

State of Minnesota  
In Court of Appeals

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JAMES E. ROEMHILDT AND BARBARA E. ROEMHILDT,  
*Respondents,*

vs.

KRISTALL DEVELOPMENT, INC., et al.,

*Defendants,*

21<sup>ST</sup> CENTURY BANK,

*Appellant.*

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RESPONDENTS' BRIEF AND APPENDIX

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

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## STATEMENT OF FACTS

Respondents concur with Appellant's Statement of Facts. However, because the events of this case occurred over six years and included several trial court decisions, it may be helpful to review them as a timeline in chronological order, as follows:

5/24/04 A warranty deed ("2004 Warranty Deed") from James and Barbara Roemhildt ("Respondents") to Kristall Development, Inc. ("KDI") was signed on 5/12/04 and recorded on 5/24/04.<sup>1</sup> The conveyance included a large parcel of land that KDI platted into approximately 40 lots.<sup>2</sup> This lawsuit concerned just two of those lots: Lots 1 and 2, Block 9, Roemhildts Waters Edge Third Addition (hereinafter "Lot 1" and "Lot 2" respectively).<sup>3</sup> This appeal focuses just on Lot 2.<sup>4</sup>

5/12/04 KDI signed a promissory note ("Note") in favor of Respondents, in the amount of \$360,000, which contains this "partial release provision": "\$10,000 is due upon the sale of each lot at the time of closing. Roemhildt will provide a partial release for the lot being sold."<sup>5</sup> The Note was due and payable in full on May 12, 2006. Respondent James Roemhildt testified at trial that KDI signed the Note at closing.<sup>6</sup> Respondents did not sign the Note.

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<sup>1</sup> Add. 13

<sup>2</sup> Respondents' Appendix (hereinafter referred to as "R.A.") 11

<sup>3</sup> ¶ 17, Add. 4

<sup>4</sup> ¶ 9, Add. 3-4

<sup>5</sup> Add. 16

<sup>6</sup> R.A. 8

- 5/12/04 A mortgage from KDI to Respondents in the amount of \$360,000 was also signed (“Respondents’ Mortgage”). It secured the Note and covered the property conveyed in the 2004 Warranty Deed plus additional land.<sup>7</sup> Respondents’ Mortgage was recorded on 5/24/04 in third position behind two mortgages in favor of Lakeland Construction Finance, LLC (“Lakeland”). Respondents’ Mortgage did not contain the partial release provision found in the Note.<sup>8</sup>
- 5/19/05 A Warranty Deed (“2005 Warranty Deed”) from KDI to Kristall Homes, Inc. (“KHI”) was signed on 5/18/05 and recorded on 5/19/05, conveying Lot 2.<sup>9</sup> Despite the language in the Note, KDI did not pay Respondents \$10,000 upon the sale of Lot 2. Consequently, Respondents were not aware of the sale and did not provide a partial release of Respondents’ Mortgage for Lot 2.<sup>10</sup>
- 5/19/05 A Mortgage (“21<sup>st</sup> Century Mortgage”) from KHI to FCC Acquisition Corp (“FCC”) in the amount of \$151,000 was recorded, presumably covering Lot 2.<sup>11</sup> KHI used the proceeds of this loan to construct a home on Lot 2.
- 6/6/05 A Partial Release of Mortgage to Lot 2 from Lakeland to KDI was recorded, releasing the two mortgages prior to Respondents’ Mortgage.<sup>12</sup>

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<sup>7</sup> Add. 14

<sup>8</sup> Id.

<sup>9</sup> Add. 18

<sup>10</sup> R.A. 11-12 and 17-18

<sup>11</sup> Add. 19 (does not include the legal description to be attached in Exhibit A)

<sup>12</sup> A. 28

Lakeland also released Lot 1 from the same two mortgages. With the exception of Lot 1 and Lot 2, Lakeland foreclosed one of its two prior mortgages against all the property covered by Respondents' Mortgage.<sup>13</sup>

11/2007 Respondents moved into the home located on Lot 2, also known as 9 Lynae Circle, Elysian, Minnesota.<sup>14</sup>

5/14/08 FCC assigned the 21<sup>st</sup> Century Mortgage to Appellant 21<sup>st</sup> Century Bank ("Appellant").<sup>15</sup>

7/25/08 Appellant obtained and recorded a Voluntary Foreclosure Agreement from KHI and individual guarantors.<sup>16</sup>

9/18/08 Upon KDI's default in paying the Note, Respondents initiated this lawsuit to foreclose Respondents' Mortgage by action.<sup>17</sup>

12/18/08 Because Appellant disputed that Respondents' Mortgage had priority over the 21<sup>st</sup> Century Mortgage with regard to Lot 2,<sup>18</sup> Respondents moved the trial court to limit the foreclosure proceeding to Lot 1 and reserved the balance of the action (on Lot 2) for further proceedings.<sup>19</sup>

2/18/09 The trial court issued its Findings of Fact, Conclusions of Law, Order for Judgment and Judgment, ordering judgment against KDI and in favor of

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<sup>13</sup> R.A. 22

<sup>14</sup> R.A. 14 and 24-25

<sup>15</sup> Add. 24

<sup>16</sup> Add. 25-27

<sup>17</sup> A. 1-6

<sup>18</sup> ¶ 19, R.A. 59

<sup>19</sup> R.A. 54

- Respondents in the amount of \$351,768.90 and ordering the sale of Lot 1.<sup>20</sup>
- 3/19/09 Appellant moved the trial court for summary judgment against Respondents as to Lot 2.<sup>21</sup>
- 5/27/09 Lot 1 was sold at Sheriff's Sale to Respondents as highest bidders for \$154,409.80.<sup>22</sup> The sale was confirmed by trial court Order Confirming Foreclosure Sale dated 7/22/09.<sup>23</sup> Lot 1 was redeemed on 1/22/10 for \$158,544.61.<sup>24</sup>
- 7/8/09 The trial court issued its Order on Motion for Summary Judgment denying Appellant's motion.<sup>25</sup>
- 3/15/10 A court trial was held before Honorable M. Michael Baxter, Judge of District Court, Le Sueur County, Minnesota.<sup>26</sup>
- 8/19/10 The trial court issued its Final Order determining that (1) Respondents were entitled to foreclose their Mortgage on Lot 2, and (2) Appellant cannot force Respondents to execute a partial release as to Lot 2.<sup>27</sup>

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<sup>20</sup> ¶¶ 1 and 3, A. 22-23

<sup>21</sup> R.A. 43-53

<sup>22</sup> A. 24-25

<sup>23</sup> A. 26-27

<sup>24</sup> ¶ 24, Add. 5

<sup>25</sup> R.A. 40-42

<sup>26</sup> R.A. 1-39

<sup>27</sup> ¶ 2, Add. 7 and ¶ 3, Add. 8

## ARGUMENT

### Introduction

In the present case, Appellant wants to take advantage of the partial release provision found in the Note between Respondents and KDI. Appellant is not a party to the Note and is not in privity with any party to the Note. As a result, the only way Appellant can enforce the partial release provision is if it can convince this court that Respondents and KDI intended the provision to be a covenant that “runs with the land” owned by Appellant (Lot 2). A covenant cannot run with the land until it is recorded. Minn. Stat. §§ 507.01 and 507.34. Because the Note was not recorded, and the partial release provision does not appear in Respondents’ Mortgage, which was recorded, Appellant argues that it has been incorporated by reference into Respondents’ Mortgage. Although Appellant cites numerous cases to support its position, none are on point. Appellant’s position is simply not supported by current Minnesota caselaw.

#### I. Standard of Review.

Respondents concur with Appellant that the standard of review in this case is *de novo*. This is a contract case, involving a promissory note and a mortgage. “The construction and effect of a contract presents a question of law, unless an ambiguity exists.” *Home Lumber Co. v. Kopfmann Homes, Inc.*, 535 N.W.2d 302, 304 (Minn. 1995). The parties here agree there is no question of ambiguity. The issue is whether the terms of the Note have been incorporated into Respondents’ Mortgage. Because this issue can be determined solely by reference to the controlling documents, the question is one of law and the standard of review is *de novo*.

**II. The trial court did not err in its decision in this case.**

Appellant argues the trial court erred in concluding that the partial release provision, contained in the Note, is not incorporated into Respondent's Mortgage so as to run with the land and be enforceable by Appellant, the current owner of Lot 2. Appellant would have this court read the Note and Respondents' Mortgage as one document ("Indeed as a matter of common sense, the terms of a note must be considered as being incorporated into the mortgage; otherwise, there would simply be no right to foreclose by reason of the borrower's default on the debt obligation." [Brief pp. 9-10]). Appellant cites no authority to support its position. For this court to reverse the trial court on this issue would be to depart from basic longstanding principles of Minnesota real property law.

**A. Under current Minnesota law, the terms of a promissory note and the terms of a mortgage do not merge to form one document.**

The trial court cited two cases in the Memorandum attached to its Final Order [Add. 11-12], which Appellant claims it relied upon erroneously. One of those cases is *White v. Miller, et. al.*, 52 Minn. 367, 54 N.W. 736 (1893). In *White*, the plaintiff held several promissory notes, some of which were due and some of which were not yet due, as well as a mortgage securing all the notes. The mortgage provided an acceleration clause for the notes, allowing the plaintiff to accelerate the due date if the defendant defaulted. The same acceleration clause did not appear in the notes. The issue was whether the plaintiff could enforce the acceleration clause with regard to notes that were not yet due and consider them to be in default. The court held "no," stating as follows:

“A note and a mortgage securing the same are separate instruments, distinctly differing in their nature and purpose. The debt evidenced by the note is the principal thing, and the note is governed by the law merchant, while the mortgage is simply an incident, and governed by the law of real property. . . .The note is always regarded as a separate and distinct instrument, enforceable according to its terms, and independently of the mortgage. . . . The plaintiff contends for a doctrine which seems to incorporate the provisions of a collateral instrument, given for one purpose—mere security, which may be ignored, if the creditor chooses—into another instrument, made for another purposes—to evidence the debt, which is the principal thing.” *Id.* at 737.

The other case cited by the trial court is *Winne v. LaHart*, 155 Minn. 307, 193 N.W. 587 (1923). Here, much like the facts in *White*, the plaintiffs held a note and mortgage from the defendants. The mortgage, not the note, included an acceleration clause. Although the defendants were in default in payments under the terms of the note, the note was not yet due. The issue was whether, in their foreclosure by action suit, plaintiffs could obtain a deficiency judgment against the defendants. The court held “no”, stating:

“It is familiar doctrine that instruments executed at the same time and for one purpose are but one instrument in the eye of the law, and are to be read and construed together as parts of the same transaction. But this does not mean that, where a note and mortgage are executed contemporaneously, the provisions of the mortgage are thereby incorporated into and become part of the note (citations omitted). . . . This court has consistently adhered to the doctrine that the note and the mortgage are separate and distinct instruments, so different in their nature and purpose that the negotiable character of the note does not affect the character of the mortgage, which always is a mere chose in action (citation omitted).” *Id.*, at 588.

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“The note was not merged in the mortgage. . . . A mortgage need not be accompanied by a personal obligation on the part of the mortgagor to repay the sum for which the mortgage was given. The consideration for the mortgage may have been advanced only on the security (citation omitted).” *Id.*, at 589.

In both *White* and *Winne*, the court refused to apply terms found in the recorded mortgage to the note. In both opinions, the court strongly stated that the note and mortgage are separate instruments with distinct purposes, resisting the plaintiffs' desire to merge the two. In the present case, the issue is whether to apply terms found in the Note to Respondents' Mortgage. Although this is the reverse fact situation from those in *White* and *Winne*, the same longstanding principles of Minnesota property law should apply here, which is what the trial court did. Citing *White* and *Winne*, the trial court concluded that Appellant cannot enforce the partial release provision contained in the Note. [Add. 12]. By following existing law, the trial court did not act in error.

In its Final Order and Memorandum, the trial court also cited and distinguished *Vawter v. Crafts*, 41 Minn. 14, 42 N.W. 483 (1889), a case on which Appellant relies heavily. In *Vawter*, a mortgage upon a tract of land secured the payment of a sum of money according to the terms of three promissory notes. The mortgage contained an agreement that the mortgagor would plat the land into 100 lots and that the mortgagee would release any of the lots from the mortgage upon payment of a specified sum for each lot (the "partial release provision"). The mortgagor sold two of the lots, but failed to obtain releases from the mortgagee for those lots. At the same time, a balance remained due on the mortgage. The issue was whether the purchaser of the two lots could enforce the partial release provision in the same way as the mortgagor. The court held "yes", that the partial release provision contained in the mortgage was a covenant running with the land, and that the benefit of the covenant passed with the land to which it was incident. *Id.*, at 484.

The trial court in the present case concluded that “*Vawter* does not control when the partial release clause is contained in a promissory note that [Appellant] was not a party to and that [Appellant] has no interest in.” [¶ 2, Add. 7]. “In this case, the mortgage does not contain such a [partial release] clause. The clause is contained in the promissory note. [Appellant] was not a party to the promissory note and is not obligated to perform any of the obligations it placed on [KDI]. . . . [Appellant] is not a party or in privity with a party to the promissory note and does not have the ability to enforce its terms.” [Add. 11-12].

**B. Appellant is not a party, or in privity with any party, to the Note.**

The trial court was correct in identifying privity of contract as the pertinent issue in this case. “In short, privity of contract is a legal relationship to the contract or its parties. To affirm one's right under a contract is therefore to affirm his privity with the party liable to him.” *La Mourea v. Rhude*, 209 Minn. 53, 57, 295 N.W. 304, 307 (1940). The parties to the Note are Respondents and KDI. Clearly, Appellant is not a party to the Note, or a successor or assign of a party to the Note, and Appellant has no legal relationship with either party to the Note. Thus, Appellant is not in a position to enforce the terms of the Note.

Because it lacks privity of contract, Appellant has attempted to refocus the issue as a real property issue by arguing the partial release provision contained in the Note “runs with the land.” This argument will be addressed in more detail below. However, it is interesting that, in making this argument, Appellant wants to pick and choose which provisions of the Note run with the land. Appellant would like to enjoy the benefits of

the Note, but has not offered to assume the obligations of the Note, such as paying the amount due thereunder.

Appellant cites the Colorado case, *Rolfes v. O'Connor*, 844 P.2d 1330 (Colo. Ct. App. 1992) to bolster its argument that privity is not the relevant issue. [Brief p. 11]. In *Rolfes*, the issue was whether defendant, holder of a promissory note secured by two deeds of trust (mortgages) executed by plaintiff, was obligated to release certain lots in accordance with the partial release provision contained in one of the deeds, upon tender of a sum by plaintiff, after foreclosure proceedings had been commenced. The *Rolfes* court cited *Vawter* as “one of the earliest and leading cases in support of” the broad rule that a right to a partial release is not dependent upon the absence of default, so long as the requirements specified for the partial release are met. *Id.*, at 1332-1333. However, the *Rolfes* court did not follow *Vawter*, holding that, because plaintiff was in default and, when he made his tender failed to offer unpaid interest on the sums tendered, he was not entitled to judicial relief. He “sought a substantial reduction in the security for the note without a concomitant reduction in the amount due thereunder.” *Id.*, at 1333. *Rolfes* does not support Appellant’s claim that a partial release provision, contained in a note that is referenced in a mortgage, is a covenant that runs with the land. In *Rolfes*, the partial release provision was included in the deed of trust, which was a recorded document. To that end, Appellant’s Footnote 6 [Brief p. 11] is misleading.

- C. **A partial release provision contained in the promissory note, but not in the mortgage, does not become a covenant that runs with the land.**
  - 1. **To “run with the land,” a covenant must be recorded.**

The *Vawter* court determined that a partial release provision included in a mortgage can be a covenant that runs with the land. No Minnesota court before or after *Vawter* has determined that a similar provision included in a note, but not in the corresponding mortgage, is a covenant that runs with the land. “A covenant runs with land when either the liability to perform it, i.e. its burden, or the right to take advantage of it, i.e., its benefit, passes to the assignee of the land.” *Shaber v. St. Paul Water Co.*, 30 Minn. 179, 182, 14 N.W. 874, 875 (Minn. 1883).

In Minnesota, for a covenant to run with the land, and for its benefit to extend to subsequent owners of the land, it must be recorded against the title to the land. The Minnesota Recording Act broadly defines the word “conveyance” to include “every instrument in writing whereby any interest in real estate is created, aliened, mortgaged, or assigned or by which the title thereto may be affected in law or in equity, except wills, leases for a term not exceeding three years, and powers of attorney.” Minn. Stat. § 507.01. Under this definition, a covenant that runs with the land is a “conveyance,” because it is an interest in real estate that is created and because it affects the title to that real estate.

In order for a conveyance to be fully effective, it must be recorded against title to the real estate it conveys. Minnesota Statutes § 507.34 states that “Every conveyance of real estate shall be recorded in the office of the county recorder of the county where such real estate is situated; and every such conveyance not so recorded shall be void as against any subsequent purchaser in good faith and for a valuable consideration of the same real estate, or any part thereof, whose conveyance is first duly recorded . . . .”

In *Sjoblom v. Mark*, 103 Minn. 193, 114 N.W. 746 (1908), the court found that, where a landowner agreed with an adjoining landowner to not sell or permit to be sold upon his land any intoxicating liquor for a period of ten years, such agreement was not a covenant running with the land. Even though the landowner executed the contract on behalf of his heirs, executors, and assigns, the court determined it was merely a personal covenant and not a “conveyance” as that term was defined by Minnesota statute (presently Minn. Stat. § 507.01), because the agreement was not contained in any deed or document in the chain of title. Therefore, subsequent purchasers and assigns did not have constructive notice of the covenant and could not be bound by it. *Id.* at 749-750.

As in *Sjoblom*, the provision Appellant seeks to enforce as a covenant is contained in a document that is not of record. Even though the Note containing the partial release provision states: “This Promissory Note shall be binding upon Maker and Maker’s successors, and assigns” [Add. 17], the Note is still a personal covenant and not a covenant that runs with the land, because it is not recorded. The Note does not even contain the words, “runs with the land.”

**2. Reference in a recorded document to an unrecorded document does not provide constructive notice to a purchaser of provisions contained in the unrecorded document.**

Appellant argues that, because Respondents’ Mortgage “specifically references the Note,” the terms of the Note are therefore “incorporated by reference” and “must be considered when interpreting the mortgage contract.” [Brief p. 10]. However, reference in a mortgage to a note that contains a covenant does not constitute recording of the covenant.

Appellant cites three cases from other jurisdictions to support its contention that a subsequent mortgagee has notice of the amount due, even when that amount is absent from the recorded mortgage, but set forth in the corresponding promissory note. [Brief p. 13]. Appellant cites a fourth case holding the same with regard to attorneys' fees. [Brief p. 14]. What Appellant omits is the Minnesota case, *Whitacre v. Fuller*, 5 Minn. 508, Gil. 40, 1861 WL 1837 (1861), which does not agree with the cases cited by Appellant. In *Whitacre*, the issue was, when a mortgage contained the repayment terms of a corresponding promissory note, and the parties renegotiated those repayment terms but did not change the mortgage to reflect the new terms, whether subsequent incumbrancers were bound by the new terms. The *Whitacre* court held, "as between the original parties to this mortgage, it is a lien upon the premises to the amount due upon the note which it secures, according to the legal amount of interest secured by said note. But subsequent incumbrancers are bound by nothing more than the record discloses (unless express notice be proved), and as the record makes no mention of the rate of interest specified in the note, as to the second mortgagee, the same must be computed at the [original rate]." *Id.*, at 6. Thus, in Minnesota, if a provision does not appear in the recorded mortgage, it is not considered "of record."

"The purpose of the record is to provide purchasers with notice 'of the existence and contents' of recorded instruments (citation omitted). The constructive notice imputed to a purchaser by the record of an instrument is strictly confined to that which is set forth on its face." *MidCountry Bank v. Krueger*, 762 N.W.2d 278, 285 (Minn. Ct. App. 2009), review granted, affirmed on other grounds, 782 N.W.2d 238 (Minn. 2010), citing *Bank of*

*Ada v. Gullikson*, 64 Minn. 91, 94, 66 N.W. 131, 132 (1896). The Minnesota Recording Act defines a “purchaser” as “every person to whom any estate or interest in real estate is conveyed for a valuable consideration and every assignee of a mortgage, lease, or other conditional estate.” Minn. Stat. § 507.01. Under this definition, Appellant is a “purchaser” of Lot 2. At the time Appellant foreclosed its mortgage on Lot 2 and became its purchaser, Appellant had constructive notice of what appeared on the face of Respondents’ Mortgage. Thus, Appellant had constructive notice that the Mortgage secured “the payment of \$360,000.00 a mortgage and note (sic) . . . .” [Add. 14]. The Mortgage did not identify the Note in any way or make any reference “on its face” to the partial release provision. As a result, Appellant did not have constructive notice of the partial release provision contained in the Note simply by reviewing the recorded Mortgage.

In general, the terms of both a note and a mortgage are binding on the parties to those documents, i.e. the mortgagor/borrower and mortgagee/lender. However, only those terms that appear on the face of the recorded mortgage extend to a subsequent purchaser of the property, unless that purchaser independently assumes the obligations under the note. Here, Appellant has not assumed the obligations under the Note and, therefore, only the terms that appear on the face of Respondents’ Mortgage extend to Appellant, as subsequent purchaser of Lot 2.

**3. The covenanting parties must intend a covenant run with the land.**

“The covenant must not only touch and concern the land; it must also be the intent

of the covenanting parties that the covenant run with the land, that is, that their successors or assigns will be bound by the terms of the covenant.” *Matter of Turners Crossroad Development Co.*, 277 N.W.2d 364, 369 (Minn. 1979), citing *Kettle River Railroad v. Eastern Railway*, 41 Minn. 461, 471, 43 N.W. 469, 473 (1889). In the present case, it was plainly not Respondents’ or KDI’s intent that the partial release provision “run with the land.” If that had been their intention, they would have included the provision in the Respondents’ Mortgage and recorded it against the title to the land. Rather, they placed the provision in the Note, where it remains, at best, Respondents’ personal obligation to KDI.

The fact is, Respondents have not signed the Note. They have not executed that written instrument required to create a “conveyance” in real property per Minn. Stat. § 507.01. A covenant affecting the title to real property must be created by a written instrument and signed by the creator, just like any other real property interest. Both the Note and Respondents’ Mortgage were signed exclusively by KDI. Although Respondents have honored the Note’s partial release provision in the past, when requested by KDI, they are not obligated to honor it with regard to Appellant.

Appellant presumes to know for what Respondents bargained with KDI, when Appellant states on page 15 of its Brief, “Had the sale of Lot 2 proceeded in the manner Respondents envisioned, they would have received \$10,000—the amount for which they bargained—and been obligated in exchange to grant [KDI] a partial release.” Just because Respondents may have bargained *with KDI* for \$10,000 per partial release does not mean Respondents intended to provide a release to another party when KDI neither

requested nor paid for a release. There is no evidence in this case that Respondents intended the partial release to become a covenant that runs with the land.

**D. Respondents will not receive a windfall in this case.**

Appellant warns that, unless the trial court's order is reversed, Respondents will receive a windfall. Indeed, if the order is reversed, it is Appellant that will receive a windfall. To be clear, Lot 2 is the last piece of property on which Respondents' Mortgage remains effective. Recall that Lakeland held two mortgages prior to Respondents' Mortgage on all the property conveyed in the 2004 Warranty Deed, plus additional land. Lakeland provided releases to KDI for Lot 1 and Lot 2, but it has foreclosed on the remaining property that was subject to Respondents' Mortgage.<sup>28</sup> Since Respondents have already foreclosed on Lot 1, their only remaining option for relief is to foreclose on Lot 2.

By trial court order dated February 18, 2009, Respondents obtained a judgment against KDI in the amount of \$351,768.90. Pursuant to the Order Confirming Foreclosure Sale, the judgment has been partially satisfied in the amount of \$153,448, as a result of the foreclosure sale of Lot 1.<sup>29</sup> That leaves \$198,320.90 of the judgment unsatisfied, not including costs and interest accruing at the rate of 4% per annum. Minn. Stat. § 549.09. If this court requires Respondents to release their Mortgage on Lot 2 in exchange for \$10,000, they will lose over \$188,000 and will not have gotten what they bargained for with KDI. Even if Respondents are allowed to go forward with their

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<sup>28</sup> A. 28; R.A. Tr. 22; ¶ 17, Add. 4

<sup>29</sup> A. 26

foreclosure of Lot 2, it is quite possible they will not recover the full amount of their remaining judgment against KDI.

It is Appellant and its predecessor, FCC, that could have prevented this situation. Recall FCC provided a construction loan to KDI's successor KHI for Lot 2. Had FCC examined title to Lot 2 prior to taking a mortgage from KHI, it would have discovered Respondents' Mortgage, which was indisputably of record at that time.<sup>30</sup> FCC could have required a release of Respondents' Mortgage prior to accepting a mortgage from KHI. Likewise, had Appellant examined title to Lot 2 prior to purchasing FCC's mortgage, it also would have discovered Respondents' Mortgage. Appellant also could have required a release of Respondents' Mortgage prior to purchasing the FCC mortgage. Instead, Appellant proceeded to obtain title to Lot 2 following a voluntary foreclosure of the FCC mortgage and took title subject to all prior liens, including Respondents' Mortgage. *See Grady v. First State Sec. Co.*, 179 Minn. 571, 229 N.W. 874 (1930). Therefore, of the two parties to this appeal, it is Appellant that could have prevented what occurred.

Respondents have done nothing wrong here. They come with clean hands. All they are attempting to do is enforce their secured interest in Lot 2. Respondents are not obligated to provide a release of their Mortgage on Lot 2 at this time for several reasons. First, they did not receive a \$10,000 payment from KDI when Lot 2 was transferred to KHI. Second, KDI is the only party to whom Respondents are arguably obligated to provide a release and KDI is not requesting one. Third, it is not Respondents' duty under

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<sup>30</sup> ¶ 27, Add. 6 and ¶ 6, Add. 7

the terms of the Note to demand payment of the \$10,000, as Appellant insinuates. [Brief p. 15].

Appellant asserts Respondents should not be allowed to enforce a “blanket” mortgage on just two lots (Lots 1 and 2) out of 36 or so in the development, citing *Premier Bank v. Becker Development, LLC*, 785 N.W.2d 753 (Minn. 2010) as an analogy to the present case. However, *Premier* can be distinguished in several respects from the present case. In *Premier*, Premier Bank held a first-priority development mortgage on all but three lots in a 59 lot development and held construction mortgages on the remaining three lots containing model homes. The general contractor, Kuechle Underground, Inc. (“Kuechle”), constructed the three model homes, but held a blanket mechanics lien against all 59 lots, pursuant to Minn. Stat. § 514.09. When the developer defaulted, both Premier and Kuechle foreclosed and the cases were consolidated. With regard to the development mortgage on the 56 lots, the trial court ruled Premier’s mortgage was prior to Kuechle’s lien. With regard to the construction mortgages on the remaining three lots, the trial court determined Kuechle’s mechanic’s lien was prior to Premier Bank’s construction mortgages and allowed Kuechle to foreclose its entire lien claim against those three lots. On appeal, the Minnesota Supreme Court reversed, holding that, because Kuechle elected to file a blanket lien (as opposed to apportioning the amount of its claim between the three lots and asserting a lien for a proportionate part upon each, pursuant to Minn. Stat. § 514.09), the blanket lien must be enforced as one lien against all 59 lots for the entire amount of the lien.

This case does not work as an analogy here. *Premier* involves a mechanic's lien foreclosure, which is strictly a statutory proceeding, whereas the present case involves a mortgage foreclosure by action, which is a court proceeding. Appellant has not cited any statute or other authority, and Respondents are not aware of any, that would prohibit Respondents from foreclosing their Mortgage on Lot 2 only. Further, Respondents are more like Premier Bank than Kuechle in this case, because Respondents provided a development loan to KDI, not labor and materials, and have priority over other loans. Finally, unlike Kuechle's blanket mechanics lien, which was effective against all 59 lots, Respondents' Mortgage is presently effective against just one lot—Lot 2. Respondents have voluntarily released their Mortgage on other lots in Roemhildts Waters Edge Third Addition, have foreclosed on Lot 1, and have lost their Mortgage on the remaining lots as the result of Lakeland foreclosing its prior mortgage. Thus, *Premier* is not controlling here, because Respondents have no additional property against which to apportion their judgment amount.

If the trial court order is reversed, Respondents will recover only \$10,000 and Appellant will receive clear title to Lot 2, despite the fact that Appellant took title to Lot 2 with constructive notice of Respondents' Mortgage. Appellant has other recourse for recovering its loss in this case, which is title insurance coverage.<sup>31</sup> Respondents do not have any other recourse.

**E. Appellant cites cases that do not support Appellant's position.**

Appellant cites several cases as "apposite" cases, but none of those cases support

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<sup>31</sup> A. 14

Appellant's position that a promissory note and a mortgage merge to become one document. For example, Appellant cites *McManaman v. Hinchley*, 82 Minn. 296, 84 N.W. 1018 (1901) to establish that a "mortgage is but an incident of the debt, and can have no separate or independent existence as a contract." *Id.*, at 1018. [Brief p. 9]. Appellant further cites *Jackson v. Mortgage Electronic Registration Systems, Inc.*, 770 N.W.2d 487 (Minn. 2009), which states, "The debt obligation or promissory note is the principal part of a mortgage transaction." *Id.*, at 494. However, those opinions do not mean the terms of the note are to be automatically incorporated into the mortgage. They simply mean there can be no mortgage without an underlying debt. The note is not the debt itself, but rather evidence of the debt.

Appellant also cites *National City Bank v. Engler*, 777 N.W.2d 762 (Minn. Ct. App. 2010), where the court stated that "all provisions of this contract can be harmonized," referencing a promissory note and mortgage. *Id.*, at 766. A close reading of the facts, however, reveals the court did not intend to merge the provisions of the note and mortgage, but referred instead to a harmonization of the actions by the husband ("Husband") and wife ("Wife") in that case. Wife and her late Husband had refinanced their home mortgage. At the request of the bank, Husband only signed the note and mortgage. Wife signed as a non-borrower, and language appearing below her signature indicated she was "signing solely for the purpose of waiving any and all homestead rights." After Husband died, she discontinued mortgage payments and the bank sought to foreclose. The issue was whether the mortgage was valid in light of Minn. Stat. § 507.02, which requires the signatures of both spouses to validly convey homestead property. The

court held the statutory requirements were satisfied when the non-signing spouse (Wife) participated in the mortgage application process, attended the closing, benefitted from the mortgage, and waived her homestead rights. *Id.* Hence, *Engler* does not support Appellant's position that the terms of note and mortgage must be merged.

### CONCLUSION

For all the reasons set forth above, the trial court did not err in ruling that Respondents may foreclose their Mortgage on Lot 2, Block 9, Roemhildts Waters Edge Third Addition (Lot 2) and are not obligated to provide Appellant with a partial release of their Mortgage as to Lot 2. Appellant is not a party to the Note in question, or in privity with any party to the Note and, therefore, not in a position to enforce the terms of the Note, which contains the partial release provision. Appellant has attempted to refocus the issue in this case as a real property issue by arguing that the partial release provision contained in the Note "runs with the land," and extends to Appellant as current owner of Lot 2. However, to run with the land, a covenant must be recorded. The Note is not recorded and, although the recorded Mortgage vaguely references the Note, it does not contain the partial release provision on its face. Even so, the partial release provision does not run with the land because the covenanting parties in this case did not intend for it to do so.

Lot 2 remains the only property subject to Respondents' Mortgage. Respondents' judgment against the mortgagor remains unsatisfied in an amount in excess of \$198,000. Respondents will not receive a windfall in this case if the trial court's Final Order is

affirmed by this court. Respondents respectfully request this court to affirm the Final Order of the trial court entered August 19, 2010.

Dated: December 28, 2010

Respectfully submitted,

A handwritten signature in black ink, appearing to read "John C. Peterson", with a long horizontal flourish extending to the right.

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