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Minn. Stat. § 480A.08, subd. 3 (2010).*

**STATE OF MINNESOTA
IN COURT OF APPEALS
A11-1827**

Wanda Stella,
Respondent,

vs.

Wells Fargo Bank, N. A., as Trustee,
Appellant,
and In the Matter of the Petition of
Wanda Stella for a New Certificate of Title to Land.

**Filed August 20, 2012
Reversed and remanded
Stauber, Judge**

Hennepin County District Court
File Nos. 27CV0929572; 27CVA33721

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respondent)

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Considered and decided by Cleary, Presiding Judge; Stauber, Judge; and
Rodenberg, Judge.

UNPUBLISHED OPINION

STAUBER, Judge

After a court trial in this mortgage dispute in which the district court ordered that
title to real property be restored free of encumbrances in respondent's name, appellant-

bank, transferee of the mortgage interests, argues that the district court erred by concluding that, among other things, appellant is not a bona fide encumbrancer under Minn. Stat. § 325N.17(f)(3) (2010). Because the district court erred by concluding that appellant is not a bona fide encumbrancer under Minn. Stat. § 325N.17(f)(3), we reverse and remand, and we need not address appellant's other arguments.

FACTS

This case involves a parcel of registered (Torrens) property that, since 1995, has been continuously occupied by respondent Wanda Stella. In January 2005, respondent was notified by her primary mortgage lender that it intended to commence foreclosure. At that time, the property was encumbered by two mortgages totaling \$70,891. In an effort to avoid foreclosure, respondent contacted a licensed real estate agent who referred respondent to Money Tree Financial, LLC. Respondent met with an agent from Money Tree who suggested various "refinancing" alternatives to assist respondent in avoiding foreclosure and to pay her other debt.

Money Tree facilitated a financing arrangement between respondent and Jeffrey Anderson whereby Anderson would purchase respondent's home, secure mortgage financing to satisfy her outstanding debts, and pay mortgage payments for one year after which respondent could make mortgage payments at a lower interest rate. Respondent would enter into a lease agreement with Anderson under which she would make payments directly to Anderson, who would apply the lease payments to the mortgage. The agreement allowed respondent to continue to reside in her home.

On February 18, 2005, respondent and Anderson executed a purchase agreement whereby respondent would sell the property to Anderson for \$152,000.¹ The agreement indicated that the purchase price would be paid by Anderson securing a “conventional mortgage” and a “seller second mortgage.” Respondent then transferred title of her property to Anderson on February 25, as part of what chapter 325N defines as a foreclosure reconveyance transaction that was structured as a conveyance and a lease back to respondent. *See* Minn. Stat. §§ 325N.01(c), .10, subd. 3 (2010) (defining foreclosure reconveyance). To finance the transaction, Anderson obtained a mortgage loan from Argent Mortgage Company in the amount of \$121,600. These funds were used at the closing to satisfy the respondent’s two existing mortgages, satisfy a judgment against respondent in the amount of \$12,455.42, pay closing costs, pay an entity named JD Investments \$32,077.06, and pay respondent \$3,857.83. The closing was conducted by Liberty Title, Inc., a licensed title company, which provided typical closing and post-closing services. At the closing, respondent conveyed the property to Anderson by warranty deed. Anderson then executed the Argent mortgage and Argent assigned the mortgage to appellant Wells Fargo Bank, N.A.

Thereafter, Anderson neglected to apply some of respondent’s lease payments to the mortgage. Respondent unilaterally rescinded her transaction with Anderson, and in September 2006, commenced a federal district court action against Anderson and other parties² alleging that the transaction was an equitable mortgage, a foreclosure reconveyance,

¹ The value of the home was based upon an appraisal for financing purposes.

² Appellant was not a party to the federal action.

and that Anderson had defrauded her. *Stella v. Anderson*, 2007 WL 1080309, at *1 (D. Minn. Apr. 9, 2007). As part of the action, respondent gave notice of her intent to rescind the transaction under both the Federal Truth In Lending Act (TILA) and Minn. Stat. §§ 325N.01–.18 (2010), which addresses certain aspects of mortgage foreclosures. At the time respondent entered into the transaction, Anderson was required to provide respondent with numerous disclosures, including the Notice of Cancellation described in Minn. Stat. § 325N.14. Anderson failed to provide these disclosures.

The federal district court found that the transaction between respondent and Anderson was an equitable mortgage and a foreclosure-reconveyance transaction. *Stella*, 2007 WL 1080309, at *1. Thus, the court concluded that respondent was entitled to rescind her transaction with Anderson and the other named parties. *Id.* at *2. The court also awarded a judgment in respondent’s favor against Anderson in the amount of \$159,566.30. *Id.*

Despite the federal district court’s rescission, the certificate of title to the property remained in Anderson’s name as owner of the property with appellant’s mortgage memorialized as an encumbrance. Respondent commenced a proceeding subsequent in an effort to obtain a certificate of title for the property in her name and to void appellant’s mortgage. The proceeding subsequent was never completed, and title to the property remained vested in Anderson, subject to appellant’s mortgage. In January 2009, appellant filed a notice of pendency to foreclose its mortgage. A sheriff’s sale was held on March 13, 2009, where appellant purchased the property for its mortgage balance of \$178,212.61. The

resulting sheriff's certificate of sale was registered on March 16, 2009, and memorialized on the certificate of title.

In September 2009, after the expiration of the redemption period, appellant commenced an eviction action, seeking possession of the property. Respondent intervened in the eviction action, seeking a 90-day stay. The district court found that appellant was entitled to possession of the property, but stayed eviction pending respondent's action to determine ownership of the property. Respondent then commenced an action seeking declaratory relief that she is the owner of the property, alleging that she rescinded the fraudulent transaction which transferred title to the property. Respondent also claimed that appellant was not a bona fide encumbrancer.

Following a court trial, the district court found that Anderson violated the prohibitions of Minn. Stat. §§ 325N.01–.18, and that respondent rescinded the transaction with Anderson and was therefore the rightful owner of the property. The court also found that (1) appellant was not a holder in due course of the note executed and delivered by Anderson evidencing the indebtedness created at the closing and (2) neither Argent nor appellant was a bona fide purchaser or encumbrancer of the property for value without notice of violation of Minn. Stat. §§ 325N.10–.18. Thus, the district court ordered cancellation of the existing certificate of title for the property, and issuance of a new certificate identifying respondent as the registered owner, free and clear of all memorials of appellant's mortgage and its foreclosure.

Appellant moved the district court to amend its findings of fact and judgment to include that respondent received a benefit from payment of her prior mortgage liens and

indebtedness, from living on the property in excess of five years without making a mortgage payment, paying rent, or paying real estate taxes. Appellant also moved for an equitable mortgage in its favor because of the unjust enrichment that would otherwise occur. The district court denied the motion. This appeal followed.

D E C I S I O N

Appellant challenges the district court's conclusion that it is not a bona fide encumbrancer under Minn. Stat. § 325N.17(f)(3). The interpretation of statutes and the application of caselaw are questions of law subject to de novo review. *In re Estate of Eckley*, 780 N.W.2d 407, 410 (Minn. App. 2010). But a district court's findings of fact shall not be set aside unless they are clearly erroneous. *Id.*

Minnesota's Foreclosure Purchaser Act (MFPA) regulates real estate transactions involving a "foreclosed homeowner" who enters into a "foreclosure reconveyance" with a "foreclosure purchaser." *See* Minn. Stat. § 325N.10 (providing definitions). Under the act, bona fide purchasers and bona fide encumbrancers³ are specifically protected from claims by the former owners of property in foreclosure reconveyance transactions. Minn. Stat. § 325N.17(f)(3). Specifically, the act provides in relevant part that:

[N]o grant of any interest or encumbrance is defeated or affected as against a bona fide purchaser or encumbrance for value and without notice of a violation of sections 325N.10 to

³ A bona fide encumbrancer is one who, in good faith and for valuable consideration, acquires a lien by an instrument which is duly recorded. *See Black's Law Dictionary* 607 (9th ed. 2009) (defining "encumbrancer" as "[o]ne having a legal claim, such as a lien or mortgage, against property"); *see also Anderson v. Graham Inv. Co.*, 263 N.W.2d 382, 384 (Minn. 1978) (stating that a bona fide purchaser is one "who gives consideration in good faith without actual, implied, or constructive notice of inconsistent outstanding rights of others").

325N.18, and knowledge on the part of any such person or entity that the property was “residential real property in foreclosure” does not constitute notice of a violation of sections 325N.10 to 325N.18. This section does not abrogate any duty of inquiry which exists as to rights or interests in persons in possession of the residential real property in foreclosure.

Here, the district court held that under section 325N.17(f)(3), a bona fide encumbrancer has duty to inquire as to the rights or interests of persons in possession of the residential real property in foreclosure. The district court then addressed several factors that should have placed appellant and Argent on inquiry notice that there were irregularities with the transaction and mortgage. The district court found that these irregularities included: (1) respondent had been in possession of the property since 1995, and was in possession as of the date of closing; (2) Argent had knowledge that Anderson did not intend to occupy the property; and (3) there were inconsistencies between the Settlement Statement, the loan transmittal documents, and the unsigned promissory note and mortgage regarding the loan from respondent to Anderson. The court held that because appellant and Argent did not make a good faith inquiry into the irregularities with the transaction, appellant is not a bona fide encumbrancer under section 325N.17(f)(3).

Appellant argues that because the property at issue is Torrens property, inquiry notice does not apply. Appellant also contends that even if inquiry notice applies, the “documents and information known by Argent as of the closing date as noted by the [district] court were insufficient to provide notice of a violation of Minn. Stat. § 325.17(f)(3).” Thus, appellant argues that the mortgage assignment is valid and

enforceable, and that appellant is a holder in due course of the note and a bona fide assignee of the mortgage without notice of a violation of Minn. Stat. §§ 325N.10–.18.

The Minnesota Recording Act gives protection to those who purchase property in good faith, for valuable consideration, and who first record their interests, by providing that

[e]very 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 for a valuable consideration of the same real estate . . . whose conveyance is first duly recorded.

Minn. Stat. § 507.34 (2010). “A good faith purchaser is someone who gives consideration in good faith without actual, implied, or constructive notice of inconsistent outstanding rights of others.” *Citizens State Bank v. Raven Trading Partners, Inc.*, 786 N.W.2d 274, 278 (Minn. 2010). The purpose of the Recording Act is to protect recorded titles against the gross negligence of those who fail to record their interests in real property. *Id.*

“In 1901, the Minnesota Legislature adopted an alternative to the abstract system—the Torrens system.” *In re Collier*, 726 N.W.2d 799, 804 (Minn. 2007). Under the Torrens system, a party seeking to register an ownership interest in property applies for a court adjudication of ownership and a court order that converts abstract property into Torrens property. Minn. Stat. § 508.22 (2010). After the court adjudicates ownership and any other existing interests in the property, the registrar of titles creates a certificate of title, which is issued to the registered owner. *See* Minn. Stat. §§ 508.34–.35 (2010). Any conveyance, lien, instrument, or proceeding that would affect the title to the now-registered Torrens property must then be filed and registered with the registrar of titles in the county where the

property is located in order to affect the title to the Torrens property. Minn. Stat. § 508.48 (2010).

Codified at chapter 508 of the Minnesota Statutes, the Torrens system was created to simplify conveyancing by issuance of a single certificate of title, thus eliminating the need to examine abstracts of title. *Hersh Props, LLC v. McDonald's Corp.*, 588 N.W.2d 728, 733 (Minn. 1999). Under the Torrens system, the purchaser of Torrens property may, subject to limited exceptions, determine the status of title by inspecting the certificate of title, eliminating time-consuming and expensive title searches, which characterize the abstract system. *Collier*, 726 N.W.2d at 804. It does not, however, “do away with the effect of actual notice, although it . . . imposes the burden of proving such notice upon the one asserting it.” *In re Juran*, 178 Minn. 55, 60, 226 N.W. 201, 202 (1929).

Appellant argues that because the property is Torrens property, the district court erroneously analyzed the transaction as if it was abstract property. Appellant contends that under the Torrens system, it is a bona fide encumbrancer because respondent cannot demonstrate that it had actual knowledge of a violation of Minn. Stat. §§ 325N.10–.18. Appellant further argues that because there “is no evidence or finding that at the time of the closing that Argent or [appellant] had any actual or constructive notice of a foreclosure reconveyance . . . or that an equitable mortgage had been created between [respondent] and Anderson,” the district court erred by concluding that Argent and appellant were not bona fide encumbrancers under section 325N.17(f)(3).

To support its argument, appellant cites *Collier*, which involved a title dispute between a mortgagee, M&I Bank FSB, that was assigned the first mortgage on a property

and a subsequent interest purchased by Collier. 726 N.W.2d at 801. M&I foreclosed on the mortgage and initiated a sheriff's sale without first having registered its mortgage interest in the property with the county registrar of titles. *Id.* Collier saw the published notice of the sale and contacted M&I offering to purchase M&I's interest in the property. *Id.* When M&I declined the offer, Collier conducted a title search and discovered M&I's failure to register its mortgage interest in the property. *Id.* Knowing that the property was Torrens property and that M&I's interest was not validly registered, Collier approached the original mortgagor and purchased the residual interest in the property for \$5,000. *Id.* at 802. Collier then sought a declaratory judgment that his interest was superior to the unregistered mortgage held by M&I, and the supreme court focused its analysis on M&I's challenge that Collier was not a good-faith purchaser. *Id.* at 803. The court concluded that a person with "actual knowledge of a prior, unregistered interest in the property is not a good faith purchaser." *Id.* at 809. Thus, the court held Collier was not a good-faith purchaser because he gained actual knowledge of M&I's interest in the property through the sheriff's office's publication of the notice of foreclosure sale and through his subsequent direct negotiations with M&I to purchase the property. *Id.*

Here, respondent agrees that "there is no finding that at the time of the closing that Argent or appellant had any actual notice of a violation . . . of sections 325N.10-.18." But respondent argues that appellant had actual knowledge of the irregularities found by the district court. Respondent contends that this actual knowledge of the purported irregularities is consistent with the actual knowledge discussed in *Collier*. Respondent argues that because appellant had actual knowledge of these irregularities, appellant had a

duty to inquire further into the Anderson/respondent transaction and, therefore, it was not a good-faith encumbrancer under *Collier*.

We disagree. The plain language of section 325N.17(f)(3) indicates that the statute does not automatically require a “duty of inquiry.” Rather the statute states that the section “does not abrogate *any* duty of inquiry” Minn. Stat. § 325N.17(f)(3) (emphasis added). This language indicates that when there *is* a duty of inquiry, such an inquiry must be conducted. For example, if the property is abstract property, a duty of inquiry may be required. But under the Torrens system, no further inquiry is needed beyond an examination of the certificate of title. *See Petition of Willmus*, 568 N.W.2d 722, 725 (Minn. App. 1997) (stating that the purpose of the Torrens system of land registration is to ensure that a person dealing with registered property need look no further than the certificate of title for any transactions that might affect the land), *review denied* (Minn. Oct. 21, 1997).

Moreover, respondent’s claim that actual knowledge of irregularities in a conveyance is akin to the actual knowledge discussed in *Collier* expands the rule of law established by the supreme court. In *Collier*, the court determined that there was actual knowledge of a prior, unregistered interest in property where Collier discovered M&I’s interest in the property through the sheriff’s office’s publication of the notice of foreclosure sale and through his subsequent direct negotiations with M&I to purchase the property. *Collier*, 726 N.W.2d at 809. But there is nothing in *Collier* that indicates that actual knowledge includes a duty to inquire further. And lenders are not guarantors that transactions between buyers and sellers are regular and without fraud as between them.

Notably, the supreme court in *Collier* specifically declined “to define the outer contours of actual notice,” limiting its “holding to the facts of [the] case.” *Id.* But the *Collier* decision and other appellate court decisions of this state indicate that actual knowledge does not constitute knowledge of an irregularity that requires further inquiry. In Minnesota, “[a]ctual notice requires actual knowledge.” *Willmus*, 568 N.W.2d at 726. “Actual knowledge is generally given directly to, or received personally by, a party.” *Wash. Mut. Bank, F.A. v. Elfelt*, 756 N.W.2d 501, 507 (Minn. App. 2008) (quotation omitted), *review denied* (Minn. Dec. 16, 2008).

In *Willmus*, this court considered a claim that purchasers of allegedly servient land had actual knowledge of an easement because the easement was referred to in a registered-land survey that was noted on their certificate of title to the allegedly servient land. 568 N.W.2d at 724. This court reasoned:

In *Kane* [*v. State*, 237 Minn. 261, 55 N.W.2d 333 (1952)], the supreme court analyzed facts and an argument similar to those here and ruled that the Torrens Act protects a good faith purchaser for value from those encumbrances mentioned in a descriptive document, *but not explicitly noted on the certificate of title*. In *Kane*, a restrictive covenant was noted on a recorded plat and the certificate of title referred to the plat. The supreme court determined that because the land was registered and, thus, governed by the Torrens Act, the subsequent good faith purchaser for value was not required to go to the plat to ascertain whether encumbrances were noted thereon. Here, while [the registered-land survey] was mentioned on the certificate of title, the easement was not. Therefore, under *Kane*, the mere mention of [the registered-land survey] on the certificate of title did not “note” the easement on the certificate of title for purposes of the Torrens Act. We conclude the [district] court did not err by recognizing that no duty on the part of the [purchasers] existed to research [the registered-land survey] to discover the easement.

Id. at 725 (emphasis added) (footnote and citations omitted).

Here, as in *Kane*, *Willmus*, and *Collier*, the property at issue is Torrens property. But unlike *Collier*, there is no evidence that appellant had actual knowledge of a violation of Minn. Stat. §§ 325N.10-.18. And this court's holdings in *Kane* and *Willmus* instruct that, absent actual knowledge, appellant was under no obligation to look beyond the certificate of title to determine whether there were violations of Minn. Stat. §§ 325N.10-.18. To rule otherwise would abrogate the Torrens system of title registration in Minnesota.

We also note that even if appellant were under an obligation to inquire further, our review of the alleged anomalies in the closing documents would not have put appellant, as a mere mortgage lender, on notice to inquire further. For example, documents indicating that Anderson did not intend to occupy the property are not unusual. As appellant points out, "borrowers commonly finance the purchase of residential properties for rental or re-sale purposes." Moreover, respondent's possession of the property would raise no red flags because a seller would ordinarily remain in possession of the property up to and often after the date of closing. Further, the alleged inconsistencies in the transactional documents were not material to the mortgage transaction; rather, they pertained to the transaction between respondent and Anderson, a transaction separate and apart from the mortgage transaction between Argent and Anderson. Accordingly, we conclude that appellant was a bona fide encumbrancer under Minn. Stat. § 325N.17(f)(3),

and, therefore, we reverse the district court's decision and remand for further proceedings not inconsistent with this opinion.⁴

Because we conclude that the district court erred by holding that appellant is not a bona fide encumbrancer under Minn. Stat. § 325N.17(f)(3), we need not address the additional arguments raised by appellant.

Reversed and remanded.

⁴ We recognize that this court recently addressed chapter 325N in *Graves v. Wayman*, 816 N.W.2d 655 (Minn. App. July 9, 2012), *pet. for review filed* (Minn. July 23, 2012). But we conclude that *Graves* is factually distinguishable from the case before us and involves inquiry issues distinct from the issue raised herein.