STATE OF MINNESOTA
IN COURT OF APPEALS
A12-0169

David A. Gruenzner,
Appellant,

vs.

Jeffrey A. Hickok,
Respondent,

Geraldine M. Hickok,
Respondent,

First National Bank of St. James,
Respondent,

Community Bank Vernon Center,
Respondent,

Professional Credit Analysts of Minnesota, Inc.,
Respondent.

Filed August 27, 2012
Affirmed
Halbrooks, Judge

Blue Earth County District Court
File No. 07-CV-09-2308

Margaret K. Koberoski, Kakeldey & Koberoski, P.A., Mankato, Minnesota (for appellant)

Jeffrey and Geraldine Hickok, Mankato, Minnesota (pro se respondents)

Ryan B. Magnus, Jennifer L. Thon, Jones and Magnus, Attorneys at Law, Mankato, Minnesota (for respondent First National Bank at St. James)

Community Bank Vernon Center, Mankato, Minnesota (respondent)

Walter J. Gates, III, Mankato, Minnesota (for respondent Professional Credit Analysts of Minnesota, Inc.)

Considered and decided by Bjorkman, Presiding Judge; Halbrooks, Judge; and Rodenberg, Judge.

U N P U B L I S H E D O P I N I O N

HALBROOKS, Judge

Appellant David A. Gruenzner challenges the district court's findings of fact and conclusions of law following a trial to determine whether specified mortgages merged into fee title or had priority over his mortgage. Because we conclude that certain issues were tried by implied consent of the parties and because the district court's finding that respondent First National Bank of St. James did not intend to merge its interests is not clearly erroneous, we affirm.

FACTS

Jeffrey and Geraldine Hickok mortgaged their home at 140 Skyline Drive five times between September 2001 and January 2007. The first two mortgages were executed in September 2001 in favor of respondent.[1] The first was for an original amount of $131,981.05, dated September 5, 2001. The next was for an original amount of $100,000 (with a credit limit of up to $200,000), dated September 13, 2001. Then, in

[1] Although the Hickoks, Community Bank Vernon Center, and Professional Credit Analysts of Minnesota, Inc. are also respondents to this appeal, those parties did not appear in the district court action and did not respond to this appeal. This opinion will therefore refer to respondent First National Bank as "respondent" and will refer to the other parties by name.

June 2005, the Hickoks signed two mortgages in connection with a $710,000 loan from Community Bank Vernon Center. One mortgage was in favor of Community Bank and the other was in favor of appellant as security for his personal guaranty of up to $300,000 on the promissory note in favor of Community Bank. Finally, in January 2007, the Hickoks signed a fifth mortgage, again in favor of respondent, for $100,000. This fifth mortgage involved a restructuring of the Hickoks' debt with respondent; the Hickoks did not receive any funds as a result of that mortgage. Appellant signed a subordination agreement after this January 2007 loan was issued.

In 2007, respondent approached the Hickoks because respondent was in violation of a banking regulation limiting the amount of debt one borrower could carry. To resolve this regulatory infraction, the Hickoks issued a deed in lieu of foreclosure to respondent in November 2007. The Hickoks then leased the home from respondent until they were evicted for nonpayment of rent. Although the home has been listed for sale, respondent still owns the home.

Respondent concedes that, due to an error by its counsel, it was not aware of the junior liens on the home when it requested and received the deed in lieu of foreclosure. Respondent discovered appellant's mortgage after it found an interested buyer. At that point, respondent realized it could not sell the property because of the "problem with ownership of the property" and because it "knew . . . it would be a court battle."

Appellant commenced a foreclosure action in 2009. Appellant claimed that, when respondent received the deed in lieu of foreclosure, it merged its pre-existing liens with the fee-simple title and that it took title subject to any other junior liens. Respondent

answered and counterclaimed that it had a valid lien on the property pursuant to the mortgage dated September 13, 2001, and that this lien had priority over appellant's.

Appellant moved for a declaratory judgment that the deed in lieu of foreclosure had merged respondent's lien estate with its fee-simple estate and thereby extinguished its lien. The district court denied this motion because it determined that there was a fact issue as to what respondent intended when it requested and received the deed in lieu of foreclosure. Respondent moved for summary judgment, and the district court denied its motion on the same ground—that respondent's intent presented a genuine issue of material fact that could not be resolved on summary judgment.

A bench trial was held in March 2011. In an order dated June 15, 2011, the district court found that "[respondent's] interest as mortgage holder did not merge with its fee title when it accepted a deed in lieu of foreclosure from the [Hickoks]." As a result, the district court declared that

> [t]he liens at [respondent] and mortgages on the property at issue dated September [5], 2001 in the amount of $131,981.05, September 13, 2001 in the amount of $200,000 and January 19, 2007 in the amount of $100,000 remain in full force an[d] effect and are senior in priority to the mortgage lien of [appellant].

On July 1, 2011, appellant moved for relief under Minn. R. Civ. P. 60.02. The district court held a hearing on the motion on July 26, 2011, and denied appellant's posttrial motion on January 6, 2012. This appeal follows.

D E C I S I O N

I.

As an initial matter, appellant argues that the district court erred by declaring that three of respondent's liens were enforceable when respondent only counterclaimed that it had one enforceable lien.

> When issues not raised by the pleadings are tried by express or implied consent of the parties, they shall be treated in all respects as if they had been raised in the pleadings. Such amendment of the pleadings as may be necessary to cause them to conform to the evidence and to raise these issues may be made upon motion of any party at any time, even after judgment; but failure so to amend does not affect the result of a trial of these issues.

Minn. R. Civ. P. 15.02. Thus, the failure to include all of the mortgages in the pleadings and the absence of a formal motion to amend the pleadings may not be fatal to the district court's resolution of these issues at trial, if these issues were tried by express or implied consent.

Respondent claims that these issues were tried by implied consent because the parties litigated the validity of all three mortgages "[t]hroughout the entire case." Indeed, respondent's memorandum in support of its motion for summary judgment argued for the enforceability of all three mortgages, and appellant did not argue against this position in his opposing memorandum. And even though appellant objected to the inclusion of all three mortgages prior to trial, appellant's counsel indicated that she was ready to proceed with trial, and evidence was presented regarding all three mortgages. We also note that the issue of whether respondent intended to merge its estates when it received the deed in

lieu of foreclosure does not depend on whether respondent is attempting to enforce one, two, or three mortgages. We therefore conclude that the parties tried these issues by implied consent and that the district court did not err.

II.

Appellant makes two additional assertions of error. First, he argues that because the debt on the loans secured by mortgages on 140 Skyline Drive was reduced to zero on respondent's balance sheet, the district court erred by not finding that the mortgages securing those loans were discharged. Second, he argues that even if respondent's act of reducing the Hickoks' debt to zero on its balance sheet did not discharge the mortgages, respondent's receipt of a deed in lieu of foreclosure merged respondent's estates, and it took fee-simple title to 140 Skyline Drive subject to appellant's lien.

"In an appeal from a bench trial, we do not reconcile conflicting evidence. We give the district court's factual findings great deference and do not set them aside unless clearly erroneous." *Porch v. Gen. Motors Acceptance Corp.*, 642 N.W.2d 473, 477 (Minn. App. 2002) (citations omitted), *review denied* (Minn. June 26, 2002). "Findings of fact are clearly erroneous only if the reviewing court is left with the definite and firm conviction that a mistake has been made." *Fletcher v. St. Paul Pioneer Press*, 589 N.W.2d 96, 101 (Minn. 1999) (quotation omitted).

Appellant's first argument has no merit. He relies on *McManaman v. Hinchley*, 82 Minn. 296, 84 N.W. 1018 (1901), for the proposition that a mortgage has no independent existence once the debt that it secures has been paid. *McManaman* involved an attempt to foreclose on a mortgage after the statute of limitations had run, based on the theory

that a late payment on the note "revived" the mortgage. *McManaman*, 82 Minn. at 297-98, 84 N.W. at 1018. *McManaman* would be instructive if there was conclusive evidence that the Hickoks' debt had been extinguished, but it does not stand for what constitutes evidence that a debt has, in fact, been extinguished. The fact that respondent changed its records to indicate that the Hickoks' debt was reduced to zero is better characterized as evidence tending to show respondent's intent when it received the deed in lieu of foreclosure rather than a stand-alone fact that automatically discharged the mortgages on the property.

Appellant's second argument is more difficult to resolve. Whether the doctrine of merger applies to this situation depends on respondent's intent when it took the deed.

> The theory [of merger] is that when a mortgagee's interest and the fee title coincide and meet in the same person, the lesser estate, the mortgage, merges into the greater, the fee, and is extinguished. Courts also state that whether merger has occurred depends on the intent of the parties, especially the one in whom the interests unite. If merger is against that party's best interest, it will not be deemed intended by the parties.

Resolution Trust Corp. v. Indep. Mortg. Servs., Inc., 519 N.W.2d 478, 482 (Minn. App. 1994) (quotation omitted), *review denied* (Minn. Sept. 28, 1994). Whether or not respondent intended to merge its interests is a question of fact. *GBJ, Inc. v. First Ave. Inv. Corp.*, 520 N.W.2d 508, 511 (Minn. App. 1994), *review denied* (Minn. Oct. 27, 1994).

The difficulty in this case stems from the fact that respondent was not operating with complete knowledge when it requested and received the deed in lieu of foreclosure.

Rather, an error by respondent's counsel led to the fact that respondent did not know that there were junior lienholders when it took the deed in lieu of foreclosure from the Hickoks. If there had been no junior lienholders, as respondent believed when it accepted the deed, it would not have been against respondent's interest to merge its lien interests with its fee-simple interest, and there would be no presumption in place. *Cf. Resolution Trust Corp.*, 519 N.W.2d at 482 ("Where a merger would frustrate the interests of the party holding both estates and that party's intent has not been expressed, merger will not be presumed to occur.").

There was sufficient evidence introduced at trial that would have allowed the district court to conclude that respondent intended to merge its interests prior to discovering that there were junior lienholders. Mark Johnson testified for respondent and stated that by December 2007 (after respondent had received the deed in lieu of foreclosure), respondent had transferred the debt associated with the September 5, 2001 loan (for an original amount of $131,981.05) to "other real estate" and reduced the Hickoks' debt associated with this loan to zero. He testified that at that point, respondent was no longer collecting on that debt but was instead working with the Hickoks to sell the property. In fact, had respondent maintained that the Hickoks still owed the debt, respondent would not have resolved its lending-limit violation. Johnson testified at one point that respondent's "intent was to take the property and get rid of our debt that was owed against that property." In addition to Johnson's testimony, the deed did not contain an anti-merger clause. Including an anti-merger clause is evidence of intent not to merge interests. *See GBJ, Inc.*, 520 N.W.2d at 511. On the whole, we tend to view the evidence

in this case as primarily pointing to an intention to merge; but it is not our role to reconcile conflicting evidence. *Porch*, 642 N.W.2d at 477.

There was also testimony at trial that could support a finding that respondent did *not* intend to merge its interests. Johnson testified that respondent did not intend to extinguish the Hickoks' debt and rather intended merely to "reduce" the debt. The district court concluded that "[t]here is no testimony of record indicating that the receipt of the deed in lieu of foreclosure was intended to extinguish the loan obligations of the Hickoks." And even though respondent stopped collecting on the debt, never attempted to foreclose its mortgage interest, and needed the debt off its books for regulatory purposes, it is true that there was no *direct* testimony that respondent extinguished the Hickoks' debt. Johnson testified that respondent intended to recoup at least some of its loss by selling 140 Skyline Drive free and clear of any encumbrances. Given the lack of direct testimony that respondent intended to merge its interests and Johnson's testimony to the contrary, we cannot conclude that the district court's finding of fact that respondent did not intend merger is clearly erroneous.

Because the question of respondent's intent is a factual determination and because the district court's finding of fact regarding intent is not clearly erroneous, we affirm.

Affirmed.