

NO. A10-1846

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State of Minnesota  
 In Court of Appeals

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

v.

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

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APPELLANT'S REPLY BRIEF

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## ARGUMENT

Respondents miss the mark in maintaining that the covenant to grant a partial release does not run with the land to the extent it protects the current owner of Lot 2 and obligates Respondents to issue a partial release in exchange for receipt of \$10,000.00. Similarly, Respondents' reliance on the applicability of the Minnesota Recording Act is misplaced.

Moreover, Respondents' attempt to foreclose Lot 2 for more than \$10,000.00 is an inequitable attempt to undo its bargained-for second lien position to Lakeland's mortgage.

### **I. Under Minnesota Law, the Covenant Here Runs with the Land and Is Enforceable against Respondents.**

The *Vawter* opinion removes all doubt that the benefit of a partial release covenant runs with the land. (*See* Appellant's Brief, p.12.) Because such a release is for the benefit of the owner, "It would be against reason, if it did not inure to the grantee of the covenantee." *Vawter*, 41 Minn. 14, 16, 42 N.W. 483, 484 (1889). Significantly, the *Vawter* court further recognized that the sales of the mortgaged lots could be accomplished in two ways, either by the mortgagor paying the stipulated sum and obtaining a release or by the purchaser buying subject to the mortgage and then paying the stipulated sum and obtaining the release. *Id.* As Appellant's previously set forth, the test for the covenant running with the land has been met here. (*See* Appellant's Brief, p.13.) Indeed, the Minnesota Supreme Court has long held that a covenant runs with the land "when either the liability to perform it (i.e., its burdens), or the right to take

advantage of it (i.e., its benefits) passes to the assignee of the land.” *First Nat. Bank of Fergus Falls v. Security Bank of Minnesota*, 61 Minn. 25, 28, 63 N.W. 264, 265 (1895). Here, the promissory note explicitly states, “This Promissory Note shall be binding upon Maker and Maker’s successors, and assigns.” (Add.17.)

Furthermore, Respondent is unable to refute the *Jackson* and *Engler* decisions, which view the mortgage and promissory note as “legally intertwined” and as being part of a “harmonized” mortgage contract. (See Appellant’s Brief, p. 10.) Respondent has failed to understand the distinction between the promissory note and the mortgage. Only the note operates to hold the promissor personally liable for the debt, while the mortgage itself creates an interest in realty that exists solely to secure the obligation set forth in the note. See *Jackson*, 770 N.W.2d at 493 (“The debt obligation or **promissory note is the principal part of a mortgage transaction.**”) (emphasis added). Yet, while mortgages are generally recorded, promissory notes are not. Hence, Respondents’ argument that the terms of the note cannot run with the land because they are not explicitly contained in a recorded document is unfounded. Respondents are unable to refute the fact that in *Engler* -- just last year -- this Court explicitly viewed the promissory note as part of the mortgage contract. 777 N.W.2d at 765-66 (“Respondent was not a borrower and respondent did not sign the promissory note, which is part of the contract.”).

To further illustrate the principle that the note is the principal part of the mortgage contract, Appellant referenced a series of extra-jurisdictional cases holding that a subsequent mortgagee has notice of the amount due where that amount is set forth in the corresponding promissory note rather than in the recorded mortgage. (See Appellant’s

Brief, pp. 13-14.) Respondents' attempt to distinguish those cases (*Fetes*, *Wilson*, *Clementz*, and *Parker*) by relying on the *Whitacre* decision is flawed. (See Respondents' Brief, p. 13.) First of all, the facts and legal disputes in *Whitacre* do not involve partial release provisions. *Whitacre* involves comparing the terms of separate and distinct mortgages, which differs qualitatively from the present factual and legal circumstances. Second, in *Whitacre*, it is unclear whether the first mortgage explicitly mentions the rate of interest or merely states that the interest rate is "specified in the note." In addition, it is unclear whether the second mortgage states that the interest rate to be applied is specified in the note or is simply completely silent as to the interest rate to be employed. See *Whitacre v. Fuller*, 5 Minn. 508, 1861 WL 1837 at \*6 (Minn.). Hence, *Whitacre* is hardly dispositive here.

Instead, *Whitacre* recognizes the principle that "subsequent purchasers" need notice. *Id.* That opinion stands for the limited proposition that a subsequent purchaser is not charged with notice of interest rates agreed upon by a prior mortgagee and borrower that are not identified in the prior recorded mortgage. *Id.* Indeed, the purpose of the Recording Act is to provide a bona fide purchaser with notice of the inconsistent outstanding rights of others. *E.g.*, *Chergosky*, 463 N.W.2d at 524. Clearly, notice is the touchstone. Quite obviously, under the Recording Act, notice is to protect the subsequent purchaser for value. Respondents do not fall within that class. Respondents had notice of the lot release provision. They authored and benefitted from it in prior closings. Because the Roemhildt Mortgage was recorded, owner 21<sup>st</sup> Century Bank had constructive notice that Lot 2 is subject to the terms of that mortgage "and note."

(Add.14.) From the Roemhildt Mortgage's property description, it is readily apparent that Lot 2 is only a small portion of the property subject to that blanket mortgage. This constructive notice was enough for 21<sup>st</sup> Century Bank to learn of the covenant for a partial release contained in the note. Accordingly, *Whitacre's* emphasis on notice, and Respondents' reliance upon it, do not affect the analysis of this case.

In any event, it is beyond dispute that **Respondents had notice of their duty under the promissory note to provide a partial release upon receipt of \$10,000.00 in conjunction with the sale of each lot.** Respondents also knew that this obligation extended to the Maker's (i.e., Kristall Development's) successors. (Add.17.)

Moreover, the covenant at issue here is qualitatively different from an outstanding, inconsistent right such as an easement or a restrictive use. Just as in *Vawter*, the covenant itself is designed to protect the new owner – through the partial release of Respondent's mortgage – once the parcel has been sold. Here, Appellant 21<sup>st</sup> Century is the owner entitled to the partial release covenant.

Respondent attempts to muddy the analysis by contending that 21<sup>st</sup> Century is unwilling to undertake the obligations of the mortgagor under the note:

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 obligation under the Note. . . .**

(*See* Respondents' Brief, p. 14) (emphasis added). Nothing could be further from the truth -- in fact, 21<sup>st</sup> Century has made it clear that it is willing to pay the \$10,000.00 required under the terms of the note in exchange for a partial release. (A.9, 17.)

## **II. Absent Reversal, Respondents Will Reap an Inequitable Windfall**

Although Kristall Development granted Respondents the Roehmildt Mortgage in the amount of \$360,000.00, Lot 2 is not subject to that full amount upon foreclosure. The record indicates that Lot 2 comprises roughly 1/36<sup>th</sup> of the property described in the mortgage. (Add.14; T.10-11.) It is also beyond dispute that Respondents knew their mortgage had second lien position to Lakeland's mortgage. (Add.14; T.6.) Furthermore, from the unambiguous language of Respondents' mortgage and promissory note, it is clear that Respondents understood they were entitled to payment of \$10,000.00 – not \$360,000.00 – upon the mortgagor's sale of each lot.

As recognized in *Premier Bank* – albeit in the mechanic's lien context – it is inequitable to “enforce a blanket lien in a manner that results in a disproportionate burden on as small fraction of the lots subject to the lien.” 785 N.W.2d 753, 762 (Minn. 2010). Respondents have utterly misstated the holding in *Premier Bank* by relating the very holding that was ultimately reversed on appeal. (See Respondents' Brief, pp. 18-19.) Although the *Premier Bank* court permitted the foreclosure of a blanket lien, it most certainly did not allow Kuechle to foreclose its entire lien amount against those three lots. In fact, the supreme court held that Kuechle's lien for the three model-home lots was “limited to the pro rata amount of the lien, or a fifty-ninth of the entire amount, per lot.” 785 N.W.2d at 763. In short, Respondents' attempt to recoup the entire amount of the blanket mortgage on just two of the 30-plus lots constitutes nothing more than an improper ruse to undo its loss of priority to Lakeland's mortgage on all but two of the lots.

Furthermore, in *Vawter*, the supreme court recognized and eliminated the possibility of a mortgagee receiving an inequitable windfall upon the mortgagor's default by confirming that the purchaser has the absolute right to retain ownership of the property by paying the stipulated per lot sum as opposed to the entire blanket sum secured by the mortgage. 41 Minn. at 18, 42 N.W. 485 ("the right to a partial release upon the stipulated terms continues until the mortgagee has fully executed the power by sale of the mortgaged premises").

Respondents' seeking of more than \$10,000.00 upon the foreclosure of Lot 2 is also inequitable because the current residence on Lot 2 was not constructed until well *after* Kristall Development granted the mortgage in 2004. At trial, Respondents admitted that Lot 2 is worth far more now than the specified sum of \$10,000.00 that it agreed to accept in exchange for a partial release. In fact, Respondents have resided in that residence free of charge since November 2007 because mortgagor Kristall Development allowed Respondents to stay pending execution of a contract for deed sale that never occurred. (*See* Appellants' Brief, pp. 6, 15.) Simply put, Respondents are trying to reap profits from development of Lot 2, profits to which they are not entitled. The promissory note incorporated into the terms of the Roemhildt Mortgage contract entitles them to nothing more than \$10,000.00.

Finally, this Court should ignore Respondents' blatantly inappropriate reference to the existence of title insurance in this case. (*See* Respondents' Brief, p. 19.) *See, e.g., Clark v. Johnson Bros. Constr.*, 370 N.W.2d 896, 900 (Minn. App. 1985) (it is improper to reference insurance coverage solely for purpose of reducing liability). Moreover, apart

from being irrelevant and prejudicial, no evidence of title insurance coverage was presented at trial. Respondent's reliance on "A.14" (*see* Respondents' Brief, p. 19 n. 31) is unfounded. This "representation" that title coverage will apply here is made by opposing counsel in an unsubstantiated post-trial letter brief. *See Toth v. Arason*, 722 N.W.2d 437, 443 (Minn. 2006) (reviewing court may consider "only those issues that the record shows were presented to and considered by the trial court").

**CONCLUSION**

Reversal is warranted under the unambiguous terms of the note, which forms part of the mortgage contract. Appellant 21<sup>st</sup> Century Bank respectfully requests that this Court reverse the trial court's judgment and order Respondents to issue a partial release as to Lot 2 in exchange for 21<sup>st</sup> Century's tender of \$10,000.00.

Respectfully submitted,

**MORRISON FENSKE & SUND, P.A.**

Dated: \_\_\_\_\_

1-10-11

By: \_\_\_\_\_



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