

NO. A08-1560

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State of Minnesota  
**In Supreme Court**

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Citizens State Bank,

*Appellant,*

vs.

Raven Trading Partners, LLC,

*Respondent,*

Raven Trading Partners, Inc. and Raven Trading, Inc.,

*Defendants.*

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**APPELLANT'S REPLY BRIEF**

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## ARGUMENT

### **I. EQUITABLE SUBROGATION IS NOT LIMITED TO A MECHANICAL SET OF ELEMENTS**

Raven Trading Partners, LLC (“Raven”) argues that Citizens State Bank (“Citizens”) failed to establish the necessary elements of an equitable subrogation claim. Specifically, Raven argues that Citizens failed to establish that it acted upon a “justifiable or excusable mistake of fact,” which it describes as one part of a two part test articulated in Carl H. Peterson Co. v. Zero Estates, 261 N.W.2d 346, 348 (Minn. 1977).<sup>1</sup> The Peterson court did state that the equitable principle would be applied “where one party has provided funds used to discharge another’s obligations if (a) the party seeking subrogation has acted under a justifiable or excusable mistake of fact and (b) injury to innocent parties will otherwise result.” Id. However, Raven fails to recognize that the Peterson Court did not expressly limit the application of the doctrine to cases involving a mistake as to a then present or currently existing fact nor did it overrule prior Supreme Court precedent. The Peterson Court simply noted that “the other cases where the equitable subrogation doctrine has been applied involve generally similar fact situations, and use the same standards.” Peterson, 261 N.W.2d at 348 and n.1 (citing Sucker v. Cranmer, 127 Minn. 124, 149 N.W. 16 (1914); Heisler v. C. Aultman, & Co, 56 Minn. 454, 57 N.W. 1053 (1894); Elliott v. Tainter, 88 Minn. 377, 93 N.W. 124, 124-25 (Minn.

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<sup>1</sup> Raven also argues that Citizens did not act under a mistake of fact when it miscalculated the mortgage registration tax because the tax amount was accurately calculated on the HUD Settlement Statement. It is true that the tax amount listed on the Settlement Statement was accurate. It is also undisputed that the wrong tax amount was sent to the Recorder, that this error was inadvertent and that the error resulted in a delay in recording the Mortgage. Whether the tax amount was listed correctly or incorrectly on the Settlement Statement is ultimately a distinction that

1903); and Emmert v. Thompson, 49 Minn. 386, 391, 52 N.W. 31 (1892)). The focus in Peterson, and in all prior Supreme Court cases, was upon the relative equities of the parties, and not upon a specific set of elements.

Equitable principles were clearly in the forefront in Heisler, the case that the Peterson court specifically relied upon in the course of articulating its decision. In Heisler, the Court noted that “this doctrine is enforced solely for the purpose of accomplishing substantial justice, and, being administered upon equitable principles, it is only when an applicant has an equity to invoke, and when innocent persons will not be injured, that a court can interfere.” 56 Minn. at 458, 57 N.W. at 1053 (citing Emmert). The focus in Heisler, as in all of the Supreme Court cases involving equitable subrogation, is upon the equitable positions of the parties and whether justice would be served by application of the principle. In Heisler, the Court stated:

“The true principle is that where money due upon a mortgage is paid, it shall operate as a discharge of the mortgage, or in the nature of an assignment of it, as may best serve the purposes of justice and the just intent of the parties. One who has paid money due upon a mortgage of lands to which he had a title that might have been defeated thereby has the right to hold the lands as if the mortgage subsisted, and had been assigned to him. The mortgage may, for his benefit, be considered as still subsisting, though formally discharged of record, in so far as he ought, in justice, to hold the property.” 56 Minn. at 459, 57 N.W. at 1054.

An analysis of all of the prior Supreme Court precedent confirms that the foundation of the principle rests entirely in equity and in the desire to avoid the unjust and inequitable result that would flow from strict application of Recording Act principles.

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should be of no significance in determining the outcome of the action.

Citizens has addressed prior Supreme Court precedent, including all of the above cited cases, at length in its Appellant's Brief, and in the interest of brevity, this discussion will not be repeated herein. However, it must be emphasized that this case is atypical, and in this sense, particularly compelling, because Citizens had made no mistake at the time the funds were advanced to pay the prior mortgages. It is this very fact that illustrates the fallacy in Raven's argument regarding Peterson and the "two part test."

Raven argues that because Citizens cannot establish that it advanced funds while acting under a mistake of fact that it cannot prevail. However, this argument completely ignores the equitable basis for the principle. The fact that it had made no mistake actually puts Citizens in a stronger equitable position than it would have been in had it made a justifiable or excusable mistake of fact, because it was completely justified at the moment that it changed its position, and improved Raven's future position, in believing that it would hold a first mortgage on the property. This distinction makes the present case that much more compelling. Equity tends to look at whether a party is approaching the court with clean hands, and in this sense, Citizens' hands were cleaner than those of the typical party seeking equitable subrogation because at the critical point where it advanced the funds to pay off the former first and second mortgages, it had made no mistake, nor had it overlooked any prior interest.

The facts in this case are most similar to those in Sucker, which was cited with favor by the Peterson court, because Sucker's "mistake" occurred after the funds were advanced, when he completely failed to record an affidavit, an error that is more properly

characterized as negligence after the fact than as action under a mistake of fact.<sup>2</sup> The Supreme Court granted relief to Sucker, confirming that justifiable or excusable negligence, mistake or inadvertence in the broader sense is sufficient to support the application of the doctrine. Citizens submits that the true significance of the concept of “mistake” is that a party seeking equitable subrogation will inevitably approach the court having made an error of some sort at some point, as it would not need equitable relief had it not made an error. The true foundation of the rule lies not in the nature of the error, but in the equitable standing of the parties and the injustice that would result if the principle were not applied.

## **II. NEGLIGENCE IS NOT A BAR TO APPLICATION OF THE PRINCIPLE**

Raven argues that Citizens’ failure to exercise ordinary care in recording its mortgage operates to bar the application of the principle of equitable subrogation. This argument is unpersuasive and contrary to precedent. The failure to remit the proper amount of the mortgage registry tax was admittedly an error, but in every one of the prior Supreme Court cases involving the principle of equitable subrogation, one party has approached the court seeking relief from an inequity resulting from its own error. Many of these errors were more egregious than that committed by Citizens. Citizens submits that there is nothing about the character of the error that it made that would preclude equitable relief.

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<sup>2</sup> “Mistake of fact” is an awkward characterization when applied to a complete failure to record an affidavit (as in Sucker) or a delay in recording, as in this case.

Past Supreme Court cases are replete with examples of litigants who were afforded relief from the adverse result of an error that could be characterized as negligence. See, e.g. Emmert, 52 N.W. at 32 (lender failed to examine the public record, which would have disclosed a prior encumbrance); Elliott, 93 N.W. at 125 (same); Heisler, 57 N.W. at 1054 (lender failed to examine the records, which would have disclosed an intervening judgment lien); Gerdine v. Menage, 41 Minn. 417, 419, 43 N.W. 91, 92 (1889) (lender foreclosed a second mortgage and satisfied a first mortgage based upon the mistaken belief that the foreclosure of the second mortgage was proper); Hirleman v. Nickels, 193 Minn. 51, 258 N.W. 13 (1934) (lender attempted to extend the terms of a first mortgage by satisfying it and granting a new mortgage, which allowed an intervening mortgage to take priority); Sucker, 149 N.W. at 18 (lender completely failed to file a necessary affidavit in order to preserve his right to recover taxes paid following foreclosure). Citizens submits that in each of these cases, the negligent act of the party that was ultimately afforded equitable relief was more egregious than a failure to remit the proper amount of the mortgage registry tax. Therefore, Raven's argument is unpersuasive.

Raven also argues that all of the prior Minnesota Supreme Court cases, including those cited above, are inapposite. No additional argument is necessary to address this contention. Citizens directs the Court to pages 12-21 of Citizens' primary brief and to Judge Crippen's concurring opinion for a discussion of these cases and the manner in which they support Citizens' position herein.

### **III. RAVEN IS NOT AN INNOCENT PARTY THAT WILL BE PREJUDICED BY THE GRANT OF EQUITABLE SUBROGATION**

Raven makes a confusing argument concerning what it perceives to be the difference between holding a mortgage in the third position, behind the two mortgages that were paid by Citizens, and holding a mortgage in the second position, behind the mortgage held by Citizens. Raven claims that holding a position subordinate to the Citizens mortgage is less favorable than holding a third position behind the two mortgages that were paid. Although the logic is elusive, the gist of the argument appears to be that if the holder of the most senior of the two former mortgages had foreclosed, the holder of the junior of the two former mortgages may not have redeemed, thereby allowing Raven to redeem from the foreclosure of the previous first mortgage without having to pay as much as it would have had to pay to redeem from the Citizens foreclosure.

Raven's argument requires the court to ignore the fact that Raven never did hold a position subordinate to the two previous mortgages, because these mortgage debts were paid before Raven took its mortgage. Therefore, the argument is without any merit. Furthermore, if Citizens had not made a new mortgage loan, and Raven actually was in a third mortgage position, one could not assume that the holder of the former first mortgage would have foreclosed, or that the holder of the former second mortgage would not have redeemed from a foreclosure. All in all, the premise for Raven's argument is fatally flawed.

Raven was not in any way prejudiced by the District Court decision. The District Court's application of the principle of equitable subrogation placed Raven in exactly the same position, subordinate to approximately \$164,000.00 of debt, as it would have been in had Citizens not made the loan. The District Court recognized that "if [Raven] is granted relief, it will receive a 'windfall' to which it is not entitled," that "it would suffer no harm" and that it "simply remains in the position anticipated: subordinate to mortgages totaling \$164,000.00." Addendum – 8 and 9. In addition, the Court of Appeals recognized that "Raven is not injured by application of equitable subrogation in this case." Addendum – 13 and 14. Raven's argument that application of the principle of equitable subrogation will result in prejudice to Raven is wholly unpersuasive, and should be disregarded.

#### **IV. THE RESTATEMENT POSITION IS CONSISTENT WITH PAST SUPREME COURT DECISIONS**

Raven characterizes the Restatement position as being one of presumptive assignment, and not a doctrine of equity, and contends that the position advanced by the Restatement is contrary to Minnesota law. Neither of these arguments is well reasoned.

Equitable subrogation is an equitable doctrine. The Restatement position with respect to equitable subrogation is an attempt on the part of the American Law Institute to codify existing law concerning equitable subrogation as applied to mortgages. "[S]ubrogation imposed as an equitable remedy, often but perhaps inaptly called 'legal subrogation,' is the subject matter of this section." Restatement (Third) of Property: Mortgages (1997) § 7.6, Comment (a). There is no question that Section 7.6 of the

Restatement is an attempt to present a scholarly refinement of the law of equitable subrogation. Raven's contention that the Restatement does not pertain to a doctrine of equity is simply wrong.

Raven also argues that if Citizens had intended to preserve the mortgages that were paid from the closing proceeds it could have elected to take an assignment of those mortgages, with the implication being that because it did not elect to take an assignment, it should not be allowed to assume the position formerly held by those lenders. Theoretically it is true that Citizens could have taken an assignment of the mortgages, assuming that the prior lenders were willing to assign them in return for payment, but the argument completely misses the point. The purpose of the doctrine of equitable subrogation is to effectuate an equitable assignment "to the extent necessary to prevent unjust enrichment." Restatement (Third) of Property: Mortgages § 7.6(a). Citizens did not expect to find itself in a subordinate position. It expected to hold a first mortgage on the property. Raven did not expect to find itself in a first priority position. Equity allows for the avoidance of an unjust windfall for Raven through application of the principle of equitable subrogation.

Raven also contends that the Restatement (Third) of Property: Mortgages (1997) § 7.6(a) position on equitable subrogation is contrary to Minnesota statutory law, as embodied in the Recording Act. What Raven is really attempting to argue is that equitable subrogation and the Recording Act cannot coexist. However, the Recording Act and the doctrine of equitable subrogation have coexisted in Minnesota for well over a century.

The Recording Act predates every one of the reported Supreme Court cases dealing with equitable subrogation. See Minnesota Territory Laws of 1854, c. 22, § 1. Therefore, this contention ignores over a century of precedent.

Minnesota Courts often look to the Restatement for guidance.<sup>3</sup> See In re Crablex, Inc., 762 N.W.2d 247 (Minn. App. 2009) (recognizing the Minnesota law is consistent with the Restatement (Third) of Property (Mortgages) § 7.1, which provides that a “valid foreclosure of a mortgage terminates all interests in the foreclosed real estate that are junior to the mortgage ... and whose holders are properly joined or notified” and recognizing that Minnesota law is consistent with the Restatement (Third) of Property (Mortgages) § 7.7 which provides that subordination can be accomplished by the mortgagee executing a simple statement identifying the interest that will gain priority and declaring the mortgage to be subordinate to it); see also VanLandschoot v. Walsh, 660 N.W.2d 152 (Minn. App. 2003) (adopting § 920A (1) of the Restatement (Second) of Torts and holding that, in property-damage cases, where the tortfeasor's insurer makes a payment directly or indirectly to the injured party, such payment shall offset the tortfeasor's liability to the injured party); Pergament v. Loring Properties, Ltd., 599 N.W.2d 146 (Minn. 1999) (applying the mortgage exception to the merger doctrine as defined in the Restatement (First) of Property, Servitudes § 497 cmt. d). As outlined in Citizens’ primary brief, of the three competing approaches to equitable subrogation, the

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<sup>3</sup> Restatements of the Law are treatises on U.S. legal topics published by the American Law Institute, an organization of legal academics and practitioners, as scholarly refinements of black-letter law, to “address uncertainty in the law through a restatement of basic legal subjects that would tell judges and lawyers what the law was.” See American

Restatement position is the most consistent with the holdings in Peterson and prior Minnesota Supreme Court cases.

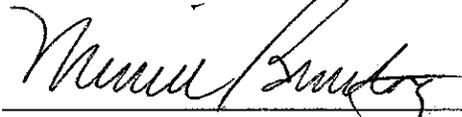
As noted in Citizens' primary brief, the court can uphold the decision of the trial court, and reverse the Court of Appeals, based solely upon the precedent of Peterson and prior Supreme Court cases dealing with equitable subrogation. The Court does not have to specifically adopt the Restatement position in order to arrive at this result. However, Citizens urges the Court to seize the opportunity presented by this case to clarify Minnesota law with respect to equitable subrogation and suggests that adoption of the Restatement position is one means to this end. The Restatement position on equitable subrogation is entirely consistent with past Supreme Court cases and specific adoption of this position would refocus the lower courts on the notions of fairness, equity and justice that provide the foundation for the principle.

#### CONCLUSION

Raven's arguments are without merit. The District Court's decision in this case was entirely consistent with Peterson and the many other prior Supreme Court cases in which the law of equitable subrogation was at issue. The District Court did not abuse its discretion in applying the principle of equitable subrogation as a means of correcting an injustice, and preventing the windfall that Raven would enjoy were the principle not applied. Accordingly, the Court of Appeals' decision must be reversed and the District Court's decision must be affirmed in all respects.

Dated: October 20, 2009

**BRUTLAG, HARTMANN & TRUCKE, P.A.**

A handwritten signature in cursive script, appearing to read "Michael Brutlag", is written over a horizontal line.

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