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NO. A09-876

State of Minnesota
In Court of Appeals

Jeffrey M. Schoenwetter,

Appellant,

v.

BankCherokee, a Minnesota corporation,

Respondent.

APPELLANT JEFFREY M. SCHOENWETTER'S BRIEF

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STATEMENT OF THE ISSUES

- I. Did the lower court improperly reject Appellant's defense of fraud in the execution?

The lower court held there was no clear and convincing proof demonstrating Appellant fell victim to fraud in the execution.

Apposite legal authorities:

- *Hetchkop v. Woodlawn at Grassmere, Inc.*, 116 F.3d 28 (2d Cir. 1997).
- *Williams v. Curtis*, 501 N.W.2d 653 (Minn. Ct. App. 1993).
- *Phillips Petrol. Co. v. Roth*, 242 N.W.629 (Minn. 1932).
- RESTATEMENT (SECOND) CONTRACTS § 163, Illus. 2 (1981).

- II. Did the lower court err by applying Minnesota Statutes section 513.33 to bar the affirmative defenses raised by Appellant?

The lower court held Minnesota Statutes section 513.33 barred Appellant's affirmative defenses.

Apposite legal authorities:

- *Resolution Trust Corp. v. Flanagan*, 821 F. Supp. 572 (D. Minn. 1993).
- *Norwest Bank Minn., N.A. v. Midwestern Machinery Co.*, 481 N.W.2d 875 (Minn. Ct. App. 1992).
- *In re Estate of Giguere*, 366 N.W.2d 345 (Minn. Ct. App. 1985).
- *Greuling v. Wells Fargo Home Mortgage, Inc.*, 690 N.W.2d 757 (Minn. Ct. App. 2005).
- Minn. Stat. § 513.33.

- III. Did the lower court improperly reject Appellant's estoppel defense?

The lower court held, as a matter of law, Appellant could not show reasonable reliance on Respondent's oral promises.

Apposite legal authorities:

- *Hoyt Props., Inc. v. Prod. Res. Group, L.L.C.*, 736 N.W.2d 313 (Minn. 2007).

- *Resolution Trust Corp. v. Flanagan*, 821 F. Supp. 572 (D. Minn. 1993).
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- *Norwest Bank Minnesota, N.A. v. Midwestern Machinery Co.*, 481 N.W.2d 875 (Minn. Ct. App. 1992).

IV. Did the lower court improperly ignore the express liability limitation in paragraph 20 of the disputed guaranty when it calculated the amount of the judgment?

The lower court awarded Respondent a judgment for \$467,504.19 without deducting the \$34,325.43 check paid to Respondent *after* the effective date of the guaranty at issue, despite language in the disputed guaranty stating the amount of the guaranty will decrease upon receipt of each payment received.

Apposite legal authorities:

- *Am. Tobacco Co. v. Chalfen*, 108 N.W.2d 702 (Minn. 1961).
- *Schmidt v. McKenzie*, 9 N.W.2d 1 (Minn. 1943).
- Minn. Stat. § 336.3-104.

STATEMENT OF THE CASE

Respondent BankCherokee, moved for summary judgment pursuant to Minn. R. Civ. P. 56.03 to enforce the purported personal guaranty of Appellant Jeffrey M. Schoenwetter (“Schoenwetter”). In opposing summary judgment, Schoenwetter moved to amend, argued his affirmative defenses prevented enforcement of the guaranty, and opposed summary judgment as premature under Minn. R. Civ. P. 56.06 because critical discovery was withheld by BankCherokee. The lower court granted BankCherokee’s motion for summary judgment, concluded each of Schoenwetter’s affirmative defenses failed as a matter of law, and determined summary judgment was appropriate in spite of Schoenwetter’s Rule 56.06 defense.

Specifically, the lower court concluded all affirmative defenses based on oral agreements (*e.g.*, unilateral and mutual mistake, no meeting of the minds, part performance and contract modification) were barred by Minnesota Statutes section 513.33 and that no waiver of the written contract requirement had occurred. On separate grounds, the lower court concluded the defense of promissory estoppel was barred because it believed Schoenwetter failed to show *reasonable* reliance. The lower court also concluded Schoenwetter's defense of fraud in the execution failed because it believed he possessed an opportunity to know that he was signing a *personal* guaranty as opposed to a *corporate* guaranty and because "no clear and convincing evidence [existed] that BankCherokee committed fraud in the execution[.]"

Because the lower court concluded Schoenwetter's proposed affirmative defenses failed as a matter of law, it denied his motion to amend to add affirmative defenses. The lower court did not, however, hold Schoenwetter's proposed affirmative defenses were raised untimely; nor was the issue raised by BankCherokee.

The lower court, over Schoenwetter's objections, entered a judgment for the full amount of the outstanding loan. The guaranty, however, capped Schoenwetter's liability and provided that liability would be diminished corresponding to any amount BankCherokee received as payment. The lower Court failed to decrease Schoenwetter's liability under the disputed guaranty by the amount of the \$34,325.43 payment received by BankCherokee *after* the effective date of the guaranty.

STATEMENT OF FACTS

A. The Parties.

1. BankCherokee services clients with personal and business banking needs. It also provides commercial and construction financing. BankCherokee's lending at all relevant times was heavily weighted in favor of real estate. (APP-62 to APP-66; APP-132, ¶ 2.) Bob Platzer ("Platzer") is Vice President of Lending at BankCherokee. (APP-37; APP-48.) Jeff Elden ("Elden") was a Credit Analyst at BankCherokee from 2006 through 2007, and then was promoted to Commercial Lender in March of 2008. (APP-169.)

2. Schoenwetter is actively engaged in Minnesota's residential real estate industry. (APP-133, ¶ 5.) In addition to Insignia Development, LLC ("Insignia"), he also owns a company that builds residential homes. (*Id.*) Schoenwetter has held a Minnesota broker's license for over twenty (20) years. (*Id.*) Schoenwetter is a past president of both the Builders Association of Minnesota and the Builders Association of the Twin Cities, and remains active in both organizations. (*Id.*) Currently, Schoenwetter serves in a leadership position for the National Association of Builders. (*Id.*)

3. From approximately mid-2005 to the present, the residential real estate market and related industries in Minnesota and across the nation dramatically and unexpectedly plummeted. (APP-42; APP-133, ¶ 6.)

4. Insignia, prior to being forced into bankruptcy in September of 2008, was one of the largest developers of residential real estate in the State of Minnesota. (APP-

133, ¶¶ 3,8; APP-142 to APP-144.) At times, it actively marketed and offered for sale over 2,500 residential lots to builders in Minnesota. (APP-133, ¶ 3.)

5. From approximately mid-2006 to the present, Insignia did not enjoy any positive cash flow. In fact, it lost millions of dollars. During this time period, Schoenwetter personally infused Insignia with millions of dollars in an attempt to payoff Insignia's debts and keep it operational. (APP-133, ¶ 7.)

6. Dave Sebold ("Sebold") is a former minority-owner of Insignia. Schoenwetter was the only other owner of Insignia. (APP-134, ¶ 9.)

7. On October 17, 2006, Sebold initiated a minority shareholder lawsuit against Schoenwetter and Insignia. Sebold sought to have his interest in Insignia purchased by Schoenwetter as the residential real estate market and related industries began to plummet, and as Insignia's debt service continued to mount above the level of Insignia's cash flow. (APP-134, ¶ 10.)

8. In April of 2007 Sebold and Schoenwetter parted ways, and in doing so divided the few assets and many liabilities then held by Insignia. The terms of their settlement are contained in a confidential agreement. (APP-134, ¶¶ 10-11.) Schoenwetter is currently the sole shareholder of Insignia. (APP-133, ¶ 4.)

B. The History Of The Lending Relationship Between BankCherokee And Insignia.

9. Insignia and BankCherokee began the relationship at issue in or about April of 2004 with three loan agreements. (APP-134, ¶ 12.) Two of the loan agreements were collateralized loans on residential developments located respectively in Eden Prairie,

Minnesota (Eden View Estates, owned by an Insignia subsidiary named Eden View Estates, LLC) and Stillwater, Minnesota (Victory Pass, owned by an Insignia subsidiary named Victory Pass, LLC). (*Id.*) Together, the Eden View Estates and Victory Pass loans, with the Line of Credit Loan to Insignia, exceeded \$3.28 million. (APP-45.) However, BankCherokee's legal lending limit was \$2.5 million. (APP-40 to APP-41.)

10. The third, most recent, loan agreement was a revolving line of credit to Insignia for up to \$200,000 with an approximate one-year term expiring in or about October of 2005. This third loan, Loan No. 20083448 (the "Line of Credit Loan"), is the loan which is at issue in this litigation and which BankCherokee claims Schoenwetter guaranteed personally. (APP-135, ¶¶ 14-15.) Platzer originated, and was BankCherokee's representative personally responsible for, each of these loans. (APP-134, ¶ 12.)

11. Over the lifetime of their banking relationship together, Insignia paid BankCherokee in aggregate over \$680,987.00 in interest payments. (APP-135, ¶ 13.)

12. Schoenwetter and Sebold executed personal guaranties securing the original promissory notes for both the Eden View Estates and Victory Pass developments. (APP-135, ¶ 15.) Likewise, both Sebold and Schoenwetter were initially required to personally guaranty the original Insignia Line of Credit Loan. (*Id.*)

13. BankCherokee admits it released Schoenwetter from his personal guaranty obligations related to Eden View Estates and Victory Pass. (APP-41A; APP-42B.)

14. BankCherokee also admits it released Insignia from a corporate guaranty and released Sebold from a personal guaranty. (APP-47, and APP-41A.)

15. BankCherokee disagrees with Schoenwetter, however, that it also released him from his personal guaranty on the Insignia Line of Credit Loan as part of the renewal of that loan in the fall of 2007. (APP-173; APP-177 to APP-179; APP-182.)

16. BankCherokee does not follow any policies or formal procedures when releasing individuals from personal guaranties. (APP-42B to APP-43.)

17. The \$200,000 line of credit extended to Insignia (*i.e.*, the Line of Credit Loan) was a package deal with the two collateralized property loans the bank had originated with respect to the Eden View Estates and Victory Pass developments. Each of these loans was negotiated between Platzer and Schoenwetter. (APP-135, ¶ 16.)

18. Platzer repeatedly and continually assured Schoenwetter that BankCherokee would satisfy any potential default on Insignia's Line of Credit Loan by first collecting against the Eden View and Victory Pass developments, which served as collateral for the BankCherokee's loans to Insignia's subsidiaries, *before* enforcing its personal guaranty against him. (APP-135, ¶ 17.) These representations by Platzer were both reasonable and necessary because, at the time these loans were originated, the market values of the Eden View and Victory Pass developments were sufficient to fully secure the amounts loaned to both developments as well as Insignia's line of credit. (APP-136, ¶ 18.) Schoenwetter relied on Platzer's representations in making his decision to sign personal guaranties in favor of BankCherokee back in 2004 and he would not otherwise have signed any personal guaranty securing the Line of Credit Loan. (*Id.*)

19. On October 22, 2005, BankCherokee increased Insignia's Line of Credit Loan to \$400,000. (APP-136, ¶ 20.) The renewed line of credit, similar to the initial line

of credit to Insignia, had a one-year term and required interest payments but no principal payments. (*Id.*)

20. On or about June 28, 2006, Insignia took its final advance on the line of credit in the amount of \$75,000, bringing the total outstanding balance to \$400,000. (APP-137, ¶ 21.)

21. Consistent with Sebold's and Schoenwetter's discussions with Platzer, distributions under Insignia's Line of Credit Loan were generally used to fund the development of Eden View Estates and Victory Pass, or were used by Insignia to repay BankCherokee's loans to its Eden View Estates and Victory Pass subsidiaries. (APP-137, ¶ 22.)

22. Insignia generally made payments as they became due through the twelfth and final month of the note, which was September of 2006. (APP-137, ¶ 23.) On September 26, 2006, Insignia made an accrued interest payment on the Line of Credit Loan in the amount of \$3,013.88, which was the total amount due at that time. (*Id.*) Five cents of this payment was credited to the principal of the outstanding balance, resulting in the figure of \$399,999.95 at issue in this lawsuit. (*Id.*)

23. On October 17, 2006, Sebold sued Insignia and Schoenwetter in an effort to force a buy-out. (APP-137, ¶ 24.) Under Schoenwetter's and Sebold's settlement of the lawsuit, Schoenwetter retained sole ownership of all Insignia shares, and Sebold and/or his wife (through a company one of them owned) took exclusive control and ownership of the Eden View Estates and Victory Pass developments. (*Id.*)

24. In the midst of Sebold's and Schoenwetter's partnership collapse, BankCherokee failed to renew Insignia's Line of Credit Loan, which expired October 22, 2006. (APP-138, ¶ 25.) As a result, Insignia was in default on its obligations under the October 22, 2005 line of credit promissory note on October 23, 2006. (*Id.*) Platzer, consistent with his past assurances, however, continued to promise Schoenwetter that BankCherokee would satisfy any default on Insignia's Line of Credit Loan by collecting from Insignia or its subsidiaries. (i.e., Eden View Estates and Victory Pass) (*Id.*) Schoenwetter relied on Platzer's assurances that BankCherokee would work with Insignia and support Insignia through the difficult economic cycle. (*Id.*)

25. Insignia did not pay any interest or principle on the Line of Credit Loan from the date the note expired in October 2006 until September 2007 when Platzer approached Schoenwetter to renegotiate Insignia's corporate line of credit and Schoenwetter's personal liability to BankCherokee. (APP-138, ¶ 26.)

C. Negotiations Between BankCherokee And Schoenwetter Related To The 2007 Loan Renewal.

26. On or about August 7, 2007, Platzer and Schoenwetter met to discuss the Eden View Estates and Victory Pass loans, as well as Insignia's Line of Credit Loan. (APP-138, ¶ 27.) Platzer told Schoenwetter he was struggling to obtain renewals from Sebold on the Eden View Estates and Victory Pass loan notes. (APP-247, ¶ 4.) He also complained about banking compliance issues related to the loans. (APP-247, ¶ ¶6-7; APP-238, ¶28; APP-44.) Platzer asked Schoenwetter to renew Insignia's expired Line of Credit Loan in order to bring that loan into compliance with Federal Deposit Insurance

Corporation (“FDIC”) rules and regulations. (APP-247, ¶¶ 4-5, 7.) At this same meeting, Platzer also told Schoenwetter that all accrued interest must be paid in order to get federal regulators off his back and to renew Insignia’s Line of Credit Loan. (*Id.*)

27. At his deposition, describing the FDIC scrutiny, Platzer testified as follows:

We [(meaning BankCherokee)] have a concentration of nonperforming loans that is higher than the FDIC likes to see it, and it is our goal to reduce the size of that nonperforming portfolio as quickly as possible. And bring us back into compliance with FDIC rules and regulations.

(APP-39.) Platzer also testified that the loans subject to this lawsuit were “part of the non-complying loans” at issue with the FDIC. (*Id.*) Platzer agreed that in light of BankCherokee not having received any payments on Insignia’s Line of Credit Loan for almost a year after it had matured, that in the August of 2007 timeframe, he was receiving “pressure” from the bank to “get this thing done,” “get it renewed and get it on a repayment plan.” (APP-42A.) Platzer characterized the Insignia Line of Credit Loan as being “seriously past due” in August and September of 2007. (APP-42.)

28. Platzer also agreed by August and September of 2007, it was “pretty important” for the bank to renew Insignia’s Line of Credit Loan that had matured in October of 2006 and for which the bank had received no interest, principal, or other payments in nearly a year. (APP-44A.) This was because the real estate market had “deteriorated substantially.” (APP-44.) Platzer testified Insignia’s Line of Credit Loan was downgraded by BankCherokee and placed in non-accrual status. (APP-45A to APP-45B.)

29. Platzer agreed he may have told Schoenwetter at the August 7, 2008 meeting that a renewal of the Insignia Line of Credit Loan was needed before the close of the fiscal quarter on September 30, 2008. (APP-44.) Platzer stated, in part:

Reporting requirements. We need to report our financial status on a quarterly basis to our reporting agencies, and if we're able to reduce any of our negative issues or remove them, we would be able to go ahead and – it would look better on a report for us.

(*Id.*) Schoenwetter testified reporting issues with the FDIC were definitely mentioned by Platzer during their negotiations regarding renewal of the Insignia Line of Credit Loan. (APP-138, ¶ 28.)

30. Because of the declining market conditions and his business separation with Sebold, Schoenwetter asked Platzer if he would agree to renew Insignia's Line of credit Loan without Schoenwetter's continuing personal guaranty. (APP-247, ¶ 5.) Schoenwetter offered, instead, to provide a corporate guaranty as Chief Manager/President of Insignia to help Platzer achieve BankCherokee's compliance with FDIC requirements. (*Id.*) Schoenwetter also discussed with Platzer terms for the renewed line of credit note that would provide Insignia sufficient time to work through continuing difficult economic conditions and its poor cash flow issues. (*Id.*)

31. Schoenwetter was willing to make a payment in the amount of the unpaid interest on the Insignia Line of Credit Loan only if he was released from personal liability and Insignia was given a reasonable opportunity to cure defaults on the loan with BankCherokee. (APP-178 to APP-179; APP-182.) At his deposition Schoenwetter testified, in part, as follows:

Conversations with Bob [Platzer], that he – he was absolutely keenly aware, crystal clear, that I did not intend to guarantee the debts of Insignia Development. And wherever I could, I was negotiating either releases or not continuing to guarantee renewals. And there was no doubt in my mind that Bob Platzer understood that I did not intend to personally guarantee debts of Insignia.

(APP-173.)

And there's no way I would have paid 30 some thousand dollars in interest, that had accrued over the previous year, if – if I wasn't being released personally. Just like I was from every other debt I had at BankCherokee.

(APP-177.)

I'm sure it was made clear, and I'm sure it was agreed to, or there's no way I would have paid the [\$34,325.43 in] interest current if I hadn't gotten the concessions or the consideration, or whatever you want to call it, relative to these renewals. It doesn't make any sense.

(APP-182.)

32. Following up on Schoenwetter's request, on or about August 22, 2007, Platzer and Schoenwetter had a conference call to discuss the Insignia Line of Credit Loan renewal. Platzer told Schoenwetter that bank policies and FDIC compliance issues were holding up the renewals, but he assured Schoenwetter that he would have the documents available soon because he needed them before the close of the fiscal quarter—when additional reporting to the FDIC was required. (APP-247, ¶ 6.)

33. On September 11, 2007, Insignia wrote a check signed by Schoenwetter to BankCherokee in the amount of \$34,325.43. (ADD-19.) This sum represented the total

accrued interest on the Insignia Line of Credit Loan due at that point in time and would therefore allow Platzer to pass the renewal through FDIC scrutiny. (APP-247, ¶ 7.)

34. Schoenwetter agreed to make a payment representing the amount of interest due on Insignia's Line of Credit Loan based on Platzer's promise that doing so would release him from all personal liability, and for the continued promise that BankCherokee would work with Insignia through the difficult economic conditions and Insignia's poor cash flow. (APP-173; APP-178 to APP-179; APP-182.)

35. On or about September 12, 2007, Bob Platzer and Schoenwetter met at Schoenwetter's offices to execute the loan renewal documents. (APP-248, ¶ 8.) Schoenwetter was satisfied the loan note renewal would provide Insignia a reasonable opportunity to repay or cure any deficiencies because the loan maturity date was more than four years out. (*Id.*) Specifically, Schoenwetter viewed the maturity date of December 12, 2011 as confirmation of Platzer's continued assurances that BankCherokee would work with Insignia through the difficult economic conditions and Insignia's poor cash flow caused by the decline in the economy. (*Id.*)

36. Schoenwetter, however, refused to sign the line of credit renewal documents as presented to him because they included a personal guaranty by him for the Insignia Line of Credit. (APP--248; APP-175.) Schoenwetter and Platzer marked up the original loan documents with the revisions necessary to reflect their true agreement, *specifically that Schoenwetter was guaranteeing the line of credit only in his corporate capacity.* (APP-248, ¶ 8.)

37. At the meeting with Platzer on or about September 12, 2007, Schoenwetter also gave Platzer Insignia's check for of \$34,325.43 in consideration for BankCherokee's promises. (APP-248, ¶ 9.) On September 14, 2008, BankCherokee processed Insignia's check in satisfaction of Schoenwetter's personal liability on Insignia's Line of Credit Loan. (ADD-19.)

38. On or about Wednesday, September 26, 2007, Platzer and Schoenwetter were scheduled to meet at Schoenwetter's office to execute the revised loan renewal documents. (APP-249, ¶ 10.) Instead, Elden came to Schoenwetter's office with a package of documents for Schoenwetter's signature. (*Id.*) Elden assured Schoenwetter the documents were prepared by Platzer in accordance with their understanding regarding Schoenwetter's corporate guaranty. (*Id.*) Platzer had previously provided these same assurances to Schoenwetter. (APP-139, ¶ 30.)

39. The documents were quickly signed by Schoenwetter in the lobby of the office because Elden was rushing him and insisting that the documents needed to be processed before the following Monday, October 1, 2007 due to bank compliance and regulatory issues. (APP-249, ¶ 11.) Schoenwetter signed all of the documents brought to him by the BankCherokee representative believing they were the properly, and as agreed, revised documents. (*Id.*)

40. Schoenwetter testified that he relied upon and trusted BankCherokee and, in particular, Platzer's assurance the guaranty had been changed to a corporate guaranty. (APP-172; APP-173; APP-176.)

I mean at that point in time – I would say I had the highest level of trust for BankCherokee and Bob Platzer. And if Bob told me this is the way it was going to be, then that was the way I assumed it would be.

(APP-173.)

41. The renewal note and guaranty attached to BankCherokee's Summons and Complaint are not the same documents Schoenwetter agreed to sign. (APP-249, ¶ 12.) Schoenwetter reviewed a guaranty that made him liable in his corporate capacity only, as Chief Manager of Insignia. (*Id.*) Schoenwetter asserts that Elden must have switched the loan documents he reviewed with a different set of documents—the documents attached to BankCherokee's Summons and Complaint. (*Id.*; APP-179 to APP 180.)

But somebody either inadvertently hit the print button or somebody, by perhaps mistake, shoved this into the loan documents. Or we can be a little more evil and we can think that someone switched the corporate guaranty and put in [a] personal one. Or that somebody typed the word individual under my signature line. Or if you ask me to go down the evil trail, I have to sit here and go, did somebody intend to hook me up to this bad deal, and did they do it with intent to defraud me and malice and all those evil things. You'd have to ask the person that put the Guaranty, in this form, into my loan package. * * * But I'm telling you for the umpteenth time, and I want to be respectful, a personal obligation of Jeff [Schoenwetter] wasn't part of this deal.

(APP-180 to APP-181.)

D. BankCherokee's Unsafe and Unsound Banking Practices.

42. On September 16, 2008, the FDIC issued an Order to Cease and Desist to BankCherokee. (APP-50 to APP-61.) The Order was based on a March 24, 2008 Report of Examination of the Bank. (APP-51.) Under the Order, BankCherokee was required to

“cease and desist” from “unsafe or unsound banking practices” which included, for example:

- A. operating with an excessive level of adversely classified loans and other real estate and nonperforming loans; and
- B. operating with an excessive concentration of real estate loans, including development and construction loans, and with an excessive volume of such loans being adversely classified.

(APP-51.) BankCherokee stipulated and consented to the FDIC’s Cease and Desist Order. (APP-50.)

43. In September of 2007, BankCherokee’s volume of assets categorized as “non-accruing” was increasing by millions of dollars each quarter, and exceeded \$14 million. (APP-162.) During this same period, BankCherokee was one of the 20 banks in the U.S. with the highest asset concentration of non-performing construction loans. (APP-62.)

44. On September 30, 2006, BankCherokee reported \$426,000 loans as assets past due 90 or more days to the FDIC. (App-156.) At that time, the Insignia Line of Credit Loan was not past due. (APP-145.) By June 30, 2007, BankCherokee’s loans as assets past due 90 or more days ballooned to \$2,170,000. (App-156.) At this point, because Insignia had not made any payments on its expired Line of Credit Loan for nine months, the Insignia Line of Credit Loan was included in this figure.

45. In the three-month period between June 30, 2007 and September 30, 2007, BankCherokee removed \$1,906,000 from its loans as assets past due 90 or more days.

(APP-161; APP-165.) This is approximately the same time period when BankCherokee and Platzer were negotiating the four-year extension on Insignia's Line of Credit and whether Schoenwetter would be required to provide a personal guaranty as opposed to a corporate guaranty. By bringing the interest current on the Insignia Line of Credit Loan, and thereby renewing the Insignia loan to a compliant status, BankCherokee avoided reporting \$400,000 of additional bad debt to the FDIC. (APP-153, ¶ 5.)

46. The desire by BankCherokee and/or Platzer to avoid issues with FDIC regulatory compliance motivated Platzer, on behalf of BankCherokee, to promise Schoenwetter a release from his personal liability in exchange for the prompt renewal, and payment of \$34,325.43 in back interest on the line of credit, including a four year extension to repay the outstanding debt—which, at the time, was nearly a year past due. (APP-39; APP-44.)

ARGUMENT

I. STANDARD OF REVIEW.

“Summary judgment is appropriate when the evidence, viewed in the light most favorable to the nonmoving party, shows that there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law.” *Anderson v. Dep’t of Natural Res.*, 693 N.W.2d 181, 186 (Minn. 2005). On appeal from summary judgment, this Court considers whether the district court erred in applying the law and must view the evidence in the light most favorable to Schoenwetter. *Id.*; *Fabio v. Bellomo*, 504 N.W.2d 758, 761 (Minn. 1993).

The lower court violated the summary judgment standard by requiring Schoenwetter to provide “clear and convincing evidence that BankCherokee committed fraud in the execution.” (ADD-9.) This Court need not defer to the district court’s application of an erroneous legal standard and may decide this issue *de novo*. *Frost-Benco Elec. Ass’n v. Minn. Pub. Utils. Comm’n*, 358 N.W.2d 639, 642 (Minn. 1984).

II. WHETHER SCHOENWETTER WAS THE VICTIM OF FRAUD IN THE EXECUTION IS A GENUINE ISSUE OF MATERIAL FACT FOR A JURY THAT DOES NOT REQUIRE CLEAR AND CONVINCING EVIDENCE AT THE SUMMARY JUDGMENT STAGE OF PROCEEDINGS.

The lower court held Schoenwetter’s affirmative defense of fraud in the execution failed because it believed he had an opportunity to know what he was signing. The lower court, however, was not authorized to decide this issue of material fact. *Hetchkop v. Woodlawn at Grassmere, Inc.*, 116 F.3d 28, 29-30, 32-34 (2d. Cir. 1997); *Lovato v. Catron*, 148 P. 490, 492 (N.M. 1915) (“Whether fraud in the [execution] exists in the

particular case is a question of fact.”). Significantly, BankCherokee did not file *any* affidavits refuting Schoenwetter’s allegations of fraud in the execution. No evidence exists in the record opposing Schoenwetter’s testimony. And, as the non-moving party, the lower court was obligated to view all disputed facts in the light most favorable to Schoenwetter. It failed to observe this standard.

The lower court violated this standard by requiring Schoenwetter to provide “clear and convincing evidence that BankCherokee committed fraud in the execution.” (ADD-9.) Clear and convincing evidence at the summary judgment stage of the proceedings, however, is not the applicable standard. *Lundgren v. Eustermann*, 356 N.W.2d 762, 765 (Minn. Ct. App. 1984) (“plaintiff does not need to produce clear and convincing evidence to defeat a summary judgment”) *rev’d. on other grounds*, 370 N.W.2d 877 (Minn. 1985); *Williams v. Curtis*, 501 N.W.2d 653, 656 (Minn. Ct. App. 1993) (finding trial court erred in requiring defendant to provide clear and convincing evidence to defeat summary judgment); *Anderson*, 693 N.W.2d at 186 (“The non-moving party does not need to produce clear and convincing evidence to defeat a summary judgment motion.”).¹

Applying a “clear and convincing” standard at the summary judgment stage requires a court to weigh the evidence and disregard the presumption that all evidence is viewed in the light most favorable to the non-moving party. To the extent a “clear and

¹ *Hentges v. Schuttler*, 77 N.W.2d 743 (Minn. 1956), cited by the lower court, is distinguishable because that case involved a claim of fraudulent inducement, not fraud in the execution, and because the *Hentges* court applied the “clear and convincing” standard only *after* a trial. *Id.* at 744, 746. *McCall v. Bushnell*, 42 N.W. 545 (Minn. 1889), cited by the lower court, is similarly distinguishable because it was decided by the trial court *after* a full trial. *Id.* at 545 .

convincing” evidentiary standard *may* be applicable at trial in this case, it is *not* applicable at the summary judgment stage, and Schoenwetter presented evidence that will satisfy a clear and convincing evidentiary standard at trial.

A. By Itself, Schoenwetter’s Unrebutted Testimony Creates A Genuine Issue Of Material Fact.

Fraud in the execution occurs when there is an agreement between the parties regarding the substance of a contract, but one of the parties secretly changes the written form of that agreement to contain different terms without the other party’s knowledge before the contract is signed. *Minneapolis, St. Paul & Saulte Ste. Marie Ry. Co. v. Chisolm*, 57 N.W. 63, 64 (Minn. 1893); *Hetchkop*, 116 F.3d at 32-34. “If the elements of the defense of fraud in the execution are met, the contract in question is not merely voidable, it is void *ab initio*.” *Colo. Plasterers’ Pension Fund v. Plasterer’s Unlimited, Inc.*, 655 F. Supp. 1184, 1186 (D. Colo. 1987). RESTATEMENT (SECOND) OF CONTRACTS § 163, Illustration 2 (1981) provides an example giving rise to fraud in the execution under facts similar to the present case:

A and B reach an understanding that they will execute a written contract containing terms on which they have agreed. It is properly prepared and is read by B, but A substitutes a writing containing essential terms that are different from those agreed upon and thereby induces B to sign it in the belief that it is the one he has read. B’s apparent manifestation of assent is not effective.

Schoenwetter’s signature appears on a *different* guaranty than he intended to sign. Schoenwetter intended only to sign a *corporate* guaranty. The only way this could have happened was by mistake, or through trickery, *e.g.*, fraud in the execution. Platzer told

Schoenwetter he was sending Elden to Schoenwetter's office to sign a *corporate* guaranty. (APP-139, ¶ 30; APP-249, ¶ 10.) Elden also reassured Schoenwetter the guaranty had been changed to reflect the terms of his agreement with Platzer to provide only a *corporate* guaranty and not a *personal* guaranty. (*Id.*) Schoenwetter then reviewed the guaranty and saw that it was, indeed, a corporate guaranty. (*Id.*)

Schoenwetter explained:

These were supposed to be replacement documents. These were the documents that had [been] created to reflect the mark-ups and the corrections that I had made to the previous set. And that was the point of the meeting[.]

(APP-177.)

Schoenwetter relied on his review of the documents and the representations of BankCherokee's representatives that the documents had been changed to reflect a *corporate* guaranty as agreed. He trusted BankCherokee and Platzer. (APP-173.) Although he did not see Elden substitute the disputed personal guaranty into the pile of documents he was signing, that is what must have occurred. (APP-249, ¶ 12.) *See Hetchkop*, 116 F.3d at 33 (observing the plaintiff switch the documents not necessary).

Despite BankCherokee's failure to submit any affidavit or other record evidence contradicting Schoenwetter's testimony, the lower court reasoned that because Schoenwetter's initials and signature were affixed to the disputed personal guaranty, "there was no question [Schoenwetter] had the opportunity to know that he was signing a personal guaranty." (ADD-9 to ADD-10.) This reasoning, however, is flawed. Of course Schoenwetter's initials and signature were on the personal guaranty—he was

tricked into putting them there. Fraud in the execution is defined by the situation when there is an agreement between the parties regarding the substance of a contract, but one of the parties *secretly* changes the written form of that agreement to contain different terms *without the other party's knowledge* before the contract is signed. *Minneapolis, St. Paul & Saulte Ste. Marie Ry. Co.*, 55 Minn. at 374, 57 N.W. at 63; *Colo. Plasterers' Pension Fund*, 655 F. Supp at 1187; *Hetchkop*, 116 F.3d at 32-34; RESTATEMENT (SECOND) CONTRACTS § 163, Illus. 2 (1981). If the lower court's oversight of this fundamental feature of fraud in the execution is allowed to stand, then the defense of fraud in the execution will disappear entirely. Indeed, if the test were simply whether a party's initials and signature are affixed to a contract, the defense for fraud in the execution could never succeed—it would cease to exist as a defense.

Schoenwetter's unequivocal testimony that his signature was procured either by mistake or by fraud is unrebutted by any record evidence. The lower court should not be allowed to supplant a jury's credibility assessment with its own. Moreover, faced with a motion for summary judgment, the lower court was required to construe all disputed facts in favor of Schoenwetter as the non-moving party. It failed to do so. Accordingly, this Court should reverse the lower court's grant of summary judgment and allow Schoenwetter to proceed to trial with his affirmative defense of fraud in the execution.

B. Schoenwetter Had No Duty To Re-Inspect The Guaranty Because He Reasonably Relied On Platzer's And Elden's Representations.

The only way Schoenwetter could have discovered BankCherokoe's fraud in the execution would have been to re-inspect each of the loan renewal documents one-by-one

before signing them. But, as Schoenwetter testified, he reviewed each of the documents presented to him by Elden and found them to be satisfactory just moments earlier. Elden then handed back to him what Schoenwetter understood to be the same documents, which he signed. In light of BankCherokee's representative, Elden, surreptitiously switching the *corporate* guaranty he had just reviewed for the *personal* guaranty at issue, Schoenwetter should not be held to a duty to re-inspect them one-by-one before signing. Indeed, Elden's and Platzer's representations that the guaranty contained the agreed upon changes—making it a corporate guaranty rather than personal guaranty—obviated any duty Schoenwetter might otherwise have possessed to further inspect the documents presented to him for signature.

Platzer and Elden told Schoenwetter, shortly before he signed the guaranty, that his requested changes had been made and that he would be signing a corporate guaranty, not a personal guaranty. (APP-139, ¶ 30; APP-249, ¶ 10.) Under these circumstances, the Supreme Court's decision in *Phillips Petrol. Co. v. Roth* is applicable. In *Phillips*, the court stated:

Where, after a verbal agreement, one of the parties undertakes to prepare the written contract, and presents it to the other for signature, the presentation of the written instrument for signature is a representation that it is the same in effect as their verbal agreement. If the representation so made is false and fraudulent, the one induced thereby to sign the written contract may defend against the enforcement thereof by the other, even though he was negligent in signing [the] same without reading it.

242 N.W. 629, 630 (Minn. 1932); *see also Finkelstein v. Henslin*, 188 N.W. 737, 737 (Minn. 1922); *City of Savage v. Varey*, 358 N.W.2d 102, 105 (Minn. Ct. App. 1984).

The Minnesota Supreme Court's decision in *C. Gotzian & Co. v. Truszinski*, 210 N.W. 880 (Minn. 1926) is directly on point. In that case, the Supreme Court admitted testimony demonstrating the guarantor was orally informed by the party presenting the guaranty for signature that it would not impose personal liability. *Id.* at 881-82. The alleged guarantor signed the personal guaranty—which had been mailed to him—without reading it. *Id.* The Supreme Court affirmed the trial court's evidentiary determination to allow testimony concerning the oral representations regarding the guaranty *not* imposing personal liability as well as the trial Court's conclusion that no personal liability existed under the guaranty. The Supreme Court explained:

A party fraudulently induced to execute a written agreement upon the false and fraudulent representation that it expresses the agreement made can defend against its enforcement by the other contracting party though he was negligent in signing it.

Id. at 882. In this case, Schoenwetter had less opportunity to inspect the guaranty than the defendant did in the *Truszinski* case.

Under the facts of this case and the controlling case law cited above, Schoenwetter is entitled to defend against the disputed personal guaranty based on BankCherokee's fraud and inequitable conduct. *See Phillips Petrol. Co.*, 242 N.W. at 631; *C. Gotzian & Co.*, 210 N.W. at 881-82. Accordingly, this Court should reverse the lower court's grant of summary judgment and allow Schoenwetter to proceed to trial with his affirmative defense of fraud in the execution.

C. BankCherokee Possessed A Motive To Commit Fraud In The Execution.

Schoenwetter set forth circumstantial evidence demonstrating BankCherokee possessed a motive to commit fraud in the execution due to its violations of FDIC banking regulations and policies. The lower court, however, abused its discretion in refusing to allow discovery of BankCherokee's unsafe and unsound banking practices as documented by the FDIC and which Platzer admitted touched and concerned the loans at issue. Accordingly, Schoenwetter was unfairly deprived of an ability to discover additional circumstantial evidence of BankCherokee's motive to engage in fraud.²

In the fall of 2007, BankCherokee was experiencing extreme financial difficulty. The Insignia Line of Credit Loan was past due nearly 12-months, with little hope for repayment, and BankCherokee had downgraded Insignia's Line of Credit Loan to non-accrual status. (APP-41.) Platzer testified he was pressured by the bank to renew Insignia's Line of Credit Loan. (APP-42A.) In September of 2007, BankCherokee's volume of assets categorized as "non-accruing" was increasing by millions of dollars each quarter, and exceeded \$14 million. (APP-161 to APP-165.)

During this same period, BankCherokee was one of the 20 banks in the U.S. with the highest asset concentration of non-performing construction loans. (APP-62.) Ultimately, the FDIC issued a Cease and Desist Order to BankCherokee based upon "unsafe and unsound banking practices" relating to loans BankCherokee had on its books

² Facts demonstrating fraud in the execution can be proven by circumstantial evidence. 4 MINNESOTA PRACTICE: MINNESOTA JURY INSTRUCTION GUIDES at CIVJIG 12.10.

in 2007. (APP-50.) Platzer admitted loans at issue in this case were subject to the FDIC's Cease and Desist Order concerning non-complying loans. (APP-39.)

In the three-month period between June 30, 2007 and September 30, 2007, BankCherokee removed \$1,906,000 from its loans as assets past due 90 or more days. (APP-164 to APP-165.) This was the same period when BankCherokee, through Platzer, negotiated the four-year extension on Insignia's Line of Credit Loan and perpetrated the fraud in the execution alleged by Schoenwetter. By bringing interest current and renewing the Line of Credit Loan to a compliant status, BankCherokee avoided reporting \$400,000 of addition bad debt to the FDIC in its next quarterly report. (APP-153.)

BankCherokee may have engaged in the fraud alleged by Schoenwetter in an attempt to avoid FDIC regulatory compliance issues and to decrease its self-reporting of unsafe and unsound banking practices to the FDIC. Because material facts in the record demonstrate BankCherokee possessed a motive to commit fraud in the execution, this Court should reverse the lower court's grant of summary judgment and allow Schoenwetter to proceed to trial with his affirmative defense of fraud in the execution.

D. Schoenwetter Is Entitled To Discovery Of Information Supporting His Defenses.

The nature of fraud in the execution is that the defrauded party was tricked into signing something he or she did not intend to sign. Often, the only direct proof available to establish fraud in the execution is testimony—such as that of Schoenwetter in this case. However, circumstantial evidence can also be used to prove fraud in the execution. In this case, the lower court abused its discretion when it ruled discovery would not be

permitted into BankCherokee's violations of FDIC rules and regulations that resulted in the FDIC issuing a Cease and Desist Order relating (in part) to the loans at issue in this appeal. *Rice v. Perl*, 320 N.W.2d 407, 412 (Minn. 1982) ("permission to engage in further discovery should not be denied to a party except in the most extreme circumstances") (noting discovery is particularly important in cases involving fraud, reversing trial court and remanding for additional discovery).

Schoenwetter defended against BankCherokee's summary judgment motion, in accordance with Minnesota Rule of Civil Procedure 56.06, by demonstrating discovery was incomplete and bringing a motion to compel. (APP-7 to APP-29; APP-210 to APP-214.) It is undisputed that BankCherokee refused to provide responses to certain Interrogatories and Document Requests, or to produce for deposition one of its corporate representatives knowledgeable about BankCherokee's violations of FDIC rules and regulations. The information sought by Schoenwetter—specifically, facts supporting BankCherokee's *motive* for committing fraud in the execution, and the making of oral promises—were not before the lower court because they had not been provided by BankCherokee in response to Schoenwetter's timely discovery.

BankCherokee's non-compliance with federal banking practices bears directly on the defenses raised by Schoenwetter in opposition to summary judgment and discovery should have been compelled. Schoenwetter respectfully requests this Court to remand this case to the lower court with instructions to allow further discovery in these areas.

III. THE LOWER COURT ERRED BY APPLYING MINNESOTA STATUTES SECTION 513.33 TO BAR SCHOENWETTER'S AFFIRMATIVE DEFENSES.

The lower court incorrectly interpreted and applied Minnesota's Credit Agreement Statute of Frauds located at Minnesota Statutes section 513.33. This Court need not defer to the lower court's application of the law (*Hubred v. Control Data Corp.*, 442 N.W.2d 308, 310 (Minn. 1989)) and must view the facts in the record in the light most favorable to Schoenwetter. *Fabio*, 504 N.W.2d at 761.

A. Minnesota's Credit Agreement Statute Of Frauds Is Inapplicable Because Schoenwetter Is Asserting Affirmative Defenses And Not An "Action" As Required To Fall Within The Purview Of The Statute.

The lower court failed to apply the clear and unambiguous language of section 513.33. Section 513.33 is applicable only to an "action" maintained by a debtor on a credit agreement. However, Schoenwetter is not maintaining an "action." Rather, Schoenwetter is asserting *affirmative defenses*. BankCherokee sued Schoenwetter, not the other way around. Significantly, neither the lower court, nor BankCherokee provide any citation to controlling legal authority holding *affirmative defenses* are barred by application of section 513.33.

Indeed, all Minnesota published case law of which Schoenwetter is aware applies section 513.33 in a preclusive manner only when it is used to bar a debtor from maintaining an *action*. See, e.g., *Becker v. First Am. State Bank of Redwood Falls*, 420 N.W.2d 239, 241 (Minn. Ct. App. 1988); *Carlson v. Estes*, 458 N.W.2d 123 (Minn. Ct. App. 1990) (applying section 513.33 to bar some claims, but declining to apply section 513.33 to bar a claim for breach of an oral contract to refrain from recording a mortgage);

Drewes v. First Nat'l Bank of Detroit Lakes, 461 N.W.2d 389 (Minn. Ct. App. 1990); *Greuling v. Wells Fargo Home Mortgage, Inc.*, 690 N.W.2d 757, 762 (Minn. Ct. App. 2005) (applying section 513.33 to bar claims relating to an oral promise creating a *new* agreement, but distinguishing that from oral promises alleged to be part of an *existing* contract):

However, case law demonstrates section 513.33 is *not* applied to bar *affirmative defenses* asserted by debtors. *See, e.g., Resolution Trust Corp. v. Flanagan*, 821 F. Supp. 572, 574 (D. Minn. 1993) (Doty, J.) (summary judgment inappropriate because fact issues exist regarding application of promissory estoppel affirmative defense); *Rural Am. Bank of Greenwald v. Herickhoff*, 485 N.W.2d 702, 705 and 708 (Minn. 1992) (section 513.33 held not to bar affirmative defense based on breach of an unsigned written contract). *See also In re Estate of Giguere*, 366 N.W.2d 345 (Minn. Ct. App. 1985) (held oral modification of a promissory note allowed and does not violate the parol evidence rule) (decided April 16, 1985 prior to effective date of section 513.33 on May 29, 1985); *Scally v. Norwest Mortgage, Inc.*, C4-02-2181 2003 WL 22039526, at *4-5 (Minn. Ct. App. Sept. 2, 2003) (promissory estoppel claim dismissed by trial court on summary judgment remanded for trial and *not* barred by Minn. Stat. § 513.33); *Norwest Bank Minn., N.A. v. Midwestern Machinery Co.*, 481 N.W.2d 875 (Minn. Ct. App. 1992) (reversing trial court and allowing appellant/defendant to take oral breach of contract and estoppel claims to a jury trial).

Norwest Bank Minnesota, N.A. v. Midwestern Machinery Co. is particularly instructive. In that case, the court explained that an “agreement may be taken outside the

statute of frauds by equitable or promissory estoppel.” 481 N.W.2d at 880. In the present case, Schoenwetter asserted claims for estoppel in his original Answer.

Other jurisdictions have enacted Credit Agreement Statutes of Fraud with language similar to section 513.33. In those jurisdictions, courts apply the plain language of those statutes and do not bar *affirmative defenses* of debtors based upon oral promises. *See, e.g., Maynard v. Cent. Nat'l Bank*, 640 So.2d 1212 (Fla. App. 5 Dist. 1994) (Florida's identical credit agreement statute of frauds does not bar affirmative defenses); *Hibernia Nat'l Bank v. Contractor's Equip.*, 804 So.2d 760, 762-63 (La. Ct. App. 2001) (holding Louisiana's identical credit agreement statute of frauds does not bar affirmative defenses in a case involving personal guaranty); *Sees v. Bank One*, 839 N.E.2d 154, 159 (Ind. 2005) (holding Indiana's similar credit agreement statute of frauds did not bar affirmative defenses in a case involving personal guaranty). This line of cases from foreign jurisdictions is instructive and should be followed when applying Minnesota's Credit Agreement Statutes of Frauds.

B. Minnesota's Credit Agreement Statute Of Frauds Is Inapplicable To Schoenwetter's Guaranty.

Assuming, *arguendo*, that section 513.33 applies to affirmative defenses, it nonetheless does not apply to personal guaranties.

BankCherokee initiated an action against Schoenwetter based upon the disputed personal guaranty. However, section 513.33 is inapplicable to contracts of guaranty because guaranties are security agreements independent and collateral to a loan transaction. Section 513.33, on the other hand, by its plain terms requires a “creditor”—

defined as a “person who extends *credit under* a credit agreement with a debtor.” Minn. Stat. § 513.33, Subd. 1(2) (emphasis added).

It is well-established that a “guaranty is not a debt, nor is it an evidence of indebtedness; it is an agreement collateral to the debt itself.” 38 AM. JUR. 2D *Guaranty*, § 1 at 872 (1999). Accordingly, a guaranty creates only a secondary obligation that is a separate, independent contract and collateral to the contractual obligation between the creditor and debtor. *Id.* § 2 at 873. Because section 513.33, in order to be applicable, requires a creditor to extend “*credit under* a credit agreement,” it is axiomatic a guaranty cannot be a credit agreement because no “*credit*” is extended “*under*” a guaranty—but rather under an associated loan agreement. In this case, “credit”³ was extended “under” Insignia’s Line of Credit Loan, and not under the disputed guaranty. Thus, section 513.33 was inappropriately applied to bar Schoenwetter’s affirmative defenses.

Moreover, the guaranty at issue, like all guaranties, fails to satisfy the prerequisites of section 513.33, Subd. 2 because a guaranty is a security agreement similar to a mortgage, and section 513.33 is not applicable to mortgage security agreements but rather to “credit agreements.” *Carlson*, 458 N.W.2d at 127 (Minn. Ct. App. 1990) (holding section 513.33 inapplicable to oral promise not to record a mortgage security agreement because a mortgage is not a “credit agreement”).

³ The term “credit” is not defined by Minn. Stat. § 513.33. However, a common definition of credit is: “the balance in a person’s favor in an account” and “an amount or sum placed at a person’s disposal by a bank account[.]” See WEBSTER’S NINTH COLLEGIATE DICTIONARY at 305 (1990); accord WEBSTER’S THIRD INTERNATIONAL DICTIONARY at 532 (1981).

C. In Minnesota, Oral Agreements Can Modify The Method And Time For Performance Of An Agreement Notwithstanding The Statute Of Frauds.

Schoenwetter presented evidence that BankCherokee orally promised and agreed to the following:

- Satisfying any default on Insignia's Line of Credit Loan by first collecting against the Eden View and Victory Pass development's equity serving as collateral for loans with BankCherokee before enforcing any guaranty against Schoenwetter. (APP-135, ¶ 12; APP-136, ¶ 17; APP-138, ¶ 25.)
- Allowing a cure period for any defaults that would last as long as the continued decline in the real estate market and the time it took for the market to recover. (APP-138, ¶ 25 to APP-139, ¶ 32.)
- Taking only a *corporate* guaranty for the renewal of the Insignia Line of Credit Loan. (APP-139, ¶ 30; APP-178 to APP-179; APP-182.)

Minnesota Statutes section 513.33 is in derogation of the common law allowing oral modification of contracts—despite the parol evidence rule. Therefore, it must be narrowly construed. *Rosenberg v. Heritage Renov., LLC*, 685 N.W.2d 320, 327-28 (Minn. 2004). BankCherokee's argument suggesting Minnesota Statutes section 513.33 defeats Schoenwetter's affirmative defenses is misplaced because Minnesota recognizes oral agreements can modify the method and time for performance of an agreement notwithstanding the statute of frauds. *Giguere*, 366 N.W.2d at 347; *Thoe v. Rasmussen*, 322 N.W.2d 775, 777 (Minn. 1982). Oral modification of the time and performance of a written contract, despite the statute of frauds, was recognized in Minnesota as early as 1898 in *Scheerschmidt v. Smith*, 77 N.W. 34 (Minn. 1898). Over a century later, *Scheerschmidt* is still good law in Minnesota.

Accordingly, parties such as BankCherokee and Schoenwetter may orally agree to waive or modify a contractual term requiring a debt to be paid by a certain date. *See, e.g., Giguere*, 366 N.W.2d at 347 (oral agreement to delay enforcement of past-due promissory note). Courts addressing section 513.33 recognize Minnesota's rich tradition of allowing oral modifications of contracts and have narrowly construed it in order to allow claims based on oral modifications. *See, e.g., Resolution Trust Corp.*, 821 F. Supp. at 574; *Scally*, 2003 WL 22039526, at * 4-5; *Norwest Bank Minn.*, 481 N.W.2d at 880. The lower court overlooked this long-standing precedent allowing oral modifications and, therefore, its order granting summary judgment should be reversed and Schoenwetter should be allowed to pursue affirmative defenses based upon the oral agreements described above.

Furthermore, under well-established Minnesota law, parol evidence is admissible to show a subsequent modification of an original contract. *See Nord v. Herreid*, 305 N.W.2d 337, 339-40 (Minn. 1981); *Giguere*, 366 N.W.2d at 347 (allowing parol evidence to show a modified agreement between the parties that delayed enforcement of a promissory note by giving time extension for payment). In this case, Schoenwetter seeks to use parol evidence to show the intended modification of his original personal guaranty signed in 2004. *See Greuling*, 690 N.W.2d at 762 (distinguishing situation where section 513.33 barred claims relating to an oral promise creating a *new* agreement, from oral promises alleged to be part of an *existing* contract).

Courts have also estopped creditors from using the statute of frauds to avoid oral credit agreements reached with their debtors in circumstances similar to this case. *See,*

e.g., *Resolution Trust Corp.*, 821 F. Supp. at 574 (denying summary judgment because fact issues existed regarding promissory estoppel affirmative defense); *Norwest Bank Minn.*, 481 N.W.2d at 880 (stating that “[a]n agreement may be taken outside the statute of frauds by equitable or promissory estoppel”).

In *Norwest Bank Minnesota v. Midwest Machinery Co.*, the Minnesota Court of Appeals determined there was an outstanding fact issue as to whether a bank orally promised to indefinitely extend a \$5 million line of credit in order to induce the borrower to sign an agreement. *Id.* at 880. Here, Schoenwetter testified BankCherokee promised, among other things, to allow a cure period for any defaults that would last as long as the continued decline in the real estate market and the time it took for the market to recover. (App-138, ¶ 12; APP-136, ¶ 17; APP-138, ¶ 25.) BankCherokee had already waited nearly a year after the loan had expired and the borrower was in default. Schoenwetter believed BankCherokee’s promises. Just as the court did in the *Norwest Bank Minnesota* case, this Court should reverse the lower court’s grant of summary judgment, and remand for a trial on the modification by estoppel issue.

D. The Parol Evidence Rule Does Not Exclude Relevant Evidence In Determining Whether A Contract Is Invalid Because Of Fraud, Mistake Or Other Reasons.

The lower court’s determination that Minnesota Statutes section 513.33 prevents Schoenwetter from alleging the oral modification of the personal guaranty at issue is misplaced because Minnesota traditionally allows parol evidence in circumstances such as this case where fraud or mistake invalidates a contract.

Specifically, the parol evidence rule does not exclude relevant evidence in determining whether a contract is invalid because of illegality, fraud, mistake or other reasons, or whether the writing was the final integration of the parties' agreement. See A. Corbin, 3A Corbin on Contracts Sec. 573 (1960); see also *Ridgway v. County of Hennepin*, 182 N.W.2d 674, 679 (Minn. 1971) ("It is well established that the parol evidence rule does not exclude evidence offered to invalidate an instrument.").

The parol evidence rule presupposes an action based on an existing valid contract, and if the issue is as to the validity or legality of the contract, the rule, by its very terms, has no application, and extrinsic evidence is admitted to determine that issue, whether such evidence tends to establish the validity or invalidity of the contract in question. Such evidence does not vary or contradict the writing, but serves to establish that it has no force or efficacy.

Id. at 138 (citing 30 AM. JUR. 2D *Evidence* § 1035). Although the parol evidence rule generally excludes evidence outside a written document if it contradicts the plain terms of the document, this rule does not apply when the allegation is that a party was induced to enter into the contract by fraudulent oral representations. *Aronovitch v. Levy*, 56 N.W.2d 570, 576 (Minn. 1953); *Nave v. Dovolos*, 395 N.W.2d 393, 396 (Minn. Ct. App. 1986). Indeed, without such evidence, a claim of fraud seldom could be proved. *Nave*, 395 N.W.2d at 396.

Schoenwetter respectfully requests that the lower court's summary judgment order be reversed and that he be allowed to proceed with his affirmative defenses of fraud, mistake, no meeting of the minds, and estoppel. Viewing the evidence in the light most

favorable to Schoenwetter, as required, facts exist upon which Schoenwetter can prove affirmative defenses that invalidate his disputed personal guaranty.

IV. WHETHER SCHOENWETTER REASONABLY RELIED ON BANKCHEROKEE'S ORAL PROMISES AND REPRESENTATIONS IS A GENUINE ISSUE OF MATERIAL FACT FOR THE JURY.

The lower court improperly determined as a matter of law that Schoenwetter did not establish reasonable reliance in support of his estoppel defense. In reaching this conclusion the lower court failed to consider the record evidence presented by Schoenwetter in the light most favorable to Schoenwetter and, therefore, inappropriately determined disputed issues of material fact rather than submitting them to a jury. The lower court also ignored case law holding reasonable reliance is always an issue of fact *unless* the record reflects a complete failure of proof. Because Schoenwetter submitted evidence demonstrating his reasonable reliance on BankCherokee's oral promises, this Court should reverse the lower court and remand the case for trial.

In Minnesota, the issue of whether reliance was reasonable is almost always a question of fact. *See Brenner v. Nordby*, 306 N.W.2d 126, 127 (Minn. 1981) (reasonableness of reliance is a question of fact); *Norwest Bank Minn.*, 481 N.W.2d at 880 (“[t]he reasonableness of a party’s reliance is [generally] a fact question for the jury”); *Hoyt Props., Inc. v. Prod. Res. Group, L.L.C.*, 736 N.W.2d 313, 321 (Minn. 2007) (“Whether a party’s reliance is reasonable is ordinarily a fact question for the jury unless the record reflects a complete failure of proof.”). “Reasonableness becomes an issue of law when the record is devoid of any facts that would support a conclusion that an action

or belief is reasonable.” *Frerichs Constr. Co., Inc. v. Minn. Counties Ins. Trust*, 666 N.W.2d 398, 402 (Minn. Ct. App. 2003).

Schoenwetter expressly testified he relied on the representations and promises made by BankCherokee’s representatives. (APP-135, ¶ 17, to APP-136, ¶ 18; APP-138, ¶ 25; APP-248, ¶ 7.) Schoenwetter’s reliance was reasonable in light of the facts and circumstances surrounding the renewal of the Insignia Line of Credit Loan which include, but are not limited to, the following:

- Insignia’s Line of Credit Loan had been in default nearly a year without BankCherokee trying to enforce Schoenwetter’s guaranty obligations, while at the same time BankCherokee sought to renew and extend Insignia’s Line of Credit Loan for an additional four-year term. (APP-246 to APP-248; APP-138, ¶ 26.)
- BankCherokee’s willingness to extend Insignia’s Line of Credit Loan four additional years indicated to Schoenwetter the bank was willing to work with him on the same terms (*i.e.*, not strictly enforcing late/absent payments or putting the borrower into default for failure to make payments). (APP-248, ¶ 8; APP-139, ¶¶ 31-32.)
- Schoenwetter personally funded Insignia with the \$34,325.43 needed to bring Insignia’s Line of Credit Loan current and testified he would not have done so absent his release from personal liability. (APP-133, ¶ 7; APP-138 TO APP-139; APP-177.)
- Paying \$34,325 to incur \$400,000 in personal guaranty liability 3-months later is irrational and no *reasonable* business person would agree to such a deal. (APP-182; APP-177.)
- Two separate BankCherokee representatives (Platzer and Elden) confirmed Schoenwetter was signing a *corporate* guaranty and his visual inspection prior to signing it (and before it was surreptitiously switched) also confirmed that fact. (APP-249, ¶ 10; APP-139, ¶ 30.)
- If Schoenwetter had not brought the Insignia Line of Credit Loan current, then BankCherokee would not have released Sebold from his personal guaranty and

likely would have sought to enforce both Schoenwetter's and Sebold's guaranty obligations—effectively diminishing Schoenwetter's exposure to liability by the amount BankCherokee recovered against Sebold.

- Schoenwetter trusted BankCherokee and Platzer based upon a history of previous business dealings and Platzer's repeated assurances. (APP-172; APP-173; App-176.)
- Platzer told Schoenwetter BankCherokee was facing regulatory scrutiny by the FDIC and needed to immediately reduce its volume of loans categorized as non-accruing. (APP-247, ¶ 6; APP-248, ¶ 7; APP-139, ¶ 32.)
- During the relevant time period, BankCherokee had: (1) released Schoenwetter from two other personal guaranties; (2) released Sebold from his personal guaranty on the Insignia Line of Credit; and (3) released Insignia from its corporate guaranty on certain loans. (APP-41A; APP-42B; APP-47)
- BankCherokee did not possess any policies or procedures related to the release of guarantors from their guaranty obligations. (APP-42B to APP-43)

Under similar circumstances, courts have held summary judgment was inappropriate. For example, in *Resolution Trust Corp. v. Flanagan*, Judge Doty denied summary judgment on an estoppel defense based on the defaulting defendant/debtor's allegation he was told by the lender that if he ceased further efforts to sell the mortgaged property and let the lender sell the mortgaged property, then no further interest would be charged on the outstanding loan. 821 F. Supp. at 573-74. *See also Norwest Bank Minn.*, 481 N.W.2d at 880 (reversing trial court and allowing borrower to assert estoppel based on oral promises by bank to keep a \$5 million line of credit in place indefinitely); *Scally*, 2003 WL 22039526, at *5 (remanding estoppel claim based on affidavit stating affiant was orally promised a mortgage at 6% and should stop making payments on existing loan).

The circumstances of this case, as described above, make the issue of reasonable reliance a question of disputed fact that should not have been decided as a matter of law. Schoenwetter respectfully requests this Court to remand this case for a full trial on the merits of the estoppel issue.

V. THE CLEAR AND EXPRESS TERMS OF THE GUARANTY, INCLUDING ITS LIABILITY LIMITATIONS, SHOULD BE ENFORCED.⁴

Assuming, *arguendo*, the guaranty is enforceable against Schoenwetter personally, this Court should give effect to the clear and unambiguous language imposing limits on the liability of Schoenwetter as guarantor.

A. The Amount Of The Judgment, Based Upon Loan Payments Received by BankCherokee, Should Be \$365,674.52.

In its Order for Entry of Judgment, the lower court awarded BankCherokee damages that did not take into account Insignia's payment of \$34,325.43 as required pursuant to the unambiguous language in paragraph 20 of the guaranty. Accordingly, to the extent this Court does not remand this case for trial, Schoenwetter respectfully requests the Court to decrease the judgment by \$34,325.43.

The clear, unambiguous and express terms contained in paragraph 20 of the guaranty at issue provide as follows:

GUARANTY IS LIMITED TO 100% OF THE CURRENT OUTSTANDING BALANCE. THE AMOUNT OF THE GUARANTY WILL DECREASE UPON RECEIPT OF EACH PAYMENT RECEIVED.

⁴ Schoenwetter does not concede, by making arguments under this heading, that any liability under the guaranty attaches to him personally.

(ADD-23, emphasis added.) Notably, the guaranty does not make receipt of a check the trigger for decreasing the amount of liability under the guaranty but, rather, it emphasizes that “*payment*” decreases liability under the guaranty only after it has been “*received.*”

Insignia’s payment by check of \$34,325.43 was negotiated by BankCherokee and posted *after* the guaranty dated September 12, 2007. (ADD-19.) Although the check is dated September 11, 2007, it was not processed or negotiated by BankCherokee until September 13th, and was finally posted on September 14th. (*Id.*) BankCherokee does not dispute these facts. Accordingly, BankCherokee did not receive payment until *after* the effective date of the guaranty.

The express language of the guaranty does not make receipt of a check the trigger for decreasing the amount of liability under the guaranty but, rather, it emphasizes that “*payment*” decreases liability under the guaranty only after it has been “*received.*” Because BankCherokee did not *receive* “*payment*” until September 13th or 14th of 2007 at the earliest—after the September 12, 2007 effective date of the guaranty—the amount of the check must be used to decrease the amount guaranteed by Schoenwetter under the express terms of the guaranty.⁵ Accordingly, the \$34,325.43 check negotiated by BankCherokee on September 13th and posted on September 14th, reduces Schoenwetter’s liability under the guaranty to \$365,674.52.

⁵ See Minn. Stat. § 336.4-215(a) describing the events that constitute “final payment” by a payor bank and Minn. Stat. § 336.4-104(a)(9) defining “item” as “an instrument or a promise or order to pay money handled by a bank for collection or payment” (*i.e.*, a check).

BankCherokee drafted the guaranty. (ADD-20 to ADD-23.) Accordingly, if this Court finds the guaranty to be ambiguous, it must be construed against BankCherokee. BankCherokee could have, but did not, draft the guaranty such that payments only of principal amounts would decrease the amount of the guaranty. Rather, BankCherokee deliberately drafted language that expressly allowed the amount of the guaranty to decrease with respect to “each payment” without regard to whether the payment related to payment of principal or interest, or whether such payment was made in a timely manner, and without regard to *when* the payment was made. Moreover, BankCherokee also drafted the guaranty in a manner that failed to address Insignia’s \$34,325.43 check that it chose to seek payment on only *after* the effective date of the guaranty.

BankCherokee’s choice to trigger a decrease in the amount of the guaranty only on “receipt” of payment was purposeful. It did not want the amount of the guaranty to decrease merely because it received a check that might later prove to be worthless. A check is merely a promise to pay; it is not actual payment. Minn. Stat. § 336.3-104(a), (b) and (f). BankCherokee wanted to protect against a situation where a stop-payment-order was issued on a check received by the bank, but not yet processed and paid. For example, if BankCherokee received a check paying off the Insignia Line of Credit Loan, but then the check subsequently *bounced* or was subject to a stop-payment-order, the bank did not want receipt of the check to reduce the guarantor’s liability; rather, the bank insisted on “*receipt*” of actual “*payment*” as a result of *cashing* a check.

BankCherokee’s decision to date the guaranty September 12, 2007 was also a conscious choice. If BankCherokee had cashed the check earlier or insisted on a later

effective date for the guaranty, then the date when the check was paid could not be used to decrease the upper limits of liability imposed by the clear and express language of the guaranty. However, BankCherokee chose both to date the guaranty September 12, 2007 *and* to require that only *receipt* of a *payment* would decrease the limit of liability to which the guarantor was exposed. Having made those decisions and drafted the guaranty, BankCherokee must be held to the bargain it struck.

Having deliberately chosen the language used in the guaranty, and having failed to specifically exempt Insignia's check for \$34,325.43 from the general provisions of paragraph 20, BankCherokee must be held to the strict letter of the guaranty it drafted. *See Am. Tobacco Co. v. Chalfen*, 108 N.W.2d 702, 704 (Minn. 1961) (holding contracts for guaranty "must be strictly construed in favor of the guarantor"); *Operating Engineers Local #49 v. Listul Erection Corp.*, 220 F.Supp.2d 1042, 1044 (D. Minn. 2002) ("a contract for guaranty . . . must be strictly construed in favor of the guarantor"); *Schmidt v. McKenzie*, 9 N.W.2d 1, 5 (Minn. 1943) ("[the guarantor] should be the favorite of the law, and have a right to stand on the strict terms of his obligation").

For these reasons, BankCherokee's receipt of a \$34,325.43 payment after the effective date of the guaranty decreases Schoenwetter's liability under the guaranty pursuant to its clear, unambiguous and express terms. Accordingly, Schoenwetter's personal liability under the guaranty is limited to the reduced amount of \$365,674.52 because BankCherokee received payment on Insignia's check *after* September 12, 2007.

CONCLUSION

Based upon the facts and arguments presented above, Schoenwetter respectfully requests the Court of Appeals reverse the lower court and remand for further discovery and a trial on the merits based upon material issues of disputed fact which will be used at trial to prove his personal guaranty was obtained by fraud in the execution. Schoenwetter also respectfully requests the Court of Appeals reverse the lower court and remand for further discovery and a trial on the merits based on the legal conclusion that Minnesota Statutes section 513.33 does not bar any of Schoenwetter's affirmative defenses. Similarly, Schoenwetter respectfully requests the Court of Appeals reverse the lower court and remand for a full trial on the merits on the issue of whether Schoenwetter reasonably relied on representations made by BankCherokee that establish his affirmative defenses as discussed above. Finally, Schoenwetter respectfully requests the Court of Appeals to hold that, if the guaranty is enforceable, the judgment is reduced by the \$34,325.43 received by BankCherokee *after* the effective date of the guaranty at issue.

Respectfully submitted,

Dated: July 6, 2009.

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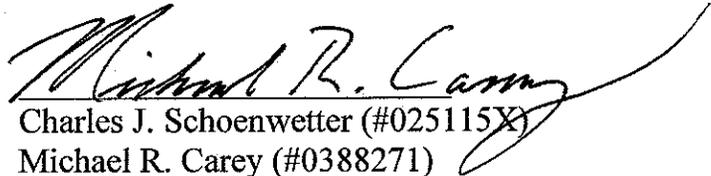
CERTIFICATE OF COMPLIANCE

I hereby certify this Appellants' Brief was prepared using Microsoft Word, in Times Roman font, 13 point, and according to the word processing system's word count, is no more than 11,157 words, exclusive of the cover page, table of contents, table of authorities, signature block and appendix, and complies with the typeface requirements of Minn.R.Civ.App.P. 132.01.

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