

NO. A10-1846

State of Minnesota  
**In Court of Appeals**

James E. Roemhildt and Barbara E. Roemhildt,  
*Respondents,*

vs.

Kristall Development Inc., et al.,  
*Defendants,*  
21st Century Bank,  
*Appellant.*

**APPELLANT'S BRIEF, ADDENDUM, 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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## LEGAL ISSUE PRESENTED

### **I. Does a Blanket Mortgage Over Multiple Lots That Incorporates by Reference a Promissory Note Requiring the Mortgagee to Grant a Partial Release upon Sale of an Individual Lot and Receipt of \$10,000.00, Run With the Land So That a Subsequent Owner of an Individual Lot May Enforce the Partial Release Covenant upon Tender of \$10,000.00?**

At trial, the subsequent owner of the subject parcel sought a ruling that the mortgagees must grant a partial release of their mortgage in exchange for payment of \$10,000.00 plus accrued interest. (A.9-12, 15-17.<sup>1</sup>) In its Final Order for judgment, the district court concluded that the covenant to grant a partial release is not enforceable because it was contained in the promissory note, not in the mortgage itself, and because the subsequent owner was “not in privity with any of the parties to the promissory note.” (Add.6-8, 11-12.<sup>2</sup>)

#### Apposite Cases:

*Vawter v. Crafts*, 41 Minn. 14, 42 N.W. 483 (1889).

*McManaman v. Hinchley*, 82 Minn. 296, 84 N.W. 1018 (1901).

*Jackson v. MERS, Inc.*, 770 N.W.2d 487 (Minn. 2009).

*National City Bank v. Engler*, 777 N.W.2d 762 (Minn. App. 2010).

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<sup>1</sup> “A. \_\_\_” refers to Appellant 21<sup>st</sup> Century Bank’s Appendix.

<sup>2</sup> “Add. \_\_\_” refers to Appellant 21<sup>st</sup> Century Bank’s Addendum.

## STATEMENT OF THE CASE

This action commenced as a mortgage foreclosure action concerning multiple parcels in Le Sueur County, Minnesota. In 2004, Respondents James E. and Barbara E. Roemhildt sold a tract of land to Kristall<sup>3</sup> Development, Inc. Because Kristall Development could not pay the full purchase price, it granted the Roemhildts a mortgage in the amount of \$360,000.00 (“Respondents’ Mortgage”) to secure a promissory note (“Note”) for the amount of the unpaid balance. (Add. 14, 16.) Respondents’ Mortgage references the Note, which contains a provision stating that upon the sale of each lot of the encumbered parcel, Respondents would execute a partial release in exchange for payment of \$10,000.00.

In 2005, Kristall Development sold Lot 2 of the property to Kristall Homes, Inc., which granted a promissory note and mortgage to FCC Acquisition Corp. (Add.18-23.) However, there is no evidence that Kristall Development remitted \$10,000.00 to Respondents; no partial release was issued. Appellant 21st Century Bank took assignment of FCC Acquisition’s mortgage, and Kristall Homes subsequently defaulted. 21st Century took title to Lot 2 following Kristall Homes’ voluntary foreclosure.

In September 2008, Respondents commenced the present action to foreclose Respondents’ Mortgage after Kristall Development defaulted under the terms and conditions of the Note and Respondents’ Mortgage. As a named defendant in this foreclosure action, 21st Century brought a motion for partial summary judgment seeking

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<sup>3</sup> Although the caption reads “Krystall Development Inc.,” all relevant documents in the record reference that entity as “Kristall Development, Inc.” Hence, the latter appellation will be used herein.

a ruling that upon its tender of \$10,000.00, Respondents were obligated to issue a partial release for Lot 2. On July 9, 2009, the Honorable M. Michael Baxter denied 21st Century's motion, finding genuine issues of material fact concerning the Note.

Following a March 15, 2010 trial, Judge Baxter issued a Final Order for Judgment, ruling *inter alia* that the partial release provision did not run with the land because it was contained in the Note rather than in Respondents' Mortgage. Judge Baxter further ruled that 21st Century could not enforce the partial release covenant because neither 21st Century nor its assignor FCC Acquisition were in privity with Respondents and Kristall Development. (Add.6-8, 11-12.) Judgment was entered on August 19, 2010. This appeal followed.

## STATEMENT OF FACTS

On May 12, 2004, Respondents James E. and Barbara E. Roemhildt sold undeveloped property located in Elysian, Minnesota to Kristall Development, Inc. (Add.13.) The parcel – which was later platted into approximately thirty-six lots – has the following legal description: Roemhildts Waters Edge Third Addition, LeSueur County, Minnesota [“the Addition”]. (*Id.*)

Kristall Development was unable to pay the entire purchase price at closing. Accordingly, it made a promissory note (“Note”) in Respondents’ favor in the amount of \$360,000.00 to cover the remaining balance. (Add.16). It also conveyed to Respondents a mortgage in that amount (“Respondents’ Mortgage”) to secure payment of the Note. (Add.14). By its terms, Respondents’ Mortgage was subordinate to the mortgages Kristall Development had already granted to Lakeland Construction Financing, LLC (“Lakeland”) to secure loans taken to finance the lion’s share of the Addition’s purchase price. (T.6;<sup>4</sup> Add.14; Ex. A to Affidavit of Joel A. Hilgendorf, dated February 2, 2009, submitted in support of Lakeland’s motion for default judgment.) Lakeland’s mortgages are beyond the scope of this appeal.

The second sentence of Respondents’ Mortgage specifically references the Note. (Add.14; T.17.) The terms of the Note require Kristall Development to pay \$360,000.00 (together with interest on any unpaid principal balance at the rate of 8% simple interest per annum) by May 12, 2006. (Add.16.) In addition, the Note explicitly sets forth the following obligation on the part of Kristall Development and Respondents:

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<sup>4</sup>“T. \_\_\_” refers to the transcript of the trial held in this matter on March 15, 2010.

**In addition \$10,000.00 is due upon the sale of each lot at the time of closing. Roemhildt [the Respondent Mortgagees] will provide a partial release for each lot sold.**

(*Id.*) (emphasis added). Notably, paragraph 10 of the Note further states that it “shall be binding upon Maker and Maker’s successors, and assigns.” (Add.17.) Although the Note is not executed, in their foreclosure Complaint, Respondents specifically rely upon the terms of the Note. (*See* A.2.) Moreover, at trial, Mr. Roemhildt fully admitted that he and his spouse were trying to foreclose the mortgage because they “have not been paid according to the terms of the note.” (T.9.)

In May 2005, Kristall Development sold Lot 2, Block 9 (“Lot 2”) of the Addition to Kristall Homes.<sup>5</sup> (Add.18-23.) In connection with that sale, Kristall Homes obtained a construction loan from FCC Acquisition Corp. in the principal amount of \$151,000.00, secured by a mortgage for that same amount. (Add.19-22.) At the closing, Lakeland provided a partial release of its prior mortgages with respect to Lot 2. (A.28.) However, no partial release was obtained with respect to Respondents’ Mortgage. Soon after the closing of the construction mortgage, Kristall Homes constructed a home on Lot 2.

In May 2008, FCC Acquisition assigned its mortgage against Lot 2 to Appellant 21st Century. (Add.24.) Subsequently, Kristall Homes defaulted on that mortgage. On July 21, 2008, Kristall Homes entered into a voluntary foreclosure agreement with 21st Century (Add.25-27), which ultimately took title to Lot 2 in the absence of any party’s redemption. Respondents were served with a notice of foreclosure as they were residing

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<sup>5</sup> Although not entirely clear from the record, the mortgaged parcel was carved into 36-40 lots. (T.10-11.)

at the home built on Lot 2 at the time the voluntary foreclosure was commenced. (A.29-31.) Respondents testified to having moved into the residence in November 2007 pursuant to an agreement with Kristall Development that allowed them to stay in the house pending execution of a contract for deed sale that never occurred. (T.14-15.)

Although not the subject of the present appeal, only one other lot encumbered by Respondents' Mortgage was sold – Lot 1, Block 9. Lakeland also provided a partial release of its prior mortgages with respect to Lot 1 upon sale of that lot. After Kristall Development defaulted on the terms of Respondents' Mortgage, Respondents obtained a judgment in the amount of \$351,768.90. (A.22-23.) In May 2009, Respondents entered a bid of \$154,409.80 at the sheriff's sale of Lot 1. The foreclosure sale and redemption for \$153,448.00 were ultimately confirmed. (A.24-27.)

In September 2008, Respondents commenced the present foreclosure action after Kristall Development defaulted on Respondents' Mortgage. As a named defendant, 21st Century sought a partial summary judgment ruling that upon 21<sup>st</sup> Century's tender of \$10,000.00, Respondents were obligated to issue a partial release for Lot 2. On July 9, 2009, the Honorable M. Michael Baxter denied 21st Century's motion, finding genuine issues of material fact concerning the Note.

Following the March 15, 2010 court trial, Judge Baxter filed a Final Order for Judgment, determining that 21st Century could not enforce the partial release provision in the Note because that covenant did not run with the land. Judge Baxter further ruled that neither 21st Century nor its assignor were in privity with Respondents and Kristall

Development when they concluded Respondents' Mortgage and the Note. (Add.6-8, 11-12.) Final Judgment was entered on August 19, 2010.

This appeal followed.

## ARGUMENT

### **I. Standard of Review.**

The district court's interpretation of a mortgage contract presents a question of law subject to *de novo* review. *See, e.g., Nat'l City Bank v. Engler*, 777 N.W.2d 762, 765 (Minn. App. 2010). Courts may not rewrite, modify, or limit the effect of an unambiguous contract. *Id.* (citing *Travertine Corp. v. Lexington-Silverwood*, 683 N.W.2d 267, 271 (Minn. 2004)). Instead, courts must "construe a contract as a whole and attempt to harmonize all clauses of the contract." *Chergosky v. Crosstown Bell, Inc.*, 463 N.W.2d 522, 525 (Minn. 1990).

### **II. The District Court Erred as a Matter of Law in Concluding that Respondents' Covenant to Issue a Partial Release upon Sale of Each Individual Lot and Receipt of \$10,000.00 Does Not Run With the Land.**

The district court has erroneously relied upon the language in *Winne v. Lahart*, 155 Minn. 307, 309, 193 N.W. 587, 588 (1923) (citing *White v. Miller*, 52 Minn. 367, 372-73, 54 N.W. 736, 737 (1893)) in ruling that Appellant 21st Century may not enforce the partial release contained in the Note – but not in Respondents' Mortgage – because they constitute "separate and distinct instruments." (Add.11-12.) However, in *Winne*, the supreme court merely held that a debt owed under a promissory note cannot be accelerated to obtain a **personal judgment** against the borrower, based on acceleration terms that appear in the mortgage, rather than in the promissory note. 155 Minn. at 310, 193 N.W. at 589. In fact, as the *Winne* court explained, in case of default, a mortgagee "has two distinct remedies. . . he may sue on the note and recover an ordinary personal judgment, or he may resort to the security of the mortgage and have the mortgaged

property sold and apply the proceeds to the payment of the debt.” *Id.* at 309-10, 193 N.W. at 588-89. Hence, while a note permits the lender to obtain a personal judgment against the borrower, a mortgage creates a security interest against the property.

**A. A Mortgage Cannot Exist Separately from the Debt It Secures.**

However, the fact that a borrower may only be subject to personal liability under the terms of a promissory note **does not mean that a mortgage has a “separate and distinct” existence apart from the debt (i.e., the promissory note) it is securing.**

Consider the following commentary:

A mortgage is but an incident of the debt that it secures and **can have no separate or independent existence** as a contract. If the debt is invalid for any reason, the mortgage is invalid.

**The underlying debt secured by the mortgage is generally regarded as the primary obligation between the parties,** the mortgage being incidental to the debt secured, since the lien of the mortgage is no greater than the actual debt. An obligation to be secured is essential to the valid existence of any mortgage.

31 Dunnell Minn. Digest, *Mortgages* § 1.07a. (5th ed. 2009) (citations omitted)

(emphasis added). Accordingly, in *McManaman v. Hinchley*, the Minnesota Supreme

Court explicitly stated:

The payment cannot be held to have had the effect of continuing the mortgage separate and independently of the unpaid note. The payment was made upon the debt, and not upon the mortgage as an independent contract. **The mortgage is but an incident of the debt and can have no separate or independent existence as a contract.**

82 Minn. 296, 297-98, 84 N.W. 1018, 1018 (1901) (emphasis added). 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.

More recently, the supreme court has recognized the “debt obligation or promissory note [as] the principal part of a mortgage transaction.” *Jackson v. MERS, Inc.*, 770 N.W.2d 487, 493 (Minn. 2009) (citing 4 George E. Osborne, *American Law of Property* § 16.107 (1952)). While promissory notes relate to the personal obligation and mortgages involve an interest in realty, these separate instruments are “legally intertwined” because the mortgage exists solely to secure the obligation set forth in the note. *Jackson*, 770 N.W.2d at 493. According to the *Jackson* court, “[T]he security instrument can have no separate or independent existence apart from the debt it secures.” *Id.* at 493-94. Similarly, the Minnesota Court of Appeals has viewed both the mortgage and promissory note as being part of the ‘mortgage contract.’ *See Engler*, 777 N.W. at 765-66 (“We conclude that all provisions of **this contract can be harmonized**: Harold Engler signed **the promissory note and mortgage. . .**”) (emphasis added).

In the instant case, Respondents' Mortgage – which encumbers *inter alia* Lot 2 -- specifically references the Note. Because the terms of the Note are incorporated by reference, they must be considered when interpreting the mortgage contract. *See Chergosky*, 463 N.W.2d at 525 (in interpreting a contract, courts must “construe a contract as a whole and attempt to harmonize all clauses of the contract”). Moreover, as seen above, the mortgage has no existence apart from the debt (i.e., the promissory note) it secures. Hence, the district court has erred as a matter of law in ruling that 21st

Century may not enforce the partial release clause simply because it is contained in the Note rather than in Respondents' Mortgage.

**B. Privity Is Not the Relevant Inquiry.**

After wrongly deeming the partial release's placement in the Note rather than in Respondents' Mortgage to be dispositive, the district court went on to conclude that 21st Century was not in privity "with a party to the promissory note." (Add.12.) However, privity is not the relevant inquiry; whether the covenant runs with the land is the touchstone of the present controversy.

According to the Colorado Court of Appeals, "Whether a provision for partial releases in a note<sup>6</sup> or encumbrance is barred by a payor's default in the performance of the general obligations under those instruments is a question upon which the courts are in apparent disagreement." *Rolfes v. O'Connor*, 844 P.2d 1330, 1332 (Colo. Ct. App. 1992) (emphasis added) (citing J.R. Kemper, *Construction of Provision in Real Estate Mortgage, Land Contract, or Other Security Instrument for Release of Separate Parcels of Land as Payments Are Made*, 41 A.L.R. 3d 7 at 56-109 (1972)). Although the specific terms of a given contract are critical to resolution of each case, both authorities cited in the sentence above recognize *Vawter v. Crafts*, 41 Minn. 14, 42 N.W. 483 (1889) as the leading case supporting the majority view that a partial release may be enforced even after foreclosure proceedings have been commenced. *See also Columbia Dev., Inc. v. H.R. Watchie*, 448 P.2d 360, 362 (Oregon 1968).

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<sup>6</sup> Clearly, the Colorado Court of Appeals is not the least concerned with whether the partial release covenant is contained in the note or in the mortgage.

*Vawter* is significant to this case for two reasons. First, in *Vawter*, the Minnesota Supreme Court ruled that the partial release covenant (albeit contained in the mortgage instrument itself) ran with the land to the benefit of the mortgagor's grantee even following the mortgagor's default:

The rule, we think, is universal that the benefit passes with the land to which it is incident. . . **The release is for the benefit of the owner**; in fact, no one but the owner could be benefited by it. It would be against reason, if it did not inure to the grantee of the covenant. This provision was manifestly inserted in the mortgage with reference to the sale of these lots, when platted, to different parties, and to facilitate such sales. . . These sales could be made in two ways – **First, by the mortgagors paying the sum or sums stipulated, and obtaining a release, and then conveying clear title to the purchaser; or second, selling subject to the mortgage, and leaving it to the purchaser to pay and obtain the release. It is argued from the fact that the covenant does not contain the words “or assigns,” it was intended as a personal one with the mortgagors. We do not think this fact is entitled to any weight.** The question must be determined from the nature and subject-matter of the covenant itself.

*Vawter*, 41 Minn. at 16, 42 N.W. at 484 (emphasis added). Thus, in *Vawter*, the supreme court recognized the importance of the ultimate purpose of the mortgage contract in construing the terms of that contract. Just as in *Vawter*, in the instant case, a partial release runs to the benefit of any subsequent owner and was essential to the mortgagor's ability to sell parcels and to meet its debt obligation set forth in the Note and secured by Respondents' Mortgage. Significantly, although the *Vawter* court did not find the covenant's lack of any reference to “assigns” as dispositive of whether it ran with the land, the instant covenant specifically contemplates that the covenant be binding upon the “Maker's successors, and assigns.” (Add.17.) Thus, there is an even stronger basis for maintaining that it runs with the land than in *Vawter*.

In any event, it is generally recognized that a covenant runs with the land if: (1) the grantor/grantee intended it to do so; (2) the covenant touches and concerns the land; (3) there is “privity of estate between the original parties to the covenant, the original parties and the present litigants, or between the party claiming the benefit of the covenant and the party burdened”; (4) the covenant is in writing; and (5) the successor of the burden had notice. See W.E. Shipley, *Comment Note. – Affirmative covenants as running with the land* 68 A.L.R. 2d 1022, at § 2 (1959) (citing *Jeremiah 29:11, Inc. v. Seifert*, 161 P.3d 750 (Kan. 2007)). Applying those factors to the present case: the Note states the covenant is to be binding on successors; *Vawter* tells us that the covenant touches and concerns the land; there was privity between the original parties to the covenant (as well as between the borrower Kristall Development and the subsequent purchaser Kristall Homes);<sup>7</sup> the covenant is written in the Note, which is referenced in Respondents’ Mortgage; and Respondents most certainly had notice of their burden of issuing a partial release upon the sale of a single lot and receipt of \$10,000.00.

Moreover, although there appears to be a split in jurisdictions, other courts have held 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. See *Fetes v. O’Laughlin*, 17 N.W. 764, 765 (Iowa 1883); *Wilson v. Vaughan*, 61 Miss. 472, 1884 WL 6446, at \*1-2 (1883); *Clementz v. M.T. Jones Lumber Co.*, 18 S.W. 599, 601 (Texas 1891). Similarly, other jurisdictions have charged a subsequent purchaser

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<sup>7</sup> The owners of Kristall Development also own Kristall Homes. (*Compare* Add.18 with Add.26.)

with constructive notice of attorney fee provisions set forth in a promissory note that is referenced in the corresponding mortgage. *See Parker v. McGinty*, 239 P. 10, 11 (Colo. 1925) (“the mortgage, however, by reference to the note, puts all purchasers on inquiry as to its terms”).

**C. Failure to Reverse Would Result in a Windfall to Respondents.**

The *Vawter* decision is also critical to the analysis here as it recognizes the danger of a windfall to the mortgagee should the partial release covenant not run with the land. There, the supreme court noted that if the third-party owner of less than all the lots were not entitled to a partial release and had to pay the full amount of the blanket mortgage upon the mortgagor’s default, that “would defeat the very purpose for which the covenant was inserted.” 41 Minn. at 17, 18, 42 N.W. at 485 (yet, mortgagee suffers no prejudice and receives full benefit of initial bargain if covenant is enforced); *see also Rolfes*, 844 P.2d at 1332-33 (under enforcement of partial release following default, “the mortgagee would receive for the lands to be released all that he otherwise would have received”).

Here, the district court’s conclusion that Respondents need not grant a partial release of Respondents’ Mortgage as to Lot 2 upon receipt of \$10,000.00 results in an inequitable windfall. More specifically, the court’s ruling will allow Respondents to bid in excess of \$190,000.00 at the foreclosure sale of Lot 2 – the difference between the total amount of their \$351,768.90 judgment (A.22-23) less the \$153,448.00 they received from the sale and redemption of Lot 1, Block 9 (A.26). Correspondingly, 21st Century will need to pay Respondents the total amount of Respondents’ bid in order to preserve

its title in Lot 2. Had the sale of Lot 2 proceeded in the manner Respondents envisioned, they would have received \$10,000.00 -- the amount for which they bargained -- and been obligated in exchange to grant Kristall Development a partial release. Under the district court's erroneous ruling, Respondents now stand to recover many times that amount upon the sheriff's sale of Lot 2, with 21st Century bearing the burden of funding Respondents' windfall. Yet, Respondents never bargained for such a result in their loan transaction with Kristall Development. *See Travertine*, N.W.2d at 271 (courts may not rewrite, modify, or limit the effect of an unambiguous contract). Indeed, had Lots 1 and 2 never sold, Respondents likely would not have received any payment whatsoever upon foreclosure. Under those circumstances, Lakeland would not have issued a partial release for those lots; since Lakeland's mortgages had priority over Respondents' Mortgage, Lakeland's foreclosure would have resulted in extinguishment of Respondents' Mortgage absent Respondents' redemption from the foreclosure sale.

Furthermore, Respondents even admitted at trial that because a house has been built on Lot 2 since the recording of Respondents' Mortgage (which references the Note), Lot 2 is now far more valuable than the \$10,000.00 required to obtain a **partial release** upon the sale of any given lot. (T.19.) In fact, Respondents stood by and watched the value of Lot 2 increase without demanding payment of \$10,000.00 (T.12) or significantly contributing to the lot's accretion in value. Instead of unfairly obtaining a bonanza at the current owner's expense, Respondents should be ordered to issue a partial release upon 21st Century's tender of \$10,000.00. *See Vawter*, 41 Minn. at 16, 42 N.W. at 484 ("The release is for the benefit of the owner."). Anything else would place Respondents in a

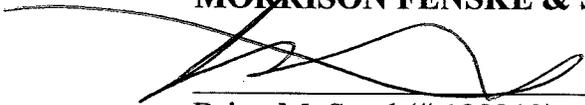
better position than that for which they initially bargained (i.e., the right to partial payment of \$10,000.00 for each lot sold).

Finally, by analogy, recent caselaw in the mechanic's lien realm compels a reversal of the district court's conclusion. In *Premier Bank v. Becker Dev., LLC*, the Minnesota Supreme Court clarified that the full value of a blanket mechanic's lien may not be enforced against less than all of the property subject to the lien. 785 N.W.2d 753, 762 (Minn. 2010) (rejecting notion that a lien holder may "enforce a blanket lien in a manner that results in a disproportionate burden on a small fraction of the lots subject to the lien"). **Similarly, to allow Respondents to enforce a blanket mortgage on just two of the roughly 36 lots subject to that mortgage would violate all principles of equity and fair-play.**

### CONCLUSION

Appellant 21st Century Bank respectfully requests that this Court reverse the district court and order Respondents to issue a partial release as to Lot 2 in exchange for 21st Century's tender of \$10,000.00.

Respectfully submitted,  
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