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**STATE OF MINNESOTA
IN COURT OF APPEALS
A11-794**

J. Ward Passe, et al.,
Appellants,

vs.

Michael E. Kohser, et al.,
Respondents.

**Filed June 25, 2012
Affirmed in part, reversed in part, and remanded
Ross, Judge**

Rice County District Court
File No. 66-CV-07-3606

David Hvistendahl, Mary L. Hahn, Hvistendahl, Moersch, Dorsey, & Hahn, P.A.,
Northfield, Minnesota (appellants)

Lance R. Heisler, Lampe Law Group, L.L.P., Northfield, Minnesota (for respondents)

Considered and decided by Rodenberg, Presiding Judge; Ross, Judge; and Harten,
Judge.*

UNPUBLISHED OPINION

ROSS, Judge

The Passes sold their lake home to the Kohsers, and at the closing, the Passes
funded an escrow account for potential repairs. After the Kohsers took possession, they

* Retired judge of the Minnesota Court of Appeals, serving by appointment pursuant to
Minn. Const. art. VI, § 10.

discovered roof infirmities not noticed by the agreed-upon roof inspector. They had the roof replaced, installed a new septic system, and hired a contractor to landscape and build a water diversion system. The parties made claims and counterclaims over the escrow funds and the cost of the new roof and septic system. The district court conducted a bench trial and concluded that the Kohsers were entitled to contract damages for the roof and septic system along with attorney fees. It dismissed all other claims. The Passes appeal, arguing that the district court erred by reforming the escrow agreement to award the Kohsers attorney fees and by finding that the Passes had breached the purchase agreement. The Kohsers contend on cross-appeal that the district court erred by not finding that they are third party beneficiaries of the escrow agreement. They also argue that the district court erred by limiting their damages and by dismissing their misrepresentation and fraud claims.

We affirm in part because the district court correctly calculated damages for roof repair, correctly applied the doctrine of merger to extinguish all nonpreserved contract obligations at closing, and correctly dismissed the Kohsers' misrepresentation and fraud claims for failure to prove damages. But we reverse in part and remand because the district court erred by reforming the escrow agreement to award attorney fees and because its judgment omitted the cost of the septic system electrical work.

FACTS

In July 2006, Michael and Sharon Kohser proposed a purchase agreement to buy a lake home in Rice County from J. Ward Passe and Ann Passe for \$340,000. The offer included five preclosing obligations for the Passes: (1) testing the water quality;

(2) inspecting the septic system; (3) sloping land away from the garage and installing drain tile; (4) sloping land away from the house; and (5) removing a buried oil tank. If the water quality test or septic system inspection revealed a problem, the offer would require the Passes to solve it before the closing. The Passes tendered a counteroffer with a \$354,500 purchase price and agreed to slope the land from the house and remove the oil tank. It stated that all other terms and conditions proposed in the July draft purchase agreement were accepted.

The Kohsers accepted the counteroffer. The Kohsers hired home inspector Ken Skok to inspect the property. Skok noted soft plywood areas of the roof and recommended that the Kohsers employ a licensed roofing inspector.

The Kohsers sought to amend the purchase agreement to address the roof problems identified by Skok. They asked the Passes to “[w]arrant or repair spongy areas of roof (east side of roof and just west of chimney).” The Passes rejected the proposed amendment and counter-proposed the following language, which the Kohsers accepted:

Sellers will have the contractor who worked on the roof two years ago inspect the roof and if the roof needs repair and/or replacement, Sellers will by closing either: (1) Have the roof repaired and/or replaced by a licensed roofing contractor or (2) Escrow an amount equal to one-and-one half times the amount of the estimated cost of the repair and/or replacement.

By closing on October 20, 2006, the Passes had not gotten the roof inspected, had not installed the septic or drainage systems, and had not removed the buried oil tank. They instead deposited \$34,650 into an escrow account under an escrow agreement with Rels Title. The agreement covered funds for two items: \$17,400 for a new septic system

at an estimated cost of \$11,600, and \$17,250 for a roof inspection and repair at an estimated cost of \$11,500. Although Michael Kohser negotiated for the amount of the escrow, neither he nor his wife signed the escrow agreement. The agreement stated that it was made by the Passes “for the benefit and protection of Rels Title.” It included an attorney fees provision, which stated that “if it shall become necessary for [Rels Title] to bring suit to enforce this Agreement, then [the Passes] will be responsible for the attorney’s fees incurred by [Rels Title] in bringing such suit.” According to Michael Kohser, the Rels Title representative who typed the agreement told him that it was created for the Kohsers’ protection to ensure that the Passes would pay for the roof and septic system and that the Kohsers would recover attorney fees if they had to sue to collect payment.

Before closing, the Passes had contacted Matt Garlie of G & G Roofing, the roofer who had replaced the roof in 2004, to arrange for inspection. Garlie told the Passes that he “had two years’ worth of work, and he wasn’t apt to get out there to look at the roof.” At the closing, the Passes informed the Kohsers of Garlie’s backlog and the lack of an inspection, but the parties closed anyway. They agreed that Michael Kohser would be present when the roof inspection eventually occurred. After the closing, the Passes again contacted Garlie to inspect the roof. They wrote him a letter asking him to “examine the roof and report your feelings about the roof’s condition.” They stated that the roof was sagging in places but expressed their opinion that it was “sound and the sagging takes place in the ventilation chambers which are beneath the shingles and allow air to vent through the ridge vent.” And they represented that the “new owners are reluctant to

accept our explanation and wish to hear it from you as you have the expertise and are familiar with the construction of the roof.”

Garlie eventually went to the home. He spent ten to fifteen minutes inspecting the roof. He did not inspect the interior for evidence of water invasion. He explained later, “[T]here was no change in anything since day one. So to me it looked fine.” He did not observe the sagging that both parties saw or the soft spots, and he asserted that the “dips” that he did observe were expected because it was a low-pitched roof. J. Ward Passe wrote Garlie a letter for him to sign and return, which stated, “Recently I examined the roof of the former Passe home at 12697 Cyrus Trail, Faribault. This roof appears to me to be serviceable. The shingles are good. Some dips in the roof are not surprising in view of the construction of this roof.” Garlie signed the letter. Michael Kohser saw it and called Garlie to tell him that he had some concerns (soft spots and discolored icicles forming underneath the roof) and asked Garlie to return for a closer look. Garlie refused.

The Kohsers got a second opinion from Phillip Olson of Northfield Construction, a licensed roof inspector. Olson saw water streaking inside the home and icicles in the rear and soffit area, indicating a moisture problem. He witnessed water dripping from the ceiling and drywall buckling on the exterior walls. He opened the roof in two places and discovered that it had inadequate ventilation and no vapor barrier. He determined that the garage rafters were not properly attached. Olson recommended that an engineer evaluate the roof and that, in his opinion, it should be replaced and modified to add ventilation and insulation. He estimated \$50,901.95 to replace the roof, which included changing the roof material from asphalt shingles to a membrane.

The Kohsers also hired an engineer, Brian Gjerde, to examine the roof. Gjerde noted some of the same issues as Olson: water staining, icicles behind the fascia, and inadequate ventilation. He noted a “double roofing condition”—the home had a newer roof built over a previous roof, which he thought could lead to trapped moisture. Gjerde also recommended replacing the roof.

The Passes had previously obtained a septic-system bid of \$15,040 from LaRoche’s, Inc. After entering the purchase agreement, the Passes obtained a bid of \$11,600 from B & B Excavating to install the same system following the same design. B & B would remove the buried oil tank, slope land away from the garage, and install drain tile. The Passes directed B & B to do the work. But when Rob DeGroot of B & B met with the Kohsers after the closing, Michael Kohser asked him about upsizing the septic system. DeGroot answered that it would raise the project’s cost. DeGroot refused to install a larger system on the original estimate and left with no agreement on how the project should proceed. The Kohsers told DeGroot not to return.

The Kohsers hired a different contractor, Advanced Septic Solutions, Inc., to install a new septic system. The cost was \$17,103. It followed a different design and was installed in a different location. Advanced Septic also removed the buried oil tank as part of the project, and the Kohsers paid for tree removal related to the septic system installation. They also temporarily removed plants and had them replaced after the septic system was installed. The Kohsers’ landscaper also installed a two-and-a-half foot high boulder retaining wall to prevent erosion near the garage. The landscaping work cost \$8,710.

The Kohsers also directed Advanced Septic to construct a \$10,323 water diversion system, which consisted of adding water inlets along the driveway, a rock trench, a 15-inch dual wall culvert, and rip rap.

In September 2007 the Passes commenced this litigation, seeking a declaratory judgment entitling them to the escrowed funds. The Kohsers answered with counterclaims for breach of contract and also for misrepresentation and fraud based on flooding and mold in the basement. The district court conducted a bench trial in 2010.

The district court found that the Garlie inspection did not satisfy the Passes' obligation to inspect the roof for the purpose of determining the need for repair or replacement, and it held that the Passes were obligated to replace the roof. But it also found that the roof could be replaced without changing its pitch. The court used the roof replacement bid prepared by Olson to determine that the Passes owed the Kohsers \$32,217 for roof repairs. This amount excluded the \$10,074 in the bid for the framing of a new roof because the court concluded that the purchase agreement did not contemplate structural improvements to change the pitch. The district court also found that the Passes were required to pay for the \$17,103 mound septic system but not the water diversion system, tree removal, or landscaping. It held that only the obligations reflected in the escrow agreement survived the closing.

The district court additionally held that the Kohsers were entitled to recover reasonable attorney fees as third-party beneficiaries to the escrow agreement, because it was "obvious" that the agreement was prepared using the wrong form, resulting in a mutual mistake by the parties. It dismissed the Kohsers' claims of misrepresentation and

fraud on the element of damages because they failed to prove that the property had a lower value as a result of the defects.

After extensive post-trial motions, the district court issued an order amending the judgment and removing any reference to the Kohsers as third-party beneficiaries to the escrow agreement. It reformed the escrow agreement to hold that the Kohsers were actual parties to it. The district court found that the Kohsers were entitled to reasonable attorney fees of \$20,000 under the escrow agreement.

The Passes appealed to this court, and the Kohsers filed a cross-appeal.

D E C I S I O N

I

The Passes argue that the district court erred when it reformed the escrow agreement *sua sponte*, holding that the parties had really intended that the escrow agreement be a contract between the Passes and the Kohsers. We will review the district court's application of the law of reformation de novo because the material facts are not in dispute. See *SCI Minn. Funeral Servs., Inc. v. Washburn-McReavy Funeral Corp.*, 795 N.W.2d 855, 861 (Minn. 2011). Reformation is the amendment of a written agreement to reflect the parties' true intent at the time of its creation. *Jablonski v. Mut. Serv. Cas. Ins. Co.*, 408 N.W.2d 854, 857 (Minn. 1987). There are three requirements for reformation of a written agreement, each of which must be established by clear and convincing evidence: (1) a valid agreement between the parties expressing their real intentions; (2) a written instrument that failed to express the parties' real intentions; (3) this failure was due to a mutual mistake of the parties. *Alpha Real Estate Co. of Rochester v. Delta*

Dental Plan of Minn., 664 N.W.2d 303, 314 (Minn. 2003). Mutual mistake requires “that both parties agree as to the content of the document but that somehow through a scrivener’s error the document does not reflect that agreement.” *Nichols v. Shelard Nat’l Bank*, 294 N.W.2d 730, 734 (Minn. 1980).

The threshold problem with the reformation here is that the Kohsers were not parties to the escrow agreement. The escrow agreement lists only two parties: Rels Title and the Passes. The Kohsers did not sign it. It is expressly designed to protect the title company, not the Kohsers. The district court therefore erred by substituting them into the agreement. “Reformation is generally allowed against the *original* parties to an instrument and those in privity with the original parties.” *Manderfeld v. Krovitz*, 539 N.W.2d 802, 805 (Minn. App. 1995), *review denied* (Minn. Jan. 25, 1996) (emphasis added). We see no facts that support the district court’s conclusion that it is “obvious” that the escrow agreement was prepared using the wrong form, and that it was signed by the Passes for the benefit of the Kohsers “in order to procure their consent to close the purchase of the property.” This conclusion is also contrary to the arguments made by both parties. The Passes argued that the escrow agreement represented a contract between themselves and Rels Title; and the Kohsers argued only that they were third-party beneficiaries to the escrow agreement, indicating that the agreement was a contract between the Passes and Rels Title. These arguments therefore foreclose the district court’s conclusion that the Kohsers were parties to the escrow agreement. Additionally, no evidence in the record suggests that the Passes agreed to pay the Kohsers’ attorney

fees, so it cannot be found that this was the real intention of the parties. For these reasons, we reverse the judgment of the district court awarding attorney fees.

We agree with the district court's conclusion that the Kohsers were not third party beneficiaries to the escrow agreement. *See Hickman v. SAFECO Ins. Co. of Am.*, 695 N.W.2d 365, 369–70 (Minn. 2005) (citing Restatement (Second) of Contracts § 302 (1979)) (requiring that the parties intended to benefit a third person). The evidence could not support a finding that the Passes and Rels Title intended to benefit the Kohsers with the creation of the escrow agreement; the agreement states unambiguously that it was created “for the benefit and protection of Rels Title.”

II

The Passes contend that the district court erred by finding that they breached the roof provision of the parties' purchase agreement. The interpretation of an unambiguous contract is a question of law, and we review questions of law de novo. *Roemhildt v. Kristall Dev., Inc.*, 798 N.W.2d 371, 373 (Minn. App. 2011).

Purchase agreement obligations generally do not survive the closing: “The merger doctrine generally precludes parties from asserting their rights under a purchase agreement after the deed has been executed and delivered.” *Bruggeman v. Jerry's Enters., Inc.*, 591 N.W.2d 705, 708 (Minn. 1999). The presumption of merger can be overcome with sufficient evidence. *Id.* at 710. It is evident from language in the amended purchase agreement that the parties intended the Passes' obligation to pay for the repair or replacement of the roof to survive the closing:

Sellers will have the contractor who worked on the roof two years ago inspect the roof and if the roof needs repair and/or replacement, Sellers will by closing either: (1) Have the roof repaired and/or replaced by a licensed roofing contractor or (2) Escrow an amount equal to one-and-one half times the amount of the estimated cost of the repair and/or replacement.

The district court found that the Passes breached their contractual duty under this provision by failing to determine the condition of the roof and correct its defects. The finding is factually supported. Although the Kohsers agreed that Garlie would perform the roof inspection, J. Ward Passe wrote the inspection request in a manner that was inconsistent with the implied call for a neutral and unbiased evaluation. He asked Garlie to examine the roof with an inaccurate caveat that urged a particular result: “We feel it is sound . . . [but] the new owners are reluctant to accept our explanation and wish to hear it from you.”

The district court found that Garlie’s roof inspection was not “professional or thorough” as the purchase agreement assumed it would be. The record also supports this finding. Garlie’s inspection took ten or fifteen minutes and included only a cursory inspection of the roof itself. Garlie never entered the home to look for evidence of seepage. The written report, supposedly from Garlie’s inspection, was not only prepared by J. Ward Passe, but it never answered whether the roof needed repair, stating only that the roof was “serviceable.” Garlie then refused to return to inspect for interior staining. The district court’s finding that the Passes breached the roof inspection provision of the purchase agreement is not clearly erroneous.

The Kohsers argue in their related cross-appeal that the district court erred by limiting the damages owed by the Passes for replacement of the roof. We are not persuaded. The district court awarded the Kohsers \$32,217 to cover repairs to the roof, based on the bid submitted by Phillip Olson of Northfield Construction. This amount included the cost of demolition of the old roof (\$4,712), insulation (\$8,250), a new membrane roof (\$15,125), soffit repair (\$3,080), and garbage removal (\$1,050). The district court did not include the \$10,074 from Olson's bid for framing a new roof, because the district court concluded that the parties' agreement did not include structural modifications. It allowed the replacement with a membrane roof because asphalt shingles would not be warranted given the shallow pitch of the roof.

The Kohsers contend that the district court's limiting of the damages is erroneous because Olson's bid for \$50,900 did not include changing the pitch. They cite two instances of Olson's testimony to suggest that his bid would maintain the original pitch, but neither instance clearly supports their argument. Nothing in the record establishes that the \$10,074 bid for roof framing meant that Olson would reframe the roof as the original. On this record the district court could find, as it did, that by recommending the framing of a new roof, Olson's bid included structural improvements to change its pitch. The district court did not clearly err by removing the \$10,074 improvement cost from the Kohsers' damages award.

At oral argument, counsel discussed with us whether the district court appropriately allowed the Kohsers to recover for certain other parts of the roof project (insulation and membrane material instead of asphalt shingles) that might have also

constituted upgrades instead of repairs or replacement. The Passes' counsel first asserted that she had raised this argument in her briefing, but on reflection acknowledged that the argument is not in the Passes' briefs. We conclude that this additional argument is not before us. *See Melina v. Chaplin*, 327 N.W.2d 19, 20 (Minn. 1982).

III

The Kohsers argue that the district court erred by concluding that the doctrine of merger extinguished the Passes' potential obligation to install a water diversion system, remove trees, landscape the property, and do electrical work related to the septic system. Under the doctrine of merger, by accepting a deed, the purchasers waive their rights under the purchase agreement to enforce the sellers' promise to complete certain tasks due before closing. *Bruggeman*, 591 N.W.2d at 708.

Water Diversion System

The addendum to the purchase agreement required the Passes to slope the land away from the garage and install drain tile. The Passes did not complete these preclosing obligations. The Kohsers seek to avoid the effect of the merger doctrine by asserting that the water diversion system was discussed at the closing and that the parties contemplated that it would be done by the septic system contractor. The problem with this argument is that the septic system bid from B & B included only minimal drainage work with the septic system installation and the escrow agreement covered only the septic system installation without any drainage component. By closing on the property and accepting a warranty deed, the Kohsers released the Passes from their obligation to install a water diversion system.

Tree Removal

The Kohsers argue that their tree removal costs should be covered since tree removal was a prerequisite to installing the septic system and the septic system obligation survived the closing. The district court appropriately did not award the Kohsers any damages for tree removal. It is true that the B & B septic system estimate included the removal of smaller trees, but DeGroot testified that the removal of larger trees was not included in the bid. And there is no mention in the purchase agreement or the escrow agreement of the Passes' obligation to pay for tree removal. We hold that any purchase-agreement obligation for tree removal costs was extinguished by merger.

Landscaping

The Kohsers argue that the \$8,710.56 in landscaping work was necessary to restore the property after the septic work was completed and the cost should be included in the Passes' obligation to pay for the septic work. The purchase agreement specifically provided that no landscaping, sodding, or reseeding was required. We hold that the landscaping costs were excluded in the purchase agreement and that even if they were not, the doctrine of merger extinguished any possible claim that the Passes were required to pay for the landscaping.

Electrical Work

The Kohsers argue that the amount they paid for electrical work required for the septic system was inadvertently omitted from the judgment. Although the electrical work necessary for the septic system was not detailed in the bids for septic installation, J. Ward Passe acknowledged that he had expressly agreed to pay for the septic electrical work.

This obligation was not extinguished by the doctrine of merger because it is a necessary component of the septic system installation. The Kohsers paid \$1,020 for electrical work for the septic system installation, and it appears to have been an oversight that the district court did not include this amount in the judgment. On remand the district court is directed to amend the judgment to reflect \$1,020 in damages to the Kohsers for the septic system electrical work.

IV

The Kohsers contend that the district court erred by dismissing their misrepresentation and fraud claims. The district court dismissed those claims because the Kohsers failed to prove damages. We will not set aside the findings of the district court on the elements of fraudulent misrepresentation unless they are manifestly contrary to the evidence and clearly erroneous, and we defer to the district court's credibility determinations. *See Nave v. Dovolos*, 395 N.W.2d 393, 396–97 (Minn. App. 1986); Minn. R. Civ. P. 52.01.

Evidence of a false representation and resulting damages are elements of a claim of misrepresentation in the sale of real property. *Bryan v. Kissoon*, 767 N.W.2d 491, 496 (Minn. App. 2009). The claimant must also prove that the alleged misrepresentation proximately caused the damages sought. *Id.* Buyers of allegedly defective property suffer no damage if the property is worth what they paid for it. *Id.* Repair costs alone are insufficient to prove damages due to fraudulent misrepresentation in a residential real-estate transaction. *Id.*, *see also Lobe Enters. v. Dotsen*, 360 N.W.2d 371, 373 (Minn. App.

1985) (holding that repair costs for a new roof “do not accurately reflect appellant’s loss proximately arising from the misrepresentation”).

The Kohsers’ fraud and misrepresentation claim is based on alleged defects in the basement and main drain of the home that resulted in water damage and mold. They allege that these defects reduced the market value of the property by \$34,825. Paul Smith, a licensed real estate appraiser, visited the property in 2008 and testified about diminution in market value. But Smith also testified that he did not perform an appraisal.

Michael Kohser testified that he had examined twenty-five lake homes within a 15 mile radius of Faribault and that he based his offer for the home, in part, on the asking prices for the homes he had examined. He testified that he lost use of 746 square feet of the basement, which was allegedly worth \$26,100. His basis for this opinion was personal research informing him that the industry valuation standard is \$15 to \$50 per square foot. He also testified that the plumbing system was at least three percent of the value in the building, or \$7,635.

The district court found that there was no persuasive evidence of the fair market value of the property when it was sold in October 2006 and that the Kohsers failed to prove that the defects caused the property to have a lower value than the price they paid. This finding is not clearly erroneous. A property owner is competent to express his opinion of the property value, but that opinion, standing alone, is of little probative value without foundation that the owner is familiar with the market value of real estate. *H.P. Droher & Sons v. Toushin*, 250 Minn. 490, 501, 85 N.W.2d 273, 281 (1957). The district

court found that Michael Kohser's testimony was not persuasive based on his lack of knowledge and experience, and we defer to this credibility determination.

Affirmed in part, reversed in part, and remanded.