

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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**RESPONDENT'S BRIEF**

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Daniel W. Stauner (#153308)  
P.O. Box 41907  
Plymouth, MN 55441-0907  
(763) 536-1415

*Attorneys for Respondent*

Bradley N. Beisel (#6191)  
Kevin J. Dunlevy (#162851)  
Michael E. Kreun (#0311650)  
BEISEL & DUNLEVY, P.A.  
282 US Trust Building  
730 Second Avenue South  
Minneapolis, MN 55402  
(612) 436-2222

*Attorneys for Minnesota Land Title Association*

Michael L. Brutlag (#123225)  
Matthew R. Doherty (#0352159)  
BRUTLAG, HARTMANN  
& TRUCKE, P.A.  
3555 Plymouth Boulevard, Suite 117  
Minneapolis, MN 55447-1399  
(763) 222-2503

*Attorneys for Appellant*

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## STATEMENT OF THE CASE

In 2005, both Appellant and Respondent received mortgages on the same parcel of real estate in Hennepin County from Feyereisen Enterprises, Inc. (Feyereisen). Although Appellant's mortgage was executed before Respondent's mortgage, Respondent recorded its mortgage first. Accordingly, Appellant's mortgage has priority over Respondent's mortgage under Minn. Stat. §507.34.

In September, 2007, Appellant commenced this action in the district court in Hennepin County seeking an order of the court declaring that its mortgage had priority over Respondent's mortgage. Appellant alleged that under the doctrine of equitable subrogation it succeeded to the rights of the holders of two mortgages that had been paid off with proceeds from the loan Appellant made to Feyereisen

Respondent and Appellant filed cross motions for summary judgment. Both parties agreed in their motions that the material facts in this case were not in dispute. Appellant argued that the doctrine of equitable subrogation rendered Respondent's mortgage subordinate to Appellant's mortgage. Respondent argued that Appellant had not established the existence of facts entitling it to equitable subrogation. The motions were heard before the Honorable Cara Lee Neville on April 9, 2008. On July 7, 2008, the district court entered an order denying Respondent's summary judgment motion and granting Appellant's motion.

Respondent appealed to the court of appeals. On June 2, 2009, that court reversed the decision of the district court, holding that Appellant had not shown it acted under an excusable mistake of fact when it made its mortgage loan and therefore was not entitled to equitable subrogation. Appellant then petitioned this court for review of the decision of the court of appeals, which petition was granted.

### STATEMENT OF FACTS

The facts in this case are not in dispute and are as follows.

In February, 2005, Feyereisen was the owner of certain real estate located in Hennepin County, Minnesota described as follows:

Lot 6, Block 2, C.A. Bartlett's Addition to Minneapolis  
(the "Property")

The Property was encumbered by a mortgage in favor of Central Bank and a second mortgage in favor of Northern Home Buyers, Inc.

On February 16, 2005, Feyereisen obtained a loan from Respondent. Feyereisen used proceeds of the loan to payoff the two mortgages encumbering the Property. To secure the debt owed to Respondent, Feyereisen granted Respondent a mortgage on the Property (the "Citizens Mortgage").

Respondent's agent, Land Title Co., sent the Citizens Mortgage to the Hennepin County Recorder for recording on February 21, 2005. However the check that accompanied the Citizens Mortgage to pay the mortgage registration tax was not in the correct amount. Appellant has claimed that this was the result of a mistaken calculation of the amount of the tax. However, the evidence presented to the court in the form of the HUD closing statement (Appellant's Appendix, page 8, line 202) and the rejection notice from Hennepin County (Appellant's Appendix, page 33) establishes that in fact Appellant knew the correct amount of the mortgage registration tax at the time it closed its loan.

The Citizens Mortgage was returned by the Recorder on March 14, 2005, without having been recorded. Appellant's agent resent the Citizens Mortgage for recording on April 20, 2005, and it was recorded on May 9, 2005, as Document No. 8577748.

On April 7, 2005, Feyereisen granted the Respondent a mortgage on the Property (the "Raven Mortgage"). Although they had already been paid, the two prior mortgages were specifically mentioned in the Raven Mortgage as exclusions from the warranty of

title by Feyereisen. Contrary to what has been claimed, there is nothing in the Raven Mortgage where Raven agreed to subordinate its mortgage to the two mortgages.

The Raven Mortgage was recorded as Document No. 8573237 on April 29, 2005, ten days before the Citizens Mortgage was recorded.

**STATEMENT OF ISSUES**

- I. DID THE COURT OF APPEALS CORRECTLY APPLY MINNESOTA LAW  
WHEN  
IT REVERSED THE DECISION OF THE DISTRICT COURT.
- II. SHOULD THE LAW OF EQUITABLE SUBORGATION IN MINNESOTA BE  
CHANGED.

## ARGUMENT

### I

#### THE COURT OF APPEALS CORRECTLY APPLIED MINNESOTA LAW TO THE FACTS OF THIS CASE.

##### A.

#### APPELLANT DID NOT ESTABLISH THE NECESSARY ELEMENTS OF A CLAIM FOR EQUITABLE SUBROGATION.

In *Carl H. Peterson Co v. Zero Estates*, 261 N. W. 2d 346 (Minn. 1977), the court articulated a two part test for equitable subrogation. In order to establish the right to equitable subrogation of a mortgage a party must show (1) that it acted under a justifiable mistake of fact at the time it took its mortgage, and (2) that no innocent party will be prejudiced as a result of the grant of equitable subrogation. The party seeking equitable subrogation must do so by clear and substantial evidence. *Ripley v. Piehl*, 700 N. W. 2d 541, 544 -545 (Minn. Ct. App. 2005). The court of appeals applying that test to the facts of this case determined that Appellant had failed to show it acted under a justifiable mistake of fact at the time it took its mortgage and therefore was not entitled to equitable subrogation. The court of appeals was correct.

Appellant has repeatedly argued that at the time it received its mortgage and provided funds that were used to pay prior mortgages, it expected to receive a mortgage that would be a first lien. That is exactly what it got. Appellant's mortgage did not lose priority under the law because Appellant was mistaken about the state of title or because Appellant had been misled as to the state of title.<sup>1</sup> Appellant's mortgage lost priority under the law because, as the result of its negligence or the negligence of its agent, Appellant failed to see that its mortgage was properly and promptly recorded. Thus

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<sup>1</sup>If anyone in this case was misled as to the state of title it is Respondent.

Appellant has failed to establish that it meets the first part of the test for equitable subrogation.

Appellant has contended that it made a mistake of fact when it miscalculated the mortgage registration tax. But the evidence presented by Appellant disproves this claim. Line 1202 of the HUD settlement statement for the closing of Appellant's mortgage loan clearly shows the correct amount for the mortgage registration tax. (See Appellant's Appendix page 28 and page 33).

Appellant offered no evidence to show that the failure to pay the proper mortgage registration tax or the subsequent delay in a second attempt to record the mortgage was in anyway excusable. Thus Appellant assumed the entirely foreseeable risk that an intervening lien would attach and take priority over its mortgage during the time its mortgage went unrecorded. Accordingly, Appellant has failed show by substantial and clear evidence that it was entitled to equitable subrogation.

#### B.

#### **APPELLANT'S NEGLIGENCE IS A BAR TO EQUITABLE SUBROGATION**

In Minnesota equity aids those who act diligently, not those who sleep on their rights. *In Re Jordon's Estate*, 199 Minn. 53, 271 N. W. 104, 108 (1937). Equity may not be used to relieve a party from the consequences of the parties failure to exercise ordinary care for the parties own protection. *Bankers Trust Co. v. U. S.*, 25 P. 3d 877, 882 (Kan. Ct. App. 2001). At least one court has held that equity should not be used to shield a title insurer who by its negligence caused the problem. *First Federal Savings Bank of Wabash v. U. S.*, 118 F. 3d 532 (7th Cir. 1997).<sup>2</sup>

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<sup>2</sup>The Seventh Circuit applied Indiana law in deciding this case. The court might reach a different conclusion in light of the decision in *Bank of New York v. Nally* 820 N. E. 2d 644 (Ind. 2005). However, although the *Nally* court found the Restatement's expression of the doctrine of equitable subrogation consistent with a statute recently enacted by the Indiana legislature, it nonetheless recognized that "preservation of the rights of intervening creditors who record their interests is plainly equitable". 820 N. E. 2d at 655. The *Nally* court also recognized that

The object of the recording statute in Minnesota is to protect recorded titles against the gross negligence of those who fail to record their claims against a property. *Akerberg v. McCraney*, 141 Minn. 230, 169 N. W. 802 (1918).

In this case, the Appellant's failure to record its mortgage, whether the result of its own negligence or the negligence of its title company, is a failure to exercise at least ordinary care to protect its own interests.<sup>3</sup> The possibility that an intervening lien would attach during the delay in the recording of Appellant's mortgage was entirely foreseeable. Appellant's failure to exercise at least ordinary care amounts to an assumption of the risk of the loss of priority by Appellant that should be a bar to its claim of equitable subrogation.

### C.

#### **THE PRIOR CASES DO NOT SUPPORT APPELLANT'S POSITION**

Appellant asserts that the Minnesota equitable subrogation cases from the 19th century and early 20th century support its claim for equitable subrogation. However, each of those cases is distinguishable on the facts and none of the cases premises subrogation solely on the fact that the party seeking subrogation has paid a prior mortgage.

*Conner v. How*, 35 Minn. 314, 29 N. W. 314 (1886) is not an equitable subrogation case. The party seeking relief was the holder of a second mortgage and the court applied the principles of estoppel to bar the owner of the property from using title the owner had acquired by quit claim deed from the party who foreclosed the first mortgage to avoid the enforcement of the second mortgage. In *Gerdine v. Menge*, 41

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negligence could be a bar to equitable subrogation.

<sup>3</sup>It is common practice for lenders such as Appellant to engage a title company to do title examination, handle the closing of the loan and recording of the mortgage documents, and provide title insurance. It is also standard practice for lenders to pass the costs of this service on to the borrower. See lines 1101, 1102, 1103, 1108, 1109, 1111, 1112, 1113, and 1206, page 29 of Appellant's Appendix. When a title company receives valuable consideration for its services, it is reasonable to expect those service to be performed with competence and care

Minn. 417, 43 N. W. 91 (1889), the party who held both a first and second mortgage was granted relief because he had satisfied the first mortgage in the mistaken belief that he had acquired title to the real estate by foreclosure of the second mortgage. In *Emmert v. Thompson* 49 Minn. 386, 52 N. W. 81 (1892), the party seeking subrogation had discharged a prior mortgage in reliance upon the false representation that there were no other encumbrances then existing on the real estate. In *Nettleton v. Ramsey County Land & Loan Co.*, 54 Minn. 395, 56 N. W. 128 (1893) the original holder of a mortgage who had transferred the mortgage not and became independently liable for the debt as an indorser was granted subrogation when he paid the debt. In *Heisler v. Aultman & Co.*, 56 Minn. 454, 57 N. W. 1053 (1894), the party seeking subrogation had purchased property from her son and satisfied her mortgage on the property in ignorance of the fact that the lien of a judgment against her son had attached to the property. In *London & N. W. American Mortgage Co. v. Tracy*, 58 Minn. 201, 59 N. W. 1001 (1894), the lender seeking subrogation was induced to make a mortgage loan by a false representation that the holder of a then existing mortgage would satisfy the mortgage. In *Elliot v. Tainter*, 87 Minn. 37, 93 N. W. 124 (1903), the lender seeking subrogation had made its loan in reliance upon an erroneous abstract supplied to the lender by the borrower that had mistakenly omitted an existing mortgage on the property.<sup>4</sup>

The case of *Hirleman v. Nickels*, 193 Minn. 51, 258 N.W. 13 (1934) is not an equitable subrogation case. In that case, a party who had mistakenly satisfied the mortgage the party held in the context of a renewal of the mortgage was granted the reinstatement of that mortgage.

The issue in *First National Bank of Menagha v. Schunk*, 201 Minn. 359, 273 N. W. 290 (1937), was whether or not the holder of a second mortgage who tendered the entire

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<sup>4</sup>The court declined to find that the misleading abstract was supplied by the lender with fraudulent intention, but the erroneous abstract could be the basis for a negligent misrepresentation claim that would justify relief.

amount due on the first mortgage in response to a demand for the full amount after a foreclosure was commenced was entitled to an assignment of the first mortgage.

In *Wentworth v. Tubbs*, 53 Minn. 388, 55 N. W. 543 (1893), the court denied equitable subrogation to party who provided funds to satisfy prior liens. The court noted that the lender had obtained by the transaction what the lender had expected, namely the extinguishment of the prior liens. The court held that the fact that another lienholder's position would be improved if subrogation was denied did not justify granting equitable subrogation.

**D.**

**THE HOLDING OF SUCKER V. CRAMMER DOES NOT SUPPORT  
APPELLANT'S POSITION**

Appellant contends that the holding in *Sucker v. Crammer*, 127 Minn. 124, 149 N. W. 16 (1914) supports its claim that a failure to record is an excusable mistake justifying equitable subrogation. However, that is not what the case holds. In *Sucker*, the owner of real estate subject to a mortgage in favor of the plaintiff had failed to pay property taxes resulting in the real state being sold for taxes. The plaintiff foreclosed its mortgage. During the redemption period for that foreclosure, the plaintiff paid the amounts necessary to redeem from the tax sale and additional taxes due in order to avoid the imposition of a penalty. The owner of the property subsequently tendered a redemption from the foreclosure that did not include the amounts the plaintiff had paid for taxes because the plaintiff had failed to record the affidavit of additional amount due as required by the foreclosure statutes. The court in *Sucker* granted the plaintiff's request to be subrogated to the lien for the taxes paid.

The holding in *Sucker* was not premised upon the idea that a failure to record is an excusable mistake but on two other factors. First the court noted that the owners of the property, who because of their redemption from the foreclosure had never lost ownership, were independently obligated to pay the property taxes. Secondly, the plaintiff in *Sucker*

had paid the taxes to protect his interest under the sheriff's foreclosure certificate from the loss of that interest that would result if there was not redemption from the tax sale. The court held he was entitled to subrogation because he had performed the obligation of another under the threat of the loss of his interest in the property.

The holding of *Sucker* is explained in the later decision by the court in *Limnell v. Limnell*, 176 Minn. 393, 223 N. W. 609 (1929). In that case the foreclosing party also paid the taxes and failed to record the affidavit of additional amount due. The holder of a junior lien redeemed without tendering payment of the taxes. The court held that the rule from *Sucker* did not apply because the junior lienholder, unlike the owners of the property in *Sucker* was not under an independent obligation to pay the taxes.

#### E.

#### THE ISSUE OF PREJUDICE TO RESPONDENT

Because Appellant did not meet the first test for equitable subrogation, the issue of prejudice that might result to Respondent from subrogation is not relevant. However, since Appellant has contended that Respondent is in exactly the position it expected to be, it is appropriate to at least address the issue.

Appellant contends that because the mortgage it received is in the same amount as the payoffs of the two prior mortgages, Respondent cannot be harmed if Appellant is granted subrogation. But this is a simplistic view of the situation that focuses on only one aspect of the matter. When making a loan a lender engages in an assessment of the risks the transaction poses. The amount of the liens against the proposed collateral is only one of the factors in the risk assessment. In this case, Respondent believed it was getting a mortgage on real estate encumbered by two seasoned mortgages, not one new mortgage. The possibility of a future refinance which might include a payoff of Respondent's loan appeared to still exist, but in fact it did not exist.

In the event of a future default and foreclosure of the first mortgage, Respondent and the second mortgage would have had the right to redeem as junior lienholders. The

possibility existed that the second mortgage holder might not redeem thereby allowing Respondent to redeem for a lower amount. When Appellant foreclosed its mortgage in this case it did one foreclosure sale and bid in the entire amount of its mortgage. It did not regard itself or conduct the foreclosure as the holder of a senior and junior mortgage by redeeming from itself as the junior lienholder. Thus if Respondent is subrogated, Respondent would be required to pay the full amount of both the prior mortgages in order to redeem rather than having the possibility of paying a lesser amount.

Appellant offered no evidence to establish that the interest rate, the amortization and the other terms of its mortgage loan did not differ in material respects from the rate, amortization and terms of the two mortgages that Respondent believed were in place.<sup>5</sup>

Finally, as the settlement statement indicates, Feyeriesen paid more than \$4,000 in closing costs for the transaction with Appellant. Those are funds that could have gone to reduce the balance due on the prior two mortgages but were no longer available for that purpose because of the transaction with Appellant. The fact is that the situation was not as Respondent was led to believe it was at the time Respondent received its mortgage.

## II.

### **THE COURT SHOULD NOT ADOPT THE RESTATEMENT'S STANDARD FOR EQUITABLE SUBROGATION**

#### A.

### **THE RESTATEMENT IS A DOCTRINE OF PRESUMPTIVE ASSIGNMENT NOT OF A DOCTRINE OF EQUITY**

Appellant and the Amicus have urged the court to adopt the doctrine of equitable subrogation set forth in the Restatement (Third) of Property (Mortgage) §7.6. The

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<sup>5</sup>The new loan from Appellant to Feyeriesen apparently carried an adjustable interest rate which can significantly alter the risk factors for the loan and any junior lienholder receiving a mortgage after that loan. See line 1113, page 20 of Appellant's Appendix which indicates the payment of an additional title insurance premium for an adjustable rate mortgage rider to the policy.

argument for doing so seems to be mainly that everyone is doing it. Jumping on the band wagon is a poor basis for making such a momentous change in Minnesota law.

The doctrine espoused in the Restatement is not really a doctrine of equity, but one of presumptive assignment. As the introductory commentary indicates, it is premised upon two assumptions. The first assumption is that every lender who provides funds to satisfy a mortgage has a legitimate and reasonable expectation of receiving the same priority as the mortgage that is being satisfied, regardless of whatever other liens may exist of record or otherwise. The second assumption is that a junior lienholder can never have a legitimate and reasonable assumption of advancing in priority and any such advance is an unjust windfall to the junior lienholder. Neither of these assumption is accurate.

A mortgage lender can only reasonably expect that its mortgage will have the priority that the law provides. A mortgage is only a device to secure payment of a debt. If the debt is extinguished by payment, so is the mortgage that secures it. When a refinancing lender furnishes funds to extinguish a debt it cannot reasonably expect the mortgage securing that debt to survive unless the lender takes specific steps to preserve that mortgage. The mechanism the law provides for doing so is an assignment. Mortgage assignments have a long history and are regularly used in the lending industry. Any mortgage lender seeking to preserve an existing lien can easily do so by taking an assignment of that lien. If there is no assignment, the reasonable presumption is that the party supplying funds to extinguish a debt did not intend to preserve the mortgage that secured that debt.

In this case Appellant contends that it expected to have a first mortgage lien when it provided funds to extinguish the debts secured by the prior mortgage. No doubt it also expected to have its mortgage promptly recorded. When recorded, Appellant's mortgage was expected to become a first lien not because the prior mortgage were preserved for its benefit, but precisely because the prior mortgages would be extinguished along with the

debt those mortgages secured. And had Appellant promptly recorded its mortgage that is what would have happened. Had Appellant intended to preserve the two prior mortgages it would have taken assignments of those mortgages.

The second assumption underlying the doctrine in the Restatement is also invalid. As discussed above the risk assessment by a lender taking collateral in the form of a junior mortgage takes into account the possibility of the its mortgage advancing in priority because of any number of circumstances. One of which is a refinancing. Part of the rationale expressed by the courts adopting the Restatement is that a refinancing is no different than an extension, renewal or work out of an existing mortgage. But that is not true. In the case of an agreement for an extension, renewal or work out of an existing mortgage the lender holding the mortgage has had its money at risk for some time. Agreements for the extension, renewal or work out of a debt often require a stepped up amortization of the debt to procure its repayment in a short time because the existing lender wants to recover its money and reduce its exposure to risk. A lender that advances new money for a refinancing, on the other hand, has less incentive to limit its risk and more incentive to extend the time for repayment of the debt so that it can earn more interest. This has a material change in the circumstances of a lender who has put its money at risk in reliance upon a seasoned mortgage when it made a junior mortgage loan.

The so called unjust windfall the junior lienholder receives when a prior mortgage is paid is illusory. In this case Respondent is seeking to recover the money it lent to Feyereisen. It is not seeking to take property it does not have a legal right to. It seeks only what it has a legal right to. The sole issue here is which of the parties has the first right to recover its money from the mortgaged real estate. Had Appellant exercised due care in seeing that it's mortgage was promptly recorded, the law would have provided it the first right. But because Appellant failed to exercise due care in recording its mortgage it lost the priority it expected. It is Appellant who seeks a windfall here by shifting the burden of its negligence from itself to the Respondent.

**B.**

**THE DOCTRINE OF THE RESTATEMENT IS CONTRARY TO MINNESOTA  
STATUTES.**

Under Minnesota law a court of equity may not disregard statutes or grant relief prohibited by statutes. *Kingery v. Kingery*, 185 Minn. 467, 241 N. W. 583 (1932). Under Minn. Stat. §507.34 a conveyance is not enforceable against a party who first records another conveyance without notice of the earlier conveyance. Under this statute the priority of liens is determined by the chronological order in which they are recorded. *Timeline, LLC v. Williams Holdings #3, LLC*, 698 N.W. 2d 181,185 (Minn. Ct. App. 2005). Mortgages are not enforceable against a third party until they are recorded. *Mavco, Inc. v. Eggink*, 739 N. W. 2d 148 (Minn. 2007).

§507.34 is clear and unambiguous. In such cases the letter of law cannot be disregarded in favor of pursuing the spirit of the law. *Zurich American Insurance Co. v. Bjelland*, 710 N. W. 2d 64 (Minn. 2006). By adopting the Restatement the court would be writing into the statute an exception to the statute for any lender who provides funds to satisfy a prior mortgage. An exception that the language of the statute does not provide. Appellate courts cannot not add language to a statute or supply what the court thinks the legislature inadvertently overlooked or omitted *Roer v. Dunham*, 682 N.W. 2d 179 (Minn. Ct. App. 2004).

Courts may not consider either the wisdom of a law, but must give effect to the statute regardless of the court's opinion of the adequacy of the law. *Norris Grain Co. v. Nordaas*, 232 Minn. 91, 46 N. W. 2d 94 (1950), *rehearing denied*.<sup>6</sup> Courts may only

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<sup>6</sup>Sometimes applying statutory law as it is written causes a significant loss to a party. But the court has in the past enforced statutes as written even when it result in a substantial loss to a party. See for example *In Re Petition of Brainerd National Bank*, 383 N. W. 2d 284 (Minn. 1986).

apply the law as the legislature has enacted it, if a change is necessary that change is part of the legislative process. *State v. Washburn*, 252 Minn. 177, 28 N. W. 2d 652 (1947).

The doctrine of equitable subrogation as expressed in the Restatement gives priority to a lender who refinance an existing mortgage regardless of what liens are of record or what liens the refinancing lender has actual knowledge of. This doctrine effectively annuls the recording statute in Minnesota for refinancing lenders. Courts may not annul validly enacted statute. *Fairview Hospital Assn. v. Public Building Service and Hospital and Institutional Employees Union Local No. 113*, 241 Minn. 523, 54 N. W. 2d 16 (1954). The Wyoming supreme court recently decline an opportunity to join the Restatement bandwagon because the doctrine espoused by the Restatement was contrary to the clear mandate of Wyoming statutes. *Countrywide Home Loans, Inc. v. First National Bank of Steamboat Springs, N. A.*, 2006 WY 132, 144 P. 3d 1224 (2006). This court should similarly decline to join the bandwagon.

### III.

#### CONCLUSION

Equitable subrogation is a common law doctrine whose purpose is to compel the payment of a debt by one who ought to pay it. *Olsen v. Blesener*, 633 N. W. 2d 544 (Minn. Ct. App. 2001) The debt owed to Appellant is not a debt of Respondent, but the debt of Feyereisen. Respondent has no obligation for the debt Feyereisen owes to Appellant and there is no equitable basis for compelling Respondent to pay Feyereisen debt.

Appellant was not misled in any way by Respondent, or for that matter, by Feyereisen. Appellant was not induced to delay recording its mortgage by Respondent or Feyereisen. Appellant's mortgage lost priority because of the negligence of Appellant or a third party. It is Appellant or the third party who ought to bear the loss occasioned by that negligence, not Respondent.

When the rights of parties are clearly established by law, a court of equity has no power to change those rights. *Petersen v. E. F. Johnson Co*, 366 F. 3d 677, 380 (8th Cir. 2004). A court's decision to grant equitable relief must be supported by both the facts and the law. *Clausen v. City of Lauderdale*, 681 N. W. 2d 722, 726 (Minn. Ct. App. 2004). Neither the facts or the law support equitable subrogation in this case. The decision of the court of appeals should be affirmed.

RESPECTFULLY SUBMITTED

Date: October 9, 2009

DANIEL STAUNER



(#153308)

Attorney for Respondent

PO Box 41907

Plymouth, MN 55441-0907

(763) 536-1415

danielstauner@comcast.net