispute that Respondent had actual knowledge of Appellant’s interest in the real property.

Fingerhut Corp. v. Suburban National Bank, 460 N.W.2d 63 (Minn. App. 1990) is distinguishable. In *Fingerhut*, Connelly defrauded Fingerhut of a large amount of money, some of which was used to purchase and improve a home in Carver County. While Fingerhut's investigation was proceeding, on August 25, 1986, Suburban National Bank agreed to loan Connelly \$50,000, to be secured by a mortgage on the Carver County property. Three days later, on August 28, Fingerhut filed suit against Connelly. On August 29, 1986, Fingerhut filed a lis pendens against the Carver County home at the same time Connelly was signing the mortgage and Suburban was disbursing the \$50,000 proceeds. Suburban's mortgage was registered on September 2. Significantly, Fingerhut did not know the Connellys had given a mortgage to Suburban, nor did Suburban know about Fingerhut's claim to the property. 460 N.W.2d at 65. Fingerhut eventually traced \$141,000 of its funds directly to the property, and a federal district court ordered legal title to the property be vested in Fingerhut as of no later than August 29, 1986

Fingerhut brought a quiet title action against Suburban. The trial court found that because the property was Torrens and Fingerhut's notice of lis pendens was registered before the Suburban mortgage, Fingerhut's interest in the property was superior. On appeal, the Court of Appeals agreed. However, as indicated above, the question of notice was never before the Court. It was undisputed neither Fingerhut nor Suburban had notice of the claims of the other. Rather, *Fingerhut* addressed the priority of two registered interests. In the instant case, Respondent was fully aware of

Petitioner's interest in the property, and chose to proceed with his purchase regardless. As set forth in Petitioner's Brief, Respondent had extensive knowledge of Petitioner's mortgage and foreclosure, and had engaged in negotiations with Petitioner to purchase its interest.

Respondent relies on *In re Petition of Alchemedes/Brookwood, Ltd.*, 546 N.W.2d 41 (Minn. Ct. App. 1996) for the proposition that actual notice of an unregistered interest does not affect Torrens title. However, this misstates the facts and holding of *Alchemedes*. *Alchemedes* involved an apartment complex in which the rental units had been converted from condominiums and purchased by Brookwood Estates Limited Partnership. Two former owners of condominium units received leases with lifetime renewal options, which were never registered. Brookwood granted a mortgage on the entire complex to Midwest Federal Savings and Loan. The mortgage noted that the complex was free of all encumbrances except those noted, which included "unrecorded leases", with no further identification. The Midwest Federal mortgage was eventually purchased by Alchemedes and foreclosed. Alchemedes subsequently petitioned for a new certificate of title in its name. The tenants holding the unregistered leases sought to have their leases memorialized on the certificate.

The Court of Appeals in *Alchemedes* noted that the Torrens Act did not "do away with the effect of actual notice", citing *Juran*. *Id.* at 42. The court analyzed the record to determine whether Midwest Federal had any actual knowledge of the unrecorded leases. It held that the reference in the mortgage to "unrecorded leases"

was insufficient to provide actual knowledge, noting that Minn. Stat. § 508.48 specifically stated that reference in a registered instrument to an unregistered instrument or interest was not actual or constructive notice of such unregistered interest. There was no evidence that Midwest Federal had any knowledge of the long term leases. Midwest Federal's in-house counsel specifically testified that no one had any knowledge of such long term leases at the time of the mortgage transaction, and that he would not have allowed the loan to close if he had known of their existence. This testimony was not contradicted. *Alchemedes* was not decided on whether the leases had actually been registered, but whether Midwest Federal had actual knowledge. As no actual knowledge was found, the Court of Appeals held that the leases should not be memorialized on the new certificate. In the present case, it is undisputed that Respondent had actual knowledge of the Petitioner's interest in the real property. Respondent's actual knowledge means that he could not take his interest in good faith.

II. *Juran* should not be overruled.

Respondent requests that the Court overrule a portion of *In re Juran*, 178 Minn. 55, 226 N.W. 201 (1929). Specifically, Respondent argues the Court should overrule the language of *Juran* where this Court stated:

[The Torrens] act abrogates the doctrine of constructive notice except as to matters noted on the certificate of title. We think, however, that it does not do away with the effect of actual notice, although it undoubtedly imposes the burden of proving such notice upon the one asserting it.

Id., 202, 60. Respondent alleges this language is inapplicable in the instant case, and further asks that the Court overrule this long-established precedent. The opinion of the Court of Appeals implicitly overrules the rule confirmed in *Juran*. *Juran* is applicable to this case, and this long standing rule should not be eliminated.

The rule of stare decisis supports preserving *Juran*. As noted by this Court in *In re Moulton's Estate*, 233 Minn. 286, 46 N.W. 667 (1951), “[d]isregard for the rule of Stare decisis in the field of trust and property law can lead only to the destruction of vested rights created in reliance upon the decisions of this court.” *Id.* at 303, 676. The Court of Appeals in *GME Consultants, Inc. v. Oak Grove Development, Inc.*, 515 N.W.2d 74 (Minn. Ct. App. 1994) stated:

Although stare decisis is not an inflexible rule of law, departure from precedent is rare, especially in the field of property law, ‘where rights may have become vested in reliance upon the decisions of this court’. On the other hand, where societal conditions or other reasons for a common law rule cease to exist, blind obedience to the past is not required.

Id. at 76 (quoting *Johnson v. Chicago, Burlington & Quincy RR*, 243 Minn. 58, 68-9, 66 N.W.2d 763, 770-1 (1954)). There has not been a change in policy or societal conditions which mandate reversing the clear rule set forth in *Juran* and decades of subsequent reliance and analysis. The principal that actual knowledge of a prior unregistered interest has an effect on a purchaser is clear and well-understood, and is consistent with the Torrens Act. The amicus brief submitted by the Hennepin County Registrar of Titles requesting that the Court reverse the decision of the Court of Appeals in this case demonstrates the broader implications to the Torrens system if

the effect of actual notice is emasculated as requested by Respondent. As noted by the Court of Appeals, it is the law in Minnesota (as noted in *Juran*) that the Torrens Act did not eliminate the effect of actual notice. *Juran* has been cited and relied upon to support the continued effect of actual notice in actions involving real property subject to the Torrens Act in many cases since 1929. See *Cook v. Luettich*, 191 Minn. 6, 8, 252 N.W. 649, 649 (1934); *Andrews v. Benson*, 476 N.W.2d 194 (Minn. Ct. App. 1991); *Comstock v. Davis, Inc. v. G.D.S. & Associates*, 481 N.W.2d 82 (1992); *In re Alchimedes/Brookwood Ltd. P'ship*, 546 N.W.2d 41 (Minn. App. 1996); *In re Petition of Willmus*, 568 N.W.2d 726 (Minn. App. 1997); see *In re Owen Financial Services, Inc.*, 649 N.W.2d 854, 857 (Minn. Ct. App. 2002)(noting the Recording Act is “race-notice” in a case involving Torrens property, and stating “there is no need for parties to race to the registrar of titles because mortgage priority as established by a filing order is defeated by actual notice or knowledge of a superior mortgage or encumbrance”). A number of previously cited unpublished opinions also rely upon *Juran*, demonstrating its continued vitality.

Affirming long-standing law that actual knowledge of a prior unrecorded interest in Torrens property means that a purchaser is not a good faith purchaser will not “turn Torrens Property into Abstract property” as claimed by Respondent. Respondent’s Brief, page 13. Respondent seeks to affirm the Court of Appeal’s significant change in prior law on the effect of actual notice of an unregistered interest in Torrens property. *Juran* has been the law of Minnesota since 1929, and the Torrens

Act still functions properly (and distinct from abstract recording). There is no significant erosion of the benefits bestowed by the Torrens Act that results from purchasers like Respondent Collier being subject to an unregistered interest of which he had actual notice and actual knowledge, especially as he purchased his interest for unconscionably less than fair market value for the property. R.G. Patton, a leading authority on Torrens law in Minnesota, cited *Juran* in his article on the advantages of the Torrens system. See R.G. Patton, *The Torrens System of Land Title Registration*, 19 Minn. L. Rev. 519, 535 (1935). Patton clearly did not think that the actual notice exception noted in *Juran* would lead to the destruction of the Torrens system, as he did not criticize the retention in *Juran* of the actual notice exception to a transfer of title free from encumbrances.

The Court of Appeals decision implicitly overrules the long-standing rule set forth in *Juran*. Although Respondent claims the rule he proposes is specific only to mortgages, it is clear that the result he seeks will result in the elimination of the effect of actual notice on all unregistered interests in Torrens property. This would overturn numerous decisions since 1929 which have been relied upon by generations of Minnesotans, in regards to mortgages, deeds, leases, easements and other interests in Torrens property. Respondent's request that *Juran* be overturned should be denied, and the decision of the Court of Appeals reversed.

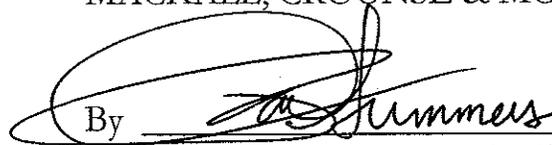
CONCLUSION

The Torrens Act abrogates constructive notice only. It does not do away with the effect of actual notice. Thus, a person having actual notice or knowledge of a prior unregistered interest in Torrens property does not have priority over the unregistered interest. For the foregoing reasons, the decision of the court of appeals must be reversed, and the judgment of the district court must be affirmed.

Dated: September 5, 2006.

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CERTIFICATE AS TO BRIEF LENGTH

I, Patrick C. Summers, do hereby certify that this brief was created in (14) point font as required by Minn.R.Civ.App.P., Rule 132.01, subd. 1 and 3. This brief is 14 pages, and contains 3,403 words, including footnotes. This brief was prepared using Microsoft Word Processing Software

Dated: September 5, 2006

A handwritten signature in black ink, consisting of several overlapping loops and a long horizontal stroke extending to the right.

Patrick C. Summers