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NO. A11-0322

State of Minnesota
In Court of Appeals

Slattengren & Sons Properties, LLC,

Respondent,

vs.

RTS River Bluff, LLC, et al.,

Defendants,

The RiverBank, a Banking Corporation
Under the Laws of the United States of America,

Appellant.

APPELLANT THE RIVERBANK'S REPLY BRIEF

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ARGUMENT

I. THE RIVERBANK MORTGAGE HAS PRIORITY OVER THE SLATTENGREN MORTGAGE UNDER MINNESOTA LAW.

The district court found that The RiverBank Mortgage was a purchase money mortgage that was both first in time and recorded first. (Add. 4-5,7 at ¶¶ 13, 19 & 23; App. 42-43, 45 at ¶¶ 13, 19 & 23) The district court also concluded that "the Slattengrens should have known that the RiverBank was providing some funding for the development . . . ." (Add. 17; App. 55). In light of these rulings of the district court, The RiverBank Mortgage has priority over the Slattengren Mortgage under Minnesota law.

A. The principles of *Olson v. Olson* and *In re Ocwen Financial Services, Inc.* are applicable to this case and support priority in favor of The RiverBank Mortgage.

To avoid an unfavorable priority analysis, Respondent attempts to distinguish *Olson v. Olson*, 203 Minn. 199, 280 N.W. 640 (1938), and *In re Ocwen Financial Services, Inc.*, 649 N.W.2d 854 (Minn. App. 2002), *review denied* (Minn. Nov. 19, 2002). (*See* Respondent's Brief at 8-11) Respondent's argument is unavailing.

In *Olson v. Olson*, the supreme court relied on the sequence of recording to determine priority between purchase money mortgages held by a third party and a vendor that "attached at the same time" and had "equality of rights." 203 Minn. at 202, 280 N.W. at 641. The *Olson* court concluded that the third party purchase money mortgage had priority over the vendor's purchase money mortgage because of the third party's "diligence in recording first" overcame the vendor's "otherwise equal standing." *Id.*

Respondent attempts to distinguish *Olson* because the vendor's prior purchase money mortgage in that case was "secret" and unrecorded at the time the third party received and recorded its mortgage. (*See* Respondent's Brief at 8) Based on this fact, Respondent contends any awareness of a subsequent mortgage to the Slattengrens removes *Olson* as a basis for decision in this case. (*See id.*) This argument overlooks the sequence of the mortgages in *Olson* and in this case and ignores longstanding principles concerning notice by a **subsequent** encumbrancer of a **prior** equity in the same property **at the time it received its encumbrance**.

The time of notice and sequence of rights in the same subject matter are important factors in a bona fide purchaser analysis:

> The rule is universal and elementary, that if a purchaser in any form receives notice of **prior adverse rights in and to the same subject-matter**, before he has completely acquired or perfected his own interests under the purchase, his position as *bona fide* purchaser is thereby destroyed, even though he may have paid a valuable consideration; **on the other hand**, notice [of prior adverse rights] given **after** his interests have been completely acquired or perfected produces no injurious effect.

3 John Norton Pomeroy, *A Treatise on Equity Jurisprudence* § 753, at 44 (Spencer W. Symons ed., 5th ed. 1941) (emphases added). This equitable principle was incorporated into Minnesota's Recording Act:

> 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 . . . .

Minn. Stat. § 507.34 (2010) (emphasis added). It is a subsequent purchaser, whose conveyance was "second in time", who must be bona fide to have priority: "The

Plaintiff's deed was first in time, but defendant's, second in time, was first recorded. Plaintiff's deed was therefore void as to defendant's, provided defendant was a bona fide purchaser." *Errett v. Wheeler*, 109 Minn. 157, 161, 123 N.W. 414, 415 (1909). Notice must be of an inconsistent interest in the same property that is prior and outstanding at the time of a conveyance: "A subsequent purchaser in good faith (a bona fide purchaser) is someone who obtains an interest in real estate by giving consideration without actual, implied, or constructive notice of inconsistent outstanding rights of others to the property." *Chergosky v. Crosstown Bell, Inc.*, 454 N.W.2d 654, 656 (Minn. App. 1990), *reversed on other grounds*, 463 N.W.2d 522 (Minn. 1990) (citing *Miller v. Hennen,* 438 N.W.2d 366, 369 (Minn. 1989)). "No person can claim the position of bona fide purchase of property, when he is informed before making the purchase that a third person has some title or interest adverse to the grantor." *Bergstrom v. Johnson*, 111 Minn. 247, 250, 126 N.W. 899, 900 (1910). These principles concerning notice in relation to the sequence of interests in the same property support reliance on *Olson*'s priority analysis in this case.

In *Olson*, the vendor's mortgage was given 11 days before the third party's mortgage. *See* 203 Minn. at 200, 280 N.W. at 640. Accordingly, the third party's lack of knowledge at the time it received its subsequent mortgage was a relevant consideration. *See id.* 203 Minn. at 201, 280 N.W. at 640.

In this case, the sequence was reversed. The district court found that RTS granted a mortgage to RiverBank on December 12, 2003—10 days before RTS delivered the Slattengren Mortgage to the Slattengrens at the closing on December 22, 2003. (Add. 4-5 at ¶¶ 13 & 19; App. 42-43 at ¶¶ 13 & 19). Because the Slattengren Mortgage was

subsequent to The RiverBank Mortgage, RiverBank could not have had notice of a prior existing equity in favor the Slattengrens at the time RiverBank received its mortgage on December 12, 2003 in exchange for a commitment to provide purchase money to RTS for the Slattengren parcel. Any awareness by RiverBank of an interest that the Slattengrens might subsequently receive is therefore not a relevant consideration and not a reason to distinguish *Olson* and its priority analysis. *Olson* would be distinguishable only if RiverBank was a subsequent mortgagee with notice of a prior mortgage held by the Slattengrens in the Slattengren parcel at the time RiverBank received its mortgage. Because the district court found the opposite—The RiverBank Mortgage was given 10 days prior—*Olson* cannot be distinguished and its priority analysis applies to this case.

Under *Olson*'s priority analysis, the Slattengrens—even if they had no actual or inquiry notice of The RiverBank Mortgage—would have had to exercise diligence in recording first to save priority of their mortgage and overcome The RiverBank Mortgage's "otherwise equal standing" as a purchase money mortgage attaching at the same time as the Slattengren Mortgage through instantaneous seisen. Because the Slattengrens failed to record first, the district court erred in deciding priority in favor of the Slattengren Mortgage.

Respondent's attempt to distinguish *In re Ocwen Financial Services, Inc.* is likewise unavailing. Respondent offers no explanation for why torrens registration of a mortgage, and its effectiveness from the time of registration, should distinguish the *Ocwen* court's priority analysis concerning the order of recording and a mortgagee's notice of a superior interest of another at the time of recording. (*See* Respondent's Brief

at 9-11) These considerations are equally applicable to abstract property: "A 'good faith purchaser' is someone 'who gives consideration in good faith without actual, implied, or constructive notice of **inconsistent outstanding** rights of others.' **The priority of a mortgage is based on the date of recording.**" *Citizens State Bank v. Raven Trading Partners, Inc.*, 786 N.W.2d 274, 278 (Minn. 2010) (quoting *Anderson v. Graham Inv. Co.,* 263 N.W.2d 382, 384 (Minn.1978)) (citing Minn. Stat. §§ 386.41, 507.34 (2008)) (citations omitted) (emphases added). Moreover, the supreme court has applied reasoning from torrens cases to determine the relative priority of mortgages on abstract property: "But like a mortgage on Torrens property, a mortgage on abstract property is not enforceable against third parties until the mortgage is recorded. *See* Minn.Stat. § 507.34. Accordingly, we find the reasoning of these cases [addressing Torrens property] instructive." *Mavco, Inc. v. Eggink*, 739 N.W.2d 148, 158 n.7 (Minn. 2007). Given the similarity of principles concerning the order of recording and notice of outstanding interests, *Ocwen*'s reasoning is instructive in this case.

This Court held in *Ocwen* that a third party lender's mortgage (securing money for the purchase of the property) had priority over a vendor's mortgage (also securing money for purchase of the property) because the third party lender's mortgage was recorded first and because the third party lender did not have notice of the superiority of a vendor's subsequently-filed mortgage where the HUD Settlement Statement unambiguously demonstrated that the vendor's subsequently-filed mortgage was understood to be a "2ND MTG." 649 N.W.2d at 855-59. This Court understood notice to mean more than the third party lender simply knowing about the vendor's mortgage; there must be notice

of a superior interest and the "2ND MTG." reference to the vendor's mortgage did nothing to contradict the third party lender's understanding that its mortgage had first-position priority:

> In this case, however, Ocwen [the third party lender] had no knowledge of an encumbrance inconsistent with its interest in the property because the Jacox [vendor's] mortgage was clearly a "second mortgage" as designated on the HUD-1 Settlement Statement. . . . The fact that Ocwen had notice of the Jacox *second* mortgage does not affect Ocwen's status as a bona fide purchaser at the foreclosure sale. Because Ocwen's mortgage was registered first and Ocwen was a bona fide purchaser, we conclude that Ocwen's mortgage had priority over the Jacox mortgage.

Id. at 857.

Under *Ocwen*'s priority analysis, The RiverBank Mortgage was prior to the Slattengren Mortgage. The RiverBank Mortgage was recorded prior to the Slattengren Mortgage and there is no evidence that RiverBank understood its mortgage to be anything other than a first-position mortgage at the time RiverBank received its mortgage on December 12, 2003 or at any time prior to the recording of its mortgage on December 31, 2003. RiverBank's efforts to ensuring that Burnet Title record The RiverBank Mortgage first was consistent with its understanding that it had a first-position mortgage and the Slattengrens had a second-position mortgage. The HUD Settlement Statement's reference to a second seller carryback mortgage would have confirmed The RiverBank's understanding that The RiverBank Mortgage was in first position. Only the Slattengrens were put on inquiry notice that there was an interest in the property inconsistent with their claim to first position priority. Therefore, the district court erred in deciding priority in favor of the Slattengren Mortgage.

B. *Schoch v. Birdsall* must be read in conjunction with other cases and authorities supporting priority in favor of The RiverBank Mortgage.

Respondent seeks guidance in no Minnesota cases other than *Schoch v. Birdsall*, 48 Minn. 441, 51 N.W. 382 (1892). (*See* Respondent's Brief at 3-12) This omission ignores over a century of other cases and authorities that have addressed purchase money mortgages and the equitable principles underlying purchase money mortgages and their relative priority. *Schoch v. Birdsall* is not the sole authority and final word on this case's priority analysis. It must be read in conjunction with other cases, decided before and after *Schoch*, favoring priority of The RiverBank Mortgage.

There are two aspects of *Schoch* that limit its application to this case. First, it is apparent that the *Schoch* court did not view the third party lender's mortgage as a purchase money mortgage on equal footing with, and attaching at the same time as, the vendor's purchase money mortgage:

> The mortgage to the defendant [third party lender] had not attached before the conveyance by plaintiff [seller] to Bothman [buyer]; neither did the lien thereof intervene between the conveyance to her and her purchase-money mortgage back to plaintiff. The seisin being instantaneous, the lien of plaintiff's mortgage took precedence of any lien, general or specific, created by her.

48 Minn. at 443, 51 N.W. at 382. The *Schoch* court viewed the third party mortgage as an ordinary interest no different than a judgment lien arising through a mortgagor. This reasoning is inconsistent with later Minnesota Supreme Court decisions recognizing the equal footing of a third party's equity in a third party purchase money mortgage and its attachment at the same time:

> If plaintiff's contract for support may also be taken as a purchase-money mortgage, it too would have **attached at the same time** as defendant's. Having **equality of rights** thus far would not plaintiff have had to record to save them? Would or would not defendant's diligence in recording first have saved his and overcome plaintiff's **otherwise equal standing**?

Olson v. Olson, 203 Minn. 199, 202, 280 N.W. 640, 641 (1938) (emphases added). The supreme court in *Marin v. Knox* stated that a third party purchase money mortgagee can acquire the "same equities" as a vendor receiving a purchase money mortgage: "It is also the settled law in this state that a person other than the vendor may obtain a purchase-money mortgage, so called, thereby acquiring the same equities as would the vendor, had he taken the mortgage." 117 Minn. 428, 431, 136 N.W. 15, 16 (1912). This statement of "settled law" runs contrary to *Schoch*'s view of the inherent inequality of the third party lender's mortgage in that case. In light of these later decisions, this aspect of *Schoch*'s reasoning is not controlling in this case.

A second limitation on *Schoch*'s application in this case concerns its discussion of the vendor's lack of knowledge of the third party mortgage. The *Schoch* court noted that the vendor "had no knowledge whatever" of the third party lender's mortgage at the time of sale and at the time of execution and receipt of the vendor's mortgage. 48 Minn. at 443, 51 N.W. at 382. "Upon these facts, plaintiff's [vendor's] mortgage was clearly entitled to the priority." *Id.* Although the court rejected the notion of record notice of the third party's mortgage, any actual notice or inquiry notice by the vendor might have changed the result. *See id.* 48 Minn. at 441, 51 N.W. at 382 (referencing "good faith" and "without notice" in the Syllabus).

Unlike the vendor in *Schoch*, the district court in this case concluded that "the Slattengrens should have known that the RiverBank was providing some funding for the development . . . ." (Add. 17; App. 55). "Should have known" is a standard of inquiry notice under Minnesota law. *Cf. State Bank of Florence v. Lyon County Nat. Bank*, 170 Minn. 161, 212 N.W. 177 (1927) (holding that a fact and circumstances a defendant knew or "should have known" were such as to put it upon inquiry). *See also Miller v. Hennen*, 438 N.W.2d 366, 370 (Minn. 1989) (stating the rule that one is not a bona fide purchaser if he had knowledge of facts which ought to have put him on an inquiry that would have led to a knowledge of such conveyance). The Slattengrens' inquiry notice of a mortgage in favor of RiverBank—evidenced in part by an October 31, 2003 Letter of Undertaking they signed—take this case out of the rule of *Schoch v. Birdsall.*

Several Minnesota cases discussed above and in RiverBank's initial Brief support the priority of The RiverBank Mortgage. *See Citizens State Bank v. Raven Trading Partners, Inc.*, 786 N.W.2d 274, 278, 287 (Minn. 2010); *Olson v. Olson*, 203 Minn. 199, 200-02, 280 N.W. 640, 641 (1938); *Benson v. Saffert-Gugisberg Cement Const. Co.*, 159 Minn. 54, 59, 198 N.W. 297, 299 (1924); *Marin v. Knox*, 117 Minn. 428, 431, 136 N.W. 15, 16 (1912); *Stewart v. Smith*, 36 Minn. 82, 83, 30 N.W. 430, 431 (1886); *In re Ocwen Financial Services, Inc.*, 649 N.W.2d 854, 855-59 (Minn. App. 2002). Other authorities also support RiverBank's priority. *See, e.g., Salem Trust Co.*, 264 U.S. 182, 199 (1924) (applying the equitable principle that "[i]f equities are equal, the first in time is best in right").

Because the doctrine giving precedence to purchase money mortgages "is one of equity, and not of statutory origin," *Stewart v. Smith*, 36 Minn. 82, 83, 30 N.W. 430, 431 (1886), the following discussion of general principles of equity also supports priority of The RiverBank Mortgage:

> . . . Two persons have equal equitable interests in the same subject-matter, when each is equally entitled, with respect of his equitable interest, to the protection and aid of a court of equity. When the court is dealing with such successive equitable interests in the same subject-matter and they are all thus equal, **the priority in time determines the priority in right**; and **the fact that the holder of the subsequent interest, under these circumstances, acquired it without notice of the prior one does not, in general, give him any right to be preferred**.

2 John Norton Pomeroy, *A Treatise on Equity Jurisprudence* § 683, at 945 (Spencer W. Symons ed., 5th ed. 1941) (emphases added). In a footnote to this discussion, Pomeroy's treatise notes that recording acts may impart an "intrinsic superiority" to a mortgage recorded at a time when the other equitable interest is not recorded:

> . . . The recording acts may modify the operation in of the equitable rule in this country, because they give to a recorded mortgage or other equitable encumbrance the very quality which imparts to it an intrinsic superiority, under the statute, over one which is not recorded.

Id. § 683, at 946 n.10.

The RiverBank Mortgage has priority under these principles because it had "priority in time" (it was granted 10 days before the Slattengren Mortgage) and it had the "intrinsic superiority" of being recorded first. As Pomeroy notes, the fact that the Slattengrens, as holders of a subsequent interest, may have acquired their equity in a purchase money mortgage without notice of RiverBank's prior equity in RiverBank's purchase money mortgage "does not" give the Slattengrens "any right to be preferred."

Under these principles, the Slattengren Mortgage would be junior even without any inquiry notice of The RiverBank Mortgage. These principles also obviate the need for analysis of steps that RiverBank or Burnet could have been taken to advise and affirmatively provide notice to the Slattengrens of the intended priority of RiverBank's purchase money mortgage. In addition, these principles make irrelevant any discussion of the need for RiverBank to obtain a subordination agreement from the Slattengrens. The RiverBank Mortgage was "first in time" by 10 days over the Slattengren Mortgage and was recorded first. Subordination was therefore unnecessary. RiverBank obtained a subordination agreement from the Plumleys because the Plumleys' seller carry back mortgage was given on August 7, 2003 and recorded on August 12, 2003—4 months prior to The RiverBank Mortgage. (Add. 4 at ¶ 12; App. 42 at ¶ 12) Under the principles discussed above, subordination in that instance was necessary to give RiverBank first-position priority in the entire St. Croix River Bluffs development. There was no need for a subordination agreement with the Slattengrens because The RiverBank Mortgage was first in time and was recorded first.

The district court found that The RiverBank Mortgage was a purchase money mortgage that was both first in time and recorded first. These facts conclusively establish priority of the RiverBank Mortgage. Therefore, the district court erred in deciding priority in favor of the Slattengren Mortgage.

CONCLUSION

Appellant The RiverBank respectfully requests that this Court reverse the trial decision of the district court and rule that the mortgage of The RiverBank was prior and superior to the Slattengren Mortgage.

Respectfully submitted,

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Certification of Brief Length

I hereby certify that this brief conforms to the requirements of Minn. R. Civ. App. P. 132.01, subds.1 and 3, for a brief produced with a proportional 13 point font. The length of this brief is 3218 words. This brief was prepared using Microsoft Word 2007.

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