STATE OF MINNESOTA
COUNTY OF ANOKA

DISTRICT COURT
TENTH JUDICIAL DISTRICT

River Run Properties LLC,

Plaintiff,

vs.

Todd W. Kappedahl, John Doe, and Mary Roe,

Defendants.

FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER FOR JUDGMENT *
[Second Trial]

File No. C2-03-10463

* Filed previously on 6/28/04 ; included here only for convenience

ATTORNEY APPEARANCES

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* * * * *

The Second Trial -- the new trial -- in this case was held before the undersigned Judge on 3/8/04 as a bench trial, to the Court without a jury. This Second Trial of the case consolidated issues of *possession* (as in an Unlawful Detainer action) with issues of *title* (as in an Ejectment action or Declaratory Judgment action).

The evidentiary record consists of the testimony and exhibits from the First Trial of 11/7/03, as now supplemented by the additional testimony and exhibits at the Second Trial of 3/8/04.

The next two pages (the Court's Order for Judgment) set forth the Court's holdings. The bottom-line of those holdings -- the outcome of the litigation -- is a Declaratory Judgment, declaring

> that the 6/9/03 transaction between the parties was really a loan, and not a sale, thereby creating an Equitable Mortgage
>
> that, in turn, the Equitable Mortgage is itself null and void, because the loan it secured intentionally provided for a usurious amount of interest

and an Unlawful Detainer Judgment

> that denies issuance of a Writ of Recovery to plaintiff River Run.

Based upon the evidentiary record and upon the arguments of the parties' attorneys and upon the Findings of Fact and Conclusions of Law stated in the attached Memorandum -- the Court now makes the following Order for Judgment :

ORDER FOR JUDGMENT

I. The Court Administrator is directed to enter Judgment in this case, which shall state substantially the following :

A. For purposes of this Judgment, the "Property" is located at 20067 West Ford Brook Drive, Anoka MN 55303 in Burns Township in Anoka County and has the legal description of Lot 2, Block 1, Brookwood Estates, Anoka County, Minnesota.

B. By way of Declaratory Judgment and Ejectment :

1. The following documents and transactions are hereby declared null and void :

(a) The Warranty Deed dated 6/9/03, by which defendant Kappedahl purportedly conveyed the Property to plaintiff River Run. [Recorded as Doc. No. 1809912 on 6/10/03 with the Anoka County Recorder's Office].

(b) The Contract for Deed dated 6/9/03, by which plaintiff River Run purportedly agreed, under the conditions stated in the Contract, to convey the Property back to defendant Kappedahl. [Recorded as Doc. No. 1821938 on 7/11/03 with the Anoka County Recorder's Office].

(c) The Purchase Agreements signed on 5/29/03 (by defendant River Run) and on 5/31/03 (by plaintiff Kappedahl) related to the Warranty Deed and the Contract for Deed.

(d) The Notice of Cancellation of the Contract for Deed.

2. The Court declares that the 6/9/03 transaction in which the Warranty Deed and the Contract for Deed were exchanged constituted a loan, not a sale, thereby creating an "Equitable Mortgage" (as that phrase is defined in Minnesota law).

3. The Court declares that the Equitable Mortgage is void, because the loan it secures provides for a usurious amount of interest.

4. The Court declares that, since the loan was usurious and since the Equitable Mortgage is thereby void, plaintiff River Run has forfeited its right to payment from defendant Kappedahl of any principal, interest, or any other money in connection with the 6/9/03 transaction.

5. The Court declares that plaintiff Todd W. Kappedahl has the fee title and ownership of the Property, free and clear of any claim, interest, or encumbrance by plaintiff River Run.

C. By way of Unlawful Detainer, defendant Kappedahl is not unlawfully detaining or possessing the Property and, accordingly, no Writ of Recovery shall be issued to River Run regarding the Property.

D. Since much of the Second Trial involved a Declaratory Judgment action under Minn. Stats. Ch. 555, neither party shall recover any costs, disbursements, or attorney fees from the other party -- pursuant to Minn. Stat. § 555.10.

II. Entry of the Judgment is stayed for 30 days following the date of this Order for Judgment.

III. The Court's Findings of Fact and Conclusions of Law, supporting this Order for Judgment, are stated in the attached Memorandum, which is expressly made a part of this Order for Judgment.

IV. The Court Administrator shall advise the parties of this Order for Judgment by providing copies of the same to the parties' attorneys, whose names and addresses are set forth on the first page of this Order.

BY THE COURT

Dated this 28th day
of June, 2004.

__/s/ Dan Kammeyer_____
Daniel M. Kammeyer
Judge of Anoka County District Court
Tenth Judicial District

MEMORANDUM

INTRODUCTORY STATEMENT

This case is all about windfalls and harsh results. That was true from the outset and that's why, early on in this litigation, I urged the parties to settle the case, so they could avoid a predictable harsh result for one side and an equally predictable windfall for the other side. Without a settlement, that kind of all-or-nothing result was guaranteed to happen. There simply was no possibility of a mutually tolerable fair-to-middling result, if the case were litigated to an ultimate Court-dictated outcome :

> EITHER a homeowner (defendant Todd Kappedahl) would suffer the harsh result of losing the home he had lived in for the past 14 years and the $190,000 equity in the home, while plaintiff River Run Properties would reap the windfall of acquiring title to Kappedahl's $275,000 home by paying less than a third of that ($85,000).
>
> OR plaintiff River Run would suffer the harsh result of losing in excess of $100,000 (the $85,000 it paid for Kappedahl's home plus some significant associated outlays of money), while homeowner Kappedahl would reap the windfall of wresting his home from the jaws of foreclosure by digging into his own pocket for exactly zero dollars.

It's the latter outcome we reach in this case : a harsh result for plaintiff River Run, a windfall for plaintiff Kappedahl. We discuss that harsh result/windfall more extensively in the last section of the present Memorandum.

The real estate transaction that generated that outcome probably took less than 15 minutes. That 6/9/03 transaction was a "warranty deed sale and a contract for deed back." More specifically in that 6/9/03 transaction, plaintiff Todd Kappedahl gave a Warranty Deed for his home (the "Property") to plaintiff River Run Properties and, minutes later, River Run gave a Contract for Deed back to Kappedahl for that very same property. But that brief 15-minutes-or-less transaction would go on to produce Two Trials and Two Orders for Judgment.

The *First Trial* was a contested unlawful detainer trial, held on 11/7/03. It resulted in the *First Order for Judgment* dated 12/9/03, directing issuance of a Writ of Recovery evicting defendant Kappedahl from the Property. The Court reached that result at the First Trial, because defendant Kappedahl stipulated that he had failed to redeem from plaintiff River Run's cancellation of the Contract for Deed. Just as important, we reached that result at the First Trial -- the unlawful detainer eviction of defendant Kappedahl -- because we determined that he had *not* established either one of two affirmative defenses to plaintiff River Run's unlawful detainer action : **[a]** that the 6/9/03 transaction was really not a sale, but rather was a loan, with the Warranty Deed constituting an EQUITABLE MORTGAGE securing

the loan ; and **[b]** that the 6/9/03 transaction was tainted by River Run's charging Kappedahl a USURIOUS amount of interest on the loan.

The *Second Trial* -- a new trial granted on defendant Kappedahl's post-trial unlawful detainer motion -- was held on 3/8/04. (We stated our reasons for granting the new trial, the Second Trial, in our 3/4/04 Summary Judgment Order, at pp. 2-6). This Second Trial consolidated the issue of POSSESSION (as in an unlawful detainer action, like the First Trial) with the issue of TITLE (as in an ejectment and/or declaratory judgment action). We have now resolved those consolidated issues in the Second Trial in the *Second Order for Judgment* issued 6/28/04, as now explained in the present Memorandum.

The result we have now reached after this consolidated 3/8/04 Second Trial is the complete opposite of the result we reached after the 11/7/03 First Trial (the one that dealt exclusively with possession, as in an unlawful detainer action). This completely opposite result stems directly from our finding that, unlike the First Trial, defendant Kappedahl *has* established his claims of equitable mortgage and usury.

Accordingly, in the 6/28/04 Second Order for Judgment, we announce the "harsh result" for plaintiff River Run and the "windfall" for defendant Kappedahl as follows : We find that the 6/9/03 transaction was not a sale from Kappedahl to River Run but, rather, a loan from River Run to Kappedahl, thereby converting the Warranty Deed to an equitable mortgage and never divesting defendant Kappedahl of title or ownership of the Property. We find that River Run charged Kappedahl a usurious amount of interest on the loan, thereby voiding the equitable mortgage and eliminating defendant Kappedahl's obligation to repay any principal and interest to plaintiff River Run on the loan. We deny plaintiff River Run an unlawful detainer Writ of Recovery of possession of the Property.

* * * * *

BACKGROUND FACTS AND PROCEDURAL HISTORY

We stated the background facts of the case in the 12/9/03 First Order for Judgment/Memorandum. Because those basic underlying facts haven't changed, and for sake of continuity and convenience, we set forth here what we said there about the factual background, from pp. 2-3 of those 12/9/03 documents, nearly verbatim (and without indentation or single spacing) :

For several years, defendant Kappedahl owned the premises, consisting of 6½ acres and a 3-bedroom single family home in Burns Township in Anoka County. Varying estimates of the property's value were presented by witnesses at the [first] trial. As best we can determine, it appears that the property's value is between $275,000 - $300,000. [Later, in the present Memorandum after the 3/8/04 Second Trial, we find that value to be $275,000].

Defendant Kappedahl defaulted on a mortgage covering the property, resulting in the mortgagee starting foreclosure proceedings and culminating in a sheriff's sale of the property on 12/10/02. That foreclosure meant that, if defendant Kappedahl wanted to redeem the property from the sheriff's sale, he would have 6 months to do so, by paying the foreclosure amount of some $85,000 by no later than 6/10/03.

About two months before the 6/10/03 mortgage redemption expiration date, Kappedahl responded to an ad in the Anoka County Shopper, placed by James Peterson. The ad offered to "bail out" homeowners who, like Kappedahl, were in foreclosure, "with a new C/D [contract for deed] or lease back." Defendant Kappedahl got in touch with Peterson who, eventually, referred him to plaintiff River Run Properties. River Run is in the business of building new homes and renovating old ones, doing some small land development properties, and -- during the last year -- helping people who are in mortgage foreclosure.

Kappedahl met with James Hoag, a principal at River Run, on 5/29/03. Hoag proposed several different options to Kappedahl, one of which called for Kappedahl to sell the property to River Run (which would then redeem the property from the sheriff's sale), and for River Run to then sell the property back to Kappedahl on a contract for deed. On that day, 5/29/03, River Run's Hoag signed two purchase agreements (Kappedahl's sale to River Run, and River Run's sale back to Kappedahl) and left them with Kappedahl. Apparently, Kappedahl signed both purchase agreements two days later, on 5/31/03.

Nine days later, on 6/9/03 (the next-to-last-day for Kappedahl to redeem the property from the sheriff's sale), Kappedahl agreed to go forward with those two sales transactions. Closings were then conducted that same day, 6/9/03 : Kappedahl sold the property on a warranty deed to River Run for the

$85,000 needed to redeem the property from the sheriff's sale, and River Run sold the property back to Kappedahl for $117,000 on a contract for deed.

In the months thereafter, defendant Kappedahl defaulted on the contract for deed payments (he hasn't made any of them), and River Run then cancelled the contract. Kappedahl did not cure the defaults within the 60-day cancellation-redemption period, but did not move out of the property. Accordingly, River Run then started an eviction (unlawful detainer) action.

NOTE : The only thing we need to add to bring the reader up to date is the procedural history of the case. We've done that already, above, where we identified and briefly discussed the Two Trials and the Two Orders for Judgment in the case : the First Trial, the unlawful detainer trial, on 11/7/03 which resulted in the 12/9/03 First Order for Judgment ; and the Second Trial, the new trial, on 3/8/04 that consolidated the original unlawful detainer action (possession) with an ejectment/declaratory judgment action (title). It's that Second Trial which is the subject of the 6/28/04 Second Order for Judgment and of the present Memorandum.

* * * * *

OUTRIGHT SALE *VERSUS* EQUITABLE MORTGAGE

This is the central issue in the case : whether the transaction between plaintiff River Run and defendant Kappedahl was

> EITHER what it appears to have been from the documents -- a *sales transaction* -- with an outright warranty deed sale of the Property by Kappedahl to River Run, and then a contract for deed sale of the Property by River Run back to Kappedahl.
>
> OR that the transaction was really something else -- *a loan transaction* -- with the warranty deed being security (an "equitable mortgage") for River Run's loan of money to Kappedahl.

Different Termination Methods and Different Redemption Periods

Resolution of that central issue (sale vs. loan) will dictate the outcome of this litigation. That's so, because a contract for deed (if this was a sales transaction) and a mortgage (if this was really a loan transaction) require different methods for termination and different periods of time for redemption from the termination.

Termination (foreclosure) of a mortgage has the disadvantage of requiring a lengthy, multi-stepped, and expensive process ; and the redemption period for the defaulting mortgagor from a mortgage foreclosure is a generous six months. By contrast, the termination (cancellation) of a contract for deed has the advantage of being simpler and quicker. Cancellation of the contract can be done in one short, cheap step -- service of a cancellation notice ; and the redemption period for the defaulting vendee from a contract cancellation is markedly sparse, only 60 days.

Effect on Unlawful Detainer and Ejectment/Declaratory Judgment

Here's how those differences between a mortgage and a contract for deed dictate the outcome of this litigation involving unlawful detainer and ejectment/declaratory judgment.

If the transaction between plaintiff River Run and defendant Kappedahl was a sale, fee title to the Property was transferred to River Run on the transaction date of 6/9/03 and, several months thereafter, owner-contract vendor River Run has already terminated vendee Kappedahl's contract interest, because Kappedahl did not redeem from River Run's cancellation of the contract within 60 days. Accordingly, in that scenario, the Court would issue an unlawful detainer Writ of Recovery to River Run, evicting Kappedahl from physical possession of the Property, and would make a declaratory judgment declaration that River Run is the owner of the Property.

On the other hand, if the transaction between plaintiff River Run and defendant Kappedahl was not an outright sale but only a loan of money, fee title to the Property would not have been transferred to River Run on the 6/9/03 transaction date but, instead, would remain in Kappedahl's name, subject to River Run's equitable mortgage. And, that resulting mortgage has not been terminated, because River Run has never even commenced a mortgage foreclosure process. Accordingly, in that scenario, the Court would not issue a Writ of Recovery evicting Kappedahl from physical possession of the Property, and would make a declaratory judgment declaration that Kappedahl continues to be the owner of the Property.

Effect on the Usury Issue

Resolution of the "sale vs. loan" issue will not, by itself, directly resolve defendant Kappedahl's other affirmative defense or claim -- that plaintiff River Run charged him an excessive (usurious) amount of interest. Rather, resolution of the sale vs. loan issue will only tell us if we need to go on and consider the usury issue in the first place. More specifically, if we find that the 6/9/03 transaction was the sale it appeared to be, then we would *not* need to go on and consider the usury issue, because usury applies to loans, not sales. That's why, after the 11/7/03 First Trial in the 12/9/03 First Order for Judgment, we did not go on to consider the usury issue -- because there we found that the 6/9/03 transaction was a sale. Resolution of the sale vs. loan issue has the same "triggering effect" at the 3/8/04 Second Trial, the new trial : *only if* we find that the 6/9/03 transaction really was a loan, do we need to go on and consider whether River Run charged Kappedahl an excessive (usurious) amount of interest on that loan.

Ultimately we now find, after the 3/8/04 Second Trial, that the 6/9/03 transaction was really a loan. Accordingly, resolution of that issue triggers our need to go on and consider whether plaintiff River Run charged defendant Kappedahl an excessive (usurious) amount of interest on that loan -- an issue we grapple with later on in this Memorandum.

Importance of Intent in
Resolving the "Sale vs. Loan" Issue

The appellate courts of probably every single state in the country have often considered the central issue in our case : whether any given transaction is what it appears to have been -- an outright sale of property that transfers title and ownership -- or only a loan that does not transfer title and ownership, but only provides security for the lender in the form of an equitable mortgage. Minnesota's appellate courts are no exception. Appellate decisions on that issue sprinkle the pages of Minnesota's law books from shortly after statehood in the 19th century down to these first years of the present 21st century.

What emerges, over and over again, from all of those appellate decisions is the fundamental importance of the *intention* of the parties or, as no less a judicial personage than Justice William Mitchell himself posed the critical inquiry many years ago : "The true test is, what was the intention of the parties? Did they intend security or sale?" *King v. McCarthy*, 52 N.W. 648 (Minn. 1892). The parties in our case agree that determining their intention at the time of the 6/9/03 transaction is the critical inquiry.

Aside from announcing that, generally, the parties' intention is the critical inquiry, the appellate decisions provide some more particular guidelines and factors to consider in conducting that inquiry. When, after the First Trial, we resolved the issue of River Run's and Kappedahl's intention, we almost exclusively considered the guidelines and factors (or so-called "corollaries") itemized in *Ministers Life and Casualty Union v. Franklin Park Towers Corp.*, 239 N.W.2d 207, 210 (Minn. 1976). See : *Court's First Tr. Memo* at pp. 3-7. Comparing the facts of our case with *Ministers Life's* corollaries, we concluded that "[a]ll of those seven corollaries apply fully to our case and show that the parties' intention was that their transaction was a sale, and not a loan." *Court's First Tr. Memo* at p. 4.

Disparity : The Linch-Pin of Our Present Decision

What's most significant about the inquiry we conducted after the First Trial into the parties' intention is -- the absence of something. For, not once during that inquiry at pp. 3-7 did we ever take note of the great disparity between the $275,000 value of the Property and the $85,000 price at which River Run bought it from Kappedahl.

It was only after the First Trial that we were struck by the stark reality of that disparity and -- more importantly in this discussion about the parties' intention -- what that disparity reveals about their true intention. In point of time, that realization first struck me during oral arguments on defendant Kappedahl's motion for post-trial relief, when defendant Kappedahl's attorney graphically illustrated the linch-pin impact of that three-times disparity on the question of the parties' intention. It was largely because of that argument, based on the disparity between the $275,000 value of the Property and the $85,000 sales price, that the Court granted Kappedahl's motion for a new trial. Because that disparity has become, at least for me, the linch-pin of this case, we'll repeat verbatim[1] here what we had to say about that disparity-based argument :

> There was one particular argument, made by defendant's attorney Kallas at the 12/16/03 oral hearing on the new trial motion, that convinced me that issuance of the unlawful detainer Writ was erroneous and not supported by the trial record. That argument went something like this :

[1] The only change, from that otherwise verbatim recitation, is that it now correctly states Kappedahl's net monetary gain from the warranty deed sale to River Run -- *$20.65*.

> Assume that the parties really intended the Warranty Deed to be an absolute sale. If so, that would mean that the parties really intended to have Kappedahl sell his $275,000 property to River Run for $85,000, from which he would garner (at the closing on the sale) the paltry sum of $20.65. That would also mean, if that's the result the parties really intended, that after the Warranty Deed sale River Run would have free-and-clear title to the property and that Kappedahl would be absolutely divested of title.
>
> That argument (by attorney Kallas) led to this bottom-line clincher, namely : no reasonable person, whether "seller" or "buyer", could really have intended that result. Rather, any reasonable seller, if he really intended to absolutely divest himself of title, could have done so with a sale that would have generated a net gain to him of much more than $20.65. Such a reasonable seller would have -- could have easily -- accomplished that much more favorable result by selling the property for its $275,000 value, thereby realizing a gain of $190,000 ($275,000 minus the $85,000 foreclosed mortgage). Admittedly, given the distressed circumstances that Kappedahl found himself in after the foreclosure of his mortgage with his bank-lender, he might have been forced to sell the property at a severely discounted price, say nearly 50%, at $150,000. But even then, for divesting himself fully of title, he would have garnered $65,000 -- which still contrasts dramatically with the $20.65 he garnered from the "sale" of the property to River Run.
>
> In summary, that argument by attorney Kallas at the 12/16/03 hearing on the new trial motion was this : no reasonable seller (Kappedahl) would have intended that result -- full divestiture of title for $20.65 ; nor would any reasonable buyer (River Run) have intended that result either, at least not if it were operating in good faith.
>
> None of that represents amended or additional findings of fact. All of those figures (the $85,000 sales price, the approximately $275,000 value of the property, the net gain to Kappedahl of $20.65) were part of the state of the record at the 11/7/03 unlawful detainer trial. But the conclusion that can reasonably be derived from that state of the record is new, at least for me. The Court, in resolving the 11/7/03 unlawful detainer trial, should have given serious consideration to that conclusion or argument. Not to do so was erroneous.

Court's 3/4/04 Summary J'ment Memo at pp. 2-3.

Importance of Disparity
in the Law : Generally

It's not only this Court that views disparity between a property's value and its sale price to be an important factor in determining the intention of transacting parties. That is also the view of Minnesota's appellate courts, many other states' appellate courts, and scholarly commentary on the subject.

Minnesota Appellate Courts

on the Subject of Disparity

Several Minnesota Supreme Court decisions have highlighted the disparity between a property's value and its sales price in determining the true intention of the transacting parties.

In *King v. McCarthy*, supra (written, as noted earlier, by Justice Mitchell), the Court stated that "[a]nother circumstance entitled to weight is the disproportion between the amount Bell was to advance to remove encumbrances and the value of the property. The amount of the encumbrances did not exceed $10,000, while Bell admits that at the time he obtained the deed from McCarthy the property was worth $22,000." 52 N.W. at 648.

In *Sanderson v. Engel*, 234 N.W. 450 (Minn. 1931), the Court found the transaction to be an equitable mortgage because, among other factors, there was a disparity between the property's value of $1,400 and its sales price of $700. That disparity "favors [the grantor, such as Kappedahl in our present case], for the trier of fact might think it unlikely that property wroth $1,400 was conveyed for $700, and more likely think that the $700 was a mortgage gradually to be paid off month to month." *Id.* at 451.

In *Gagne v. Hoban*, 159 N.W.2d 896, 900 (Minn. 1968), the Court upheld a trial court's determination that the transaction was an equitable mortgage because, among other things, "the trial court could take into consideration the fact that the value of the property was greater than the consideration given for the deed, a circumstance which could well have influenced the court in determining that the debt was intended to operate as a mortgage."

In *Holien v. Slee*, 139 N.W. 493, 495 (Minn. 1913), the Court found that the deeds in that case were really mortgages, and stated that "[i]nadequacy of consideration and conduct inconsistent with the theory of ownership are always material to establish a claim such as is here made by the plaintiffs [who were in the position defendant Kappedahl is in our case] . . . It appears conclusively that the consideration, claimed to have been paid by the defendant for the farm lands, was grossly inadequate . . . ."

Those decisions by the Minnesota Supreme Court call into serious question -- actually, totally refute -- the assertion by plaintiff River Run that "defendant [Kappedahl] cannot now challenge the consideration provided by either party in the transaction, and courts do not inquire into the sufficiency of the consideration the parties to a contract have agreed upon." *Pl. River Run's Post-2nd Tr. Memo* at p. 6. That latter assertion may be true in a case at law, but has no application to a case like ours, where equity is fully at play.

Finally, I have not found any Minnesota appellate decision, nor has any been called to my attention, where the disparity between the value of the property and its sales price was as great as it is in our case : more than three times greater (3.24 times to be precise) than the $85,000 sales price, if the Property's value is the $275,000 we have found, and still nearly three times greater (2.88 times to be

precise) than the $85,000 sales price, if the Property's value were the $245,000 opined by plaintiff River Run's expert real estate appraiser at the Second Trial. So, the disparity in our case is -- quite literally -- unprecedented in the pages of Minnesota appellate history.

Scholarly Commentary on the Relationship Between Disparity and Intention

A long-recognized, well-respected source of scholarly comment on the law of real estate is *Powell on Real Property*. In his discussion at § 37.18, "Equitable Mortgages--Absolute Deed Given as Security", Powell says the following about the effect of disparity :

> The courts always examine the intentions of the parties. The intentions of the parties can be established by a review of the facts. Some of the facts tending to establish the mortgage character of the transaction are :
>
> > (1) the size of the sum owed in comparison with the value of the land interest conveyed (the greater the disparity, the more likely that the deed was intended as security) . . . .

4 *Powell on Real Property* (Michael Allan Wolf, general editor) § 37.18 at p. 37-118 (2000). One of the appellate decisions cited by Powell for that quoted proportion is *Sanderson v. Engel*, a Minnesota Supreme Court decision discussed by us in the immediately preceding section of this Memorandum.

An equally-respected source of scholarly commentary on the law of real property is the American Law Institute's *Restatement Third, Property*. One volume of the Restatement is devoted entirely to Mortgages, wherein is found § 3.2, "The Absolute Deed Intended as Security." In its "black-letter" statement of the law on that particular topic, the Restatement also gives prominence, not simply to mere disparity, but to "substantial" disparity between market value and sales price :

> (b) Intent that the deed serve as security must be proved by clear and convincing evidence. Such intent may be inferred from the totality of the circumstances, including the following factors : . . .
>
> > (2) the presence of a <u>substantial disparity</u> between the value received by the grantor and the fair market value of the real estate at the time of the conveyance.

Restatement Third, Property (Mortgages), § 3.2 (1997) (emphasis added). The Restatement then goes on to point out what hardly needs to be pointed out -- the common sense basis for the importance of this factor of "substantial disparity" :

> A substantial disparity between the value received by the grantor and the fair market value of the land at the time of the conveyance is strong evidence that security was intended, as in Illustrations 3 and 5. Normally rational people, other than in gift transactions, do not transfer land without receiving a purchase price that approximates its fair market value. On the other hand, as in Illustration 4, if the disparity between the amount advanced and the fair market value of the land is relatively small, it indicates a sale and not a mortgage transaction.

Id. at p. 118 (emphasis added).

The respective disparities in the Illustrations (at p. 119) are noteworthy, when contrasted with the disparity in our case : the disparity which the Restatement views as being "substantial" in Illustrations 3 and 5 ($50,000 market value and a $25,000 sales price) is a mere two-times disparity contrasted with the three-times-plus disparity in our case ; the disparity which the Restatement views as being "relatively small" in Illustration 4 ($25,000 to $30,000 market value and a $25,000 sales price) isn't even in the same ballpark as the three-times-plus disparity in our case.

Appellate Decisions by
Other States' Courts on the
Subject of Disparity

Those views by Powell ("the greater the disparity, the more likely that the deed was intended as security") and by the Restatement ("A substantial disparity . . . is strong evidence that security was intended") are shared by appellate courts in many states. Many of those decisions are collected and discussed in an extensive annotation at 89 *ALR 2d* 1040, entitled "Value of property as factor in determining whether deed was intended as a mortgage."

This *ALR 2d* annotation devotes a section to appellate decisions that could be characterized, in Powell's words, as standing for the proposition "the greater the disparity, the more likely that the deed was intended as security." More specifically, this annotation heads off that section with this introductory statement :

> In the following cases it was held that the disparity between the value of the property purported to have been conveyed by the instrument in question and the amount of the recited consideration was *so substantial* as to warrant a finding, in connection with other facts, that the instrument, although in form an absolute deed, was intended by the parties to be a mortgage, or at least, was a *potent or material factor* indicating that a mortgage was intended, when considered in connection with other circumstances tending to negative a conveyance.

89 *ALR 2d* at 1046 (emphasis added).

The many cases (collected and discussed following that *ALR 2d* introductory statement) illustrate and re-inforce the interpretative effect of the disparity being "so substantial" or at least being a "potent or

material factor." Admittedly, in some of those collected cases, the disparity was not merely substantial -- it was downright ridiculous, for example, in a Colorado Supreme Court case where the sales price was $150 and the property's value was 13 to 16 times greater, somewhere between $2,000 and $2,500.

But most of those collected cases have a disparity between value and sales price that is about the same as -- sometimes even less than -- the "three times factor" in our case. We're not going to set forth *all* those collected cases here (there are at least 25 such cases in the main text of 89 *ALR 2d* and three more in the *ALR 2d* Later Case Service where the disparity is about the same or even less than the disparity in our case). You can consult the annotation and those collected cases on your own.

Those collected cases establish the nation-wide appellate consensus that, in determining the intention of the transacting parties, disparity between value and sales price is always a factor to at least take into account and -- if great enough -- a factor that becomes almost determinative that the parties intended a loan and not an outright sale. I think the same is true for Minnesota. I seriously doubt that Minnesota law (Minnesota equity, really) is likely to characterize a transaction as an outright sale, where the disparity between value and sales price was a factor of three times, as it was in our case.

Facts and Circumstances the Court Ignored at the First Trial

The disparity between the value of defendant Kappedahl's Property and the price plaintiff River Run paid for it was not the only fact we ignored in our Order/Memorandum after the First Trial. Now, after the Second Trial, we have taken account of those other facts for the first time and have given them the weight they deserve. We think these other facts, taken together with the disparity between value and sales price, shed an even brighter light on the parties' intention that the 6/9/03 transaction would really constitute a loan/security transaction, and not an outright sale. We'll discuss these other facts, ignored by us at the First Trial, pretty much in chronological sequence.

Nature of the Solicitation That Gave Rise to the Transaction : The solicitation that would ultimately lead to the 6/9/03 transaction between defendant Kappedahl and plaintiff River Run was an ad in a shopper-type newspaper. The ad had been placed, not by River Run, but by James Peterson, a realtor with ReMax Realty who sometimes referred people responding to the ad to River Run (as Peterson did with Kappedahl).

When we discussed that ad in our Order/Memorandum after the First Trial, we quoted only that part of the ad which says (in regular print) : "We will bail you out with a new C/D [contract for deed] or lease back." *Court's First Tr. Memo* at pp. 2 and 6. But we never quoted the larger-print, bold-face, eye-catching headline to that ad : "**DON'T LOSE YOUR HOME!**" *See :* Exh. 113.

As defendant Kappedahl's attorney has correctly observed, the "message of this advertisement is to allow the customer to be bailed out and keep their home. The advertisement is not directed to one who is interested in selling his home." *Def. Kappedahl's Post-2d Trial Memo* at p. 4 (emphasis added). And that phrase "Don't Lose Your Home!" epitomized all of Kappedahl's testimony at both trials. By that testimony, defendant Kappedahl established his intent not to sell his home, an intent probably more strongly-held than with the average homeowner : Kappedahl bought the 6 ½ acres of raw land on which the house sits, he designed the structure himself and built it, and has lived there for about 14 years. Over the years he has improved the structure, a process that is still on-going today. All of that conduct by Kappedahl is consistent with a homeowner who does not want to "lose" his home and who does not want to outright sell it.

Plaintiff River Run will predictably complain about our findings about the ad, since the ad was placed by realtor Peterson, not by River Run. But, given Peterson's occasional practice of referring customers responding to the ad to River Run, we agree with degree Kappedahl that "the content of the ad is a circumstance surrounding the transaction that sheds light on Kappedahl's *and* River Run Properties' motivation." *Def. Kappedahl's Post-2d Tr. Memo* at p. 4 (emphasis added).

No Attempt to Sell on the Open Market ; Never Advertised for Sale : These italicized circumstances were never even alluded to in our Order/Memorandum following the First Trial. As one "bail out" option, realtor Peterson did offer to list the Property for sale, on the open market, in the usual way, but defendant Kappedahl rejected that option out of hand. When Peterson ultimately referred Kappedahl, River Run must have had at least an inkling that Kappedahl didn't want to outright sell the Property on the open market, or why else would Peterson -- a listing realtor -- have referred him to River Run? Apparently, River Run itself is not a listing realtor.

We think this conduct by the parties (not listing the Property for outright sale on the open market) tends to support our finding that both parties intended the 6/9/03 transaction to be a loan/security arrangement, not an outright sale of the Property by Kappedahl to River Run. One of the long-recognized, well-respected commentators on real estate law (whom we cited earlier) is of the same opinion. He lists this kind of circumstance as a factor tending to support the parties' intent to loan/borrow, not to sell/purchase : "(6) the normal steps accompanying a sale of real estate are not taken (i.e., there is no listing with a broker and no contract of sale)." 4 *Powell on Property*, supra, § 37.18 at 37-119 (1997) (emphasis added).

Admittedly, Powell mentions "contract for sale" (meaning a purchase agreement) and, of course there were two purchase agreements in the transaction between our parties, one for the warranty deed sale by Kappedahl and one for the contract for deed sale by River Run. But in our case, those purchase

agreements were not generated by the mechanism of the open market, as they are in almost all transactions where the parties intend an outright sale.

No Negotiations on the Sales Price ; Sales Price Not Based on Value : We never took these italicized facts into account in the Order/Memorandum following the First Trial. The $85,000 sales price for River Run to purchase the Property from Kappedahl had nothing to do with the $275,000 value of the Property. Rather, the sales price was based entirely on the amount ($83,955.85) needed to redeem the Property from the sheriff's foreclosure sales of six months earlier.

That reliance (on an amount other than the Property's value to set the sales price) was a feature of the parties' discussions from the outset, starting with the first time James Hoag of River Run met with Kappedahl on 5/29/03 at Kappedahl's home. In setting the sales price for the warranty deed at their first (and only) pre-closing meeting, Hoag did not use the Property's value as a benchmark ; rather, he was only intent on calculating the monthly payments that Kappedahl would have to make on the contract for deed that River Run would give back to Kappedahl. *See :* Exh. 55, Hoag's handwritten calculations at their first meeting.

Pegging the sales price on an amount other than -- and far less than -- the Property's value is conduct by the parties that is inconsistent with an intention to complete an outright sale of the Property.

Further, that $85,000 sales price on the warranty deed sale from Kappedahl to River Run was fixed in stone from the outset and was never the subject of any negotiations -- again, contrary to the usual haggling practice of parties who are intent on effecting an outright sale. Apparently, though, River Run's attorney disputes that characterization of the parties' pre-closing discussions. At many points in her cross-examination of defendant-witness Kappedahl, especially at the Second Trial, she led and coaxed Kappedahl to acknowledge that Kappedahl himself had "negotiated the sales price for the Property to River Run." Plaintiff's attorney argued the same thing in writing : "Defendant [Kappedahl] negotiated the price of the sale. He admitted that if they [River Run] did not meet his price he would not do the deal." *Pl. River Run's Post-2d Tr. Memo* at p. 7.

But that's simply not true. What defendant Kappedahl was able to negotiate was a reduction of the balloon payment on the contract for deed from River Run back to Kappedahl. The parties never even attempted to negotiate the $85,000 sales price for Kappedahl's warranty deed sale to River Run. And it's the warranty deed part of the transaction that's critical here, because plaintiff River Run bases its claim of Kappedahl's outright sale of the Property on that warranty deed.

Incidentally, the fact that defendant-witness Kappedahl was so easily led and coaxed into acknowledging that he had "negotiated the price of the sale", even though that's not true, reveals a lot about him. It reveals, as his attorney suggests, "Mr. Kappedahl's ability to be directed or controlled." *Def. Kappedahl's Post-2d Trial Memo* at p. 4. It also reveals that Kappedahl does not have nearly the

extent of real estate expertise that River Run attributes to him, since -- long after the 6/9/03 transaction -- he still has little appreciation for what actually transpired there.

Simultaneous Transfer of the Warranty Deed and the Contract for Deed ; Sale Conditioned on Repurchase : We alluded to these italicized facts in our Order/Memorandum following the First Trial. But there we made no meaningful exploration of the implications to be drawn from those facts. We have done so now, after the Second Trial, but we'll let defendant Kappedahl's attorney articulate those implications :

> The [contract for deed] back to Kappedahl was contemplated at the time of [his warranty deed sale of the Property], as evidenced by the fact that both purchase agreements were signed by each party on the same day and the closing for each transaction occurred at the same time, at the same closing table, with the same settlement agent. The warranty deed to River Run Properties was conditioned upon the sale back to Kappedahl. The Minnesota Supreme Court has recognized that, if the second transaction was contemplated at the time of the first transaction, then an equitable mortgage would be found insofar as the first transaction would not be unconditional [that is, would not be an absolute outright sale]. The Court in *Roehrs v. Thompson*, 228 N.W. 340, 341 (Minn. 1929) stated :
>
> > The evidence does not compel the conclusion that when the deed was given the contract which followed 24 days later had been agreed upon, or that it was or ever became a mere instrument of defeasance converting the deed into a mortgage. Plaintiff's testimony is bluntly unequivocal to the contrary. It is opposed by that of Mr. Gruber, a witness for defendant and the banker who brought the parties together and drew the papers for them. He insists that when the deed was agreed upon and signed the contract was also agreed upon. Strange, then, that it was not signed and delivered concurrently with the deed.

Def. Kappedahl's Post-2d Tr. Memo at p. 3.

We agree with that *Roehrs*-based argument by defendant Kappedahl's attorney. A fairly drawn implication from the *Roehrs* holding is this : the closer in time that the contract for deed is given after the warranty deed has been given, the greater likelihood that the parties intended a loan/security transaction. In our case, they were given about as close together as is possible -- simultaneously, at the same closing.

Continuous Occupancy by the Grantor (Kappedahl) After the Transaction : At the First Trial we never considered these italicized facts. After Kappedahl's 6/9/03 warranty sale of the Property to River Run, he nonetheless continued to physically occupy the home, just as he had for the 14 previous years. His continued physical occupancy of the home was specifically contemplated by both parties from the outset. That's not a usual feature of an outright warranty deed sale of a home, where the grantee almost always takes physical possession of the home.

That's why Powell places this circumstance as high as second place in his catalog of facts and circumstances tending to show that the transacting parties intended a loan/security arrangement, not an outright sale : "(2) the retention of possession by the grantor after the conveyance." 4 *Powell on Real Property*, supra, § 37.18 at p. 37-119 (1997). The Restatement also high-lights this same factor in its "black-letter" catalog of factors for determining if the parties intended a loan, not an outright sale : "(3) the fact that the grantor retained possession of the real estate." *Restatement Third, Property* (Mortgages) at § 3.2.

Minnesota law also recognizes the significance of a grantor remaining in occupancy and not relinquishing possession. See : *Gagne v. Hoban*, 159 N.W.2d 896 (Minn. 1968). In *Gagne*, the grantor-plaintiff gave a deed, but took an option to purchase back. The *Gagne* Court found the transaction to be a loan transaction, and not an absolute sale, in large part because "the option contract . . . gave plaintiff the right to continue in use and occupancy of the property", thereby distinguishing it from an earlier case -- *Citizens Bank of Morris v. Meyer*, 182 N.W. 913 (Minn. 1921) -- where "the grantor relinquished possession of the premises." *Gagne*, 159 N.W.2d at 900 (emphasis added).

The *Ministers Life* List
Of "Corollaries"

As noted earlier, when we resolved the issue of River Run's and Kappedahl's intention after the First Trial -- and ultimately determined that they intended the 6/9/03 transaction to be an absolute sale and not a mortgage -- we considered, almost exclusively, the seven factors (called "corollaries") listed in *Ministers Life*, supra. See : *Court's First Tr. Memo* at pp. 3-7. Having now re-visited that issue of the parties' intention, we think our earlier nearly-exclusive reliance on the *Ministers Life* corollaries was wrong-headed, for a couple of reasons.

(1) *Undue Emphasis on the Facial Form of the Transaction Documents :* In an earlier Memorandum we noted this first instance of our mis-handling the *Ministers Life* corollaries :

> [T]he intent of the parties at the time they signed the Warranty Deed is the critical factor. In our 12/9/03 Order, we placed too much emphasis on the facial four-corners of the transaction documents, at the expense of the parties' intent with regard to those documents. That's apparent from our extended discussion in the 12/09/03 Memorandum of the "corollaries" listed by the Minnesota Supreme Court in its *Ministers Life* decision, 239 N.W.2d at 210. Some of those corollaries deal exclusively with the facial form of the Warranty Deed. Consideration of those corollaries is an important aspect of the analysis. But, from that severely narrowed perspective, the four corners of virtually any warranty deed will give the appearance of an absolute deed with full divestiture of title.

> However, inspecting the facial form of the deed-document only begins the inquiry. Otherwise, as defendant Kappedahl points out, there would be no such doctrine as "equitable mortgage." Rather, the inquiry must quickly leave the facial form of the deed-document to consider the parties' intent with regard to that document.

Court's 3/4/04 Summ. J'ment Memo at p. 4.

From earliest times, not just in Minnesota but in the United States, equity has taken that kind of enlarged -- not narrowed -- perspective of the transaction documents, no matter what their facial form might be. For example, 167 years ago, United States Supreme Court Justice Story (acting as a federal circuit justice) said that "[i]f the transaction resolves itself into a security, whatever may be its form, it is in equity a mortgage." *Flagg v. Mann* , 9 Fed. Cas. 202, 2 Sumn. 486, 533 (1837) (emphasis added), quoted by the Minnesota Supreme Court in *Stitt v. Rat Portage Lumber Co.*, 104 N.W. 561, 564 (Minn. 1905). And 121 years ago, the Minnesota Supreme Court said that "in order to carry out the actual intention in such a case, an enlarged view of the facts constituting the transaction will be taken by the court." *Madigan v. Mead*, 16 N.W. 539 (Minn. 1883) (emphasis added), also quoted in *Stitt*, supra. Probably the most succinct and eloquent statement of equity's enlarged view in these types of cases was made, also a long time ago, by the Minnesota Supreme Court in *Holien v. Slee* :

> Equity's vision is not circumscribed by formal instruments, but extends through matters of form to the heart of the transaction.

Holien v. Slee, 139 N.W. 493, 495 (Minn. 1913).

Similar statements of this principle -- discounting the facial form of the transaction documents *if, in fact, the parties intended a loan and not a sale* -- abound in Minnesota's appellate decisions. See, e.g. : *Hill v. Edwards*, 11 Minn. 22, 26 (1865) ("The particular form of words of the conveyance are unimportant") ; *Jentzen v. Pruter*, 180 N.W. 1004, 1005 (Minn. 1921) ("the form of the instrument upon which the lender acquires his security is not important. Whatever the form, there is a mortgage in fact") ; *Albright v. Henry*, 174 N.W.2d 106, 111 (Minn. 1970) ("whatever the form of the instrument of conveyance taken as the security, it is treated in equity as a mortgage") ; *First Nat'l Bank of St. Paul v. Ramier*, 311 N.W.2d 502, 503 (Minn. 1981) ("it may be treated as an equitable mortgage, without regard to the actual form of the instrument of conveyance. It is within the province of the court to determine, by looking beyond the form, the actual character of the transaction").

Our Order/Memorandum following the First Trial completely ignored that time-honored equitable principle of "looking beyond the form" of the parties' transaction documents. Far from looking beyond the four corners of those documents, we over-emphasized their facial form, at the expense of the

substance of the transaction. In doing so, we gave undue importance to the absence of technical terminology conventionally used in drafting mortgages, as per *Ministers Life's* corollaries (3) and (5) :

> (3) . . . The fact that the documents and negotiations were not in terms of "debt", "security", or "mortgage" is a strong circumstance indicating that the parties did not have a mortgage in mind . . . .
>
> (5) The fact that the instrument [document] claimed to be a mortgage does not contain a statement as required by Minn. Stat. § 287.03 that it is intended for security is important . . . .

Ministers Life, 239 N.W.2d at 210. But the absence of that technical drafting terminology was put in proper perspective by the Minnesota Supreme Court, again, a long time ago :

> It is true that witnesses did not use the specific technical terms conventionally appropriate to the creation of the relationship of mortgagor and mortgagee ; but this is not essential. Equity looks at the substance and not at the form.

Stitt, supra, 104 N.W. at 564.

(2) *The* Ministers Life *"Corollaries" Are Not an Exhaustive List ; The Context of the Unique Fact Situation in* Ministers Life *:* The second instance of our mis-handling the *Ministers Life* list of seven corollaries was to treat them as though they were a fixed formula or an exhaustive list of considerations. But, the *Ministers Life* corollaries are not the only factors. Nobody could ever compile such a one-size-fits-all list of factors by which to equitably measure all of the many different kinds of real estate deals that people in our society put together.

That factors in addition to the *Ministers Life* corollaries have to be taken into account should be apparent from our extended discussion (earlier in this Memorandum) about other important and relevant factors -- not specifically included within the *Ministers Life* corollaries -- such as disparity between value and sales price, the fact that the Property was never advertised for sale on the open market, grantor Kappedahl's continued occupancy of the Property after the purported outright sale, and the like. The *Ministers Life* Court itself recognized that it was compiling a non-exhaustive list of factors. It prefaced its listing of those factors (or corollaries) with this qualifying language : "Some of the corollaries which are particularly relevant to an evaluation of the present factor situation are : [and then the Court itemizes those seven corollaries]." *Ministers Life*, 239 N.W. 2d at 210 (emphasis added).

In our Order/Memorandum following the First Trial, we ignored the context of that "fact situation" in *Ministers Life*, even though it apparently was that "fact situation" which dictated just exactly which factors the *Ministers Life* Court choose to include on its list of corollaries. That fact situation in *Ministers Life* was truly unique, unlike any other among the many cases in which Minnesota's appellate courts have wrestled with the critical issue of "sale vs. loan."

The uniqueness of that fact situation was directly attributable to a circumstance entirely missing from our case : the proactive handling of grantor Franklin's side of the underlying transaction by an extraordinarily expert attorney, Stephen A. Scallen. That heavy involvement in the transaction by expert attorney Scallen -- on behalf of the ***grantor*** -- greatly assuaged the usual equitable concern that Minnesota courts have to protect an over-matched grantor (such as Kappedahl) against "overreaching." The Court explicitly acknowledged that this unique aspect, the heavy involvement of expert real estate attorney Scallen on the grantor's behalf, greatly assuaged that usual equitable concern :

> Running through all of these cases is the basic philosophy that a court will exercise its equitable powers to effectuate the intent of both parties to a transaction and to prevent any overreaching by one party which would unfairly exploit the other party's financial position or relative lack of expertise in real estate dealings. Applying this basic principle to the instant case, we first observe the unique situation of the party here seeking to invoke this court's equitable intervention. Franklin was represented throughout its dealings with Ministers by Scallen, whose sophistication and expertise in the field of real estate financing are so great that our basic concern for protecting a party against overreaching, which in past cases has prompted this court to construe a deed absolute on its face as an equitable mortgage, simply is not a factor here. In fact, the evidence in this case can lead to the conclusion that if there was any overreaching, it was on the part of the grantor, rather than the recipient, of the deed. . . .
>
> The fact that Scallen is a lawyer with unusual expertise in complex real estate financing is a factor that should therefore be given weight in evaluating Franklin's claim that the original transaction was intended as an equitable mortgage.

Ministers Life, 239 N.W.2d at pp. 210-11.

Of all the many Minnesota appellate cases dealing with equitable mortgages, we could not have chosen a case more unlike our own to serve as a standard than *Ministers Life*. We then compounded the problem by mechanically -- almost formulaically -- applying its limited list of seven corollaries to our case, without recognizing the uniqueness of the Ministers Life "fact situation." Doing so got our analysis off on the wrong foot and skewed the analysis we did thereafter in the First Trial Order/Memorandum. As a result, we cavalierly abandoned the Minnesota Supreme Court's "basic concern for protecting a party against overreaching, which in past cases has prompted [the Supreme Court] to construe a deed absolute on its face as an equitable mortgage." *Ministers Life*, 239 N.W.2d at 211.

Kappedahl's Real Estate Experience

Corollary (6) on the *Ministers Life* list says that "the fact that the grantor is experienced in business and real estate transactions, and is represented by a lawyer [during the underlying transaction] is material." 259 N.W.2d at 210. More than being "material", this factor apparently overwhelmed every other consideration in the estimation of the *Ministers Life* Court, given the extraordinary expertise of attorney Scallen who represented grantor Franklin during the underlying transaction.

Plaintiff River Run contends that Corollary (6) -- the grantor's (Kappedahl's) experience in business and real estate transactions -- is material in our case too. Kappedahl has had such experience in transactions involving two pieces of real estate : first, the subject Property (his home in Burns Township) ; and second, an investment piece of property in Andover. There was a little testimony at the First Trial about his involvement in purchasing (and eventually mortgaging) the subject Property. There was much more testimony at the Second Trial about his involvement with both pieces of real estate, especially the investment property in Andover.

We agree with plaintiff River Run that this trial testimony about defendant Kappedahl's business and real estate experience is "material." But, we disagree that Kappedahl had as much meaningful real estate experience as River Run suggests, and we certainly disagree that -- even if he does -- this factor would overcome the many other equitable considerations that show that both parties intended their 6/9/03 transaction to constitute a loan by River Run, and not an outright sale by Kappedahl. We evaluate this factor of Kappedahl's real estate experience in that way for a number of reasons, four to be exact :

FIRST, defendant Kappedahl may have been involved in a couple other real estate transactions before his 6/9/03 transaction with River Run, but he made no input into the actual structure of those transactions. Rather, he simply signed the documents that were put before him at the closings of those various transactions. He certainly was bound by signing those documents in those other transactions. But the point here, in evaluating the significance of Kappedahl's real estate experience, is that he lacked sufficient expertise to decide in the first instance what documents needed to be signed or to play any role in drafting those necessary documents.

All of that was true for the transaction which superficially makes him out to be a sophisticated, knowledgeable real estate investor. In this transaction Kappedahl bought a house -- the Andover Property -- for $140,000 from the owner who was in financial distress, fixed the house up, and then turned around and sold that house just a year later for $230,000.

But, although this investment idea originated with Kappedahl, it was not a solo performance. He had two co-investors, both of whom were realtors or, at least, were "in the real estate business" (Mitch Madsen and Marie Bakke). Madsen and Bakke determined the actual structure (the necessary

documents) needed for that transaction and, again, all Kappedahl did was to sign those documents. His actual contribution to the transaction was to do the hands-on fixing up of the house, for which he was reimbursed in the final accounting among the three co-investors, who split the investment profits three ways. As Kappedahl's attorney points out, evidence of that Andover investment project "does not demonstrate that Mr. Kappedahl is sophisticated in any way other than as a handyman." *Def. Kappedahl's Post-2d Tr. Memo* at p. 8.

SECOND, all of this testimony about defendant Kappedahl's purported real estate experience may be a lot of fuss over very little. Admittedly, from his experience with two other real estate transactions, Kappedahl probably was well aware of the nature of the documents (warranty deed, contract for deed) he signed at the 6/9/03 closing with River Run -- and the legal results that usually follow from an exchange of such documents. But equity is not somehow suspended, simply because a grantor knows the nature of those documents or the usual results that follow from an exchange of those documents -- just as long as other facts and circumstances show that both parties did not really intend those results to follow (that is : did not really intend the Warranty Deed to constitute an outright sale). And, that's exactly what we have determined other facts and circumstances in the case do, indeed, show.

In other words, at least for purposes of this point in the analysis, defendant Kappedahl concedes that he knew the nature and usual results of the 6/9/03 transaction documents. He is not claiming that he was mistaken about those documents or that he was surprised when those documents showed up at the 6/9/03 closing. Nor is he claiming that plaintiff River Run fraudulently tricked him into signing those documents. But defendant Kappedahl doesn't have to show the existence of those kinds of state of mind, either on his part or River Run's : "It is unnecessary to prove fraud, mistake, or surprise in the execution of the deed . . . All that it is necessary to prove is the intention of the parties." *Hewitt v. Baker*, 24 N.W.2d 47, 52 (Minn. 1946).

THIRD, River Run's heavy reliance on defendant Kappedahl's purported real estate experience may counter-productively generate two Catch-22-type problems for River Run in this analysis : **(1)** The more clearly it is shown that Kappedahl knew the nature of a warranty deed and its usual resulting divestiture of title, the more likely it is that he would not have intended that result with the 6/9/03 transaction, in light of his fervent desire not to "lose" his home (a desire that the other party to the transaction, River Run, was also well aware of). **(2)** The greater the extent of Kappedahl's real estate savvy, the less likely he would have entered into a transaction if he really intended the un-savvy business result of selling a $275,000 piece of property for $85,000. Or, as his attorney puts it : "Further, if Mr. Kappedahl were sophisticated in structuring and documenting real estate transactions, such proof would further support our contention that the transaction was a loan, for certainly a person sophisticated in

structuring and documenting real estate transactions would not sell a valuable piece of property for a net price of $20.65." *Def. Kappedahl's Post-2d Tr. Memo* at p. 8.

FOURTH, it's not just grantor Kappedahl's real estate experience that has to be taken into account. Rather, there's a ratio involved, in which grantee River Run's own real estate experience has to be factored. That's apparent from the *Ministers Life* decision itself, where the Court stated that equity will step in to "prevent any overreaching by one party which would unfairly exploit the other party's financial position or *relative* lack of experience in real estate dealings." 239 N.W.2d at 210 (emphasis added). In an unreported decision, the Minnesota Court of Appeals, citing *Ministers Life*, also noted the importance of that ratio : "[I]t is uncontroverted that McClelland [the grantee] possessed far greater business and real estate expertise than did Wagner [the grantor] and McClelland had previously made loans to other individuals." *Redmond v. McClelland*, No. C0-99-1811, 2000 WL 1015774, at *3 (Minn. App. July 25, 2000).

If that ratio of the parties' relative real estate expertise is the correct framework by which to analyze this factor, then there's no contest in our case. Near the very end of the First Trial, James Hoag (River Run's principal) testified -- perhaps unwittingly in this context -- that "we sell 1300-1400 houses a year through our real estate company." Further, near the start of the First Trial, he testified that "we have helped about 20 people in this fashion [i.e., by taking a warranty deed and giving a contract for deed back]." By contrast, on the other side of the ratio, Kappedahl had been involved in transactions on only 2 houses before his 6/9/03 transaction, and had never before been involved in a "warranty deed /contract for deed back" transaction.

Value of the Kappedahl Property ; Commission of "Waste"

As must be apparent by now, the disparity between the $85,000 sales price of the Property and its $275,000 value was the most important factor in this Court's conclusion that the parties intended the 6/9/03 transaction to really be a loan, not a sale.

At the Second Trial, plaintiff River Run presented considerable evidence about the physical condition of the Property. I'm assuming that one of the objectives River Run hoped to achieve by presenting that evidence was to reduce the disparity between the Property's value and the $85,000 that River Run paid Kappedahl to purchase the Property. Another objective for River Run's presenting that evidence about the Property's physical condition was to show that defendant Kappedahl had committed "waste" on the Property, i.e., either that he had passively allowed the Property to become run down, or that he had aggressively trashed the Property. Common sense dictates that committing waste is inconsistent with what Kappedahl argues he still has -- ownership of the Property.

Plaintiff River Run did not achieve either objective with its extensive presentation of evidence about the physical condition of the Property : we continue to find that the value of the Property was $275,000 ; and we do not find that Kappedahl committed waste on the Property.

Plaintiff River Run's Expert Appraiser ; The Interior of the House : James Hoag, River Run's principal, testified about the physical condition of the house. But, plaintiff River Run's major evidence about the physical condition of the Property -- and its value -- came from its expert witness, Michael Voto, a licensed real estate appraiser. At the Second Trial, he opined a value of $245,000 for the Property (contrasted with our ultimate finding of $275,000). For a number of reasons, though, we do not find appraiser Voto's testimony to be persuasive.

Voto himself characterized his appraisal as being only a "limited" appraisal. We would have characterized his appraisal in that way too, even if Voto hadn't. Voto only did a "drive-by" or "windshield" appraisal of the Property. He never set foot in the house itself. And the photos of the interior of the house that River Run provided to Voto for his appraisal were very few and very misleading. There were *no* interior photos whatsoever for Voto to review that showed :

the kitchen
the living room
the lower pool (billiards) room
the bathrooms
the upper level bedrooms
the lower level bedroom
the lower level family room
the walk-in closet

See : Exh. 54, the photos. Instead, the interior photos that Voto did get to review unfairly concentrated almost exclusively on some areas of the interior where Kappedahl has some improvement projects going on. During his own testimony, Kappedahl gave (what we find to be) an adequate report on the status of those on-going improvement projects.

Nothing in Voto's expert opinion, or in the interior photos, or in James Hoag's testimony shows that defendant Kappedahl has committed waste in the interior of the house. If anything, Kappedahl's testimony showed that he was taken steps to enhance the value of the Property. All of that evidence about the physical condition of the house's interior is consistent, not with the conduct of someone who feels divested of title, but rather of someone who believes he never relinquished title. Further, we find that the physical condition of the house's interior has not appreciably diminished the overall value of the Property.

Unprofessional Character of Voto's Appraisal Report : Getting back to expert appraiser Voto's opinion (that the Property has a value of only $245,000) : another reason we did not find his testimony to be persuasive is that it simply wasn't very expert, wasn't very professional. He acknowledged that, in a number of places in his written appraisal report (Exh. 57), there were "errors" and "incorrect information" and statements that "should have been omitted" and sentences that "could probably use some clarification" (all Voto's own words during his testimony).

Physical Condition of Land Surrounding the House : There was also testimony about and exterior photos of the physical condition of the land immediately surrounding the house. And, admittedly, those exterior photos depict a real mess : many (apparently) junked vehicles and other miscellaneous personal property scattered around the Property. However, that evidence of the physical condition of the land back-fired on River Run, and provided defendant Kappedahl an opportunity to make an emotional explanation about the junked vehicles. More specifically, Kappedahl testified that the junked vehicles belonged to his older brother, who was in the business of buying and selling such vehicles. When his brother recently died from cancer, those vehicles were on other people's property. So, Kappedahl moved them onto his own Property. Just as important, since the exterior photos were taken in January or February of 2004, Kappedahl has now moved those junked vehicles off his Property.

That history of the junked vehicles does not show that Kappedahl has committed waste on the land itself immediately adjacent to the house. Further, we find that the presence of those vehicles on the Property did not appreciably diminish the value of the Property.

Amount of Insurance Coverage on the Property : The only other piece of evidence that River Run offered at the Second Trial, in order to reduce the disparity between value and sales price, was the fact that Kappedahl insured the Property for only $144,300. *See :* Exh. 65. However, we did not find that insurance evidence to be compelling on the issue of the Property's value.

For one thing, that figure of $144,300 obviously represents the replacement value of only the house/structure ; that figure does not account for the value of the land (6 ½ acres of fully wooded land). Further, Kappedahl explained that he had not chosen that figure of $144,300 recently. Rather, he surmised that insurer State Farm had probably adopted that figure from earlier versions of the policy, years before. Frankly, that may be the experience of many homeowners with regard to the stated coverage for their houses/structures.

Conclusion : Value of the Property and Kappedahl's Commission of Waste : Ultimately, we find that the value of the Property at the time of Kappedahl's 6/9/03 transaction with River Run was $275,000. That figure nestles somewhere between the $245,000 figure urged by plaintiff River Run and the $300,000 urged by Kappedahl. Also, that value of $275,000 is only a few dollars more than the $273,100 determined by the county assessor, whose estimated market values are, as Kappedahl's attorney

has noted, "notoriously low." Accordingly, the disparity between the $275,000 value of the Property and the $85,000 that River Run paid Kappedahl for the Property -- a disparity we feel is the linch-pin factor on the "sales vs. loan" issue -- remains in the case.

And, finally, we find that defendant Kappedahl has not committed waste, either in the interior of the house or on the land itself. Hence, at least in that regard, defendant Kappedahl has not engaged in conduct inconsistent with his claim of continued ownership of the Property.

River Run's Own List of Facts and Circumstances

Plaintiff River Run has compiled its own list of facts and circumstances which, River Run argues, show that the parties intended their 6/9/03 transaction to be just exactly what it appears to have been -- an outright Warranty Deed sale of the Property by defendant Kappedahl and a Contract for Deed back from River Run. It's a long list, containing no less than 32 such facts and circumstances. See : *Pl. River Run's Post-2d Tr. Memo* at pp. 7-9.

We have carefully reviewed the River Run List, but we find that the Items listed there, whether considered individually or collectively, do not undercut the other facts and circumstances (which we have already extensively discussed in the Memorandum) that show the parties intended the 6/9/03 transaction to be a loan, not a sale. [**NOTE :** I'll warn the reader in advance -- our discussion of the River Run List of Items is very random, and not in any particular pattern or sequence].

The length of the River Run List is due, in part, to repetitious variations on several similar themes, such as :

> The facial form of the transaction documents [River Run **Items 1, 14, 15, 16, 17, 18, 19, 23, and 24**].
>
> The fact that defendant Kappedahl knew the nature of the transaction documents and the results that usually follow from an exchange of such documents [River Run **Items 9, 11, 27, 28, and 29**].
>
> Defendant Kappedahl's purported real estate experience [River Run **Items 10 and 30**].

In our earlier discussion in this Memorandum, we adequately addressed those Items as follows : we put into proper perspective the facial form of the transaction documents (that is, equity looks beyond the facial form of the transaction documents) ; we showed the irrelevance of Kappedahl's knowledge of the nature of the transaction documents and of the results that usually follow from an exchange of such documents (in that he's not claiming mistake, surprise, or fraud) ; and we severely discounted the extent of defendant Kappedahl's real estate experience and expertise.

Along the same lines as Kappedahl's knowledge of the true nature of the underlying documents exchanged at the 6/9/03 closing, is his knowledge of River Run's true status -- not as a "mortgage company", but as a "building business" -- meaning, I guess, that Kappedahl knew full well that he was unlikely to be giving a mortgage to a building business. [River Run **Items 6 and 25**].

I do not find Items 6 and 25 to be persuasive. For one thing, I frankly do not think Kappedahl has enough business experience to have made that subtle connection. More important, Kappedahl wanted help from somebody -- anybody. It's doubtful that, in those desperate financial circumstances, he would have had much concern over the exact status of the entity that could ultimately give him help.

In **Item 7**, River Run points out that Kappedahl "had time to think about the sale because of the time span [nine days] between signing purchase agreements and deciding to sell." However, this is an ambiguous circumstance which could cut either way. Kappedahl actually had much more time than that to "think about" it ; he had a full six months from the 12/10/02 sheriff's foreclosure sale. At any point during that six-month time span, he could have sold the property outright and reaped the considerable equity that would have remained after paying off the sheriff. Hence, it could be argued just as persuasively that, having had that extended span of time to think about it, Kappedahl chose to reject *that* option and thereby solidified his resolve not to sell his home outright.

That discussion of River Run Item 7 ("enough time to think about it") also goes a long way toward effectively addressing River Run **Item 12** : "[Kappedahl] made a conscious decision to refuse to sell [and, instead, to] gamble with his equity even though he could have netted his equity." But, Kappedahl was *not* "gambling with his equity" in the 6/9/03 transaction with River Run. Rather, having had six months to think about it, he saw the 6/9/03 transaction not as a "gamble", but as a "sure thing" -- a way to *keep* his home and equity. That's not gambling, and it's not the conduct of a homeowner who intended to outright sell his home.

Two of the Items on the River Run List are either factually inaccurate or are greatly overstated by River Run, as shown by our discussion earlier in this Memorandum : **Item 4**, in which River Run says that defendant Kappedahl "negotiated the price of the sale" ; and **Item 32**, in which River Run maintains that "the photos [Exh. 54] clearly showed distress and the waste of the property."

We missed the point of River Run's inclusion of two Items on its List or, at least, River Run hasn't explained how these Items show that the parties really did intend an outright sale, not a loan. In **Item 2**, River Run says that "[River Run] borrowed the money [the $85,000] to purchase the property." I do not understand why the source of River Run's funds shows its intent -- one way or another -- either to outright buy Kappedahl's home or to lend him money. If anything, River Run's borrowing the money tends to cast it in the role of a commercial investor, not a bona fide home-buyer. In **Item 13**, River Run (apparently talking now, for whatever reason, about Kappedahl's potential source of funds) says that

"[Kappedahl] had the money because he admitted he was working in 2003 but admitted making no payments on the house." I cannot even guess which way this Item points -- toward Kappedahl's intent to outright sell his home or toward his intent to borrow money.

In its **Item 8**, River Run says that "[River Run] and its realtor viewed the property like a purchaser", thereby arguably exhibiting conduct consistent with an intent to buy property, not lend money. The evidentiary basis for this Item rests on one single, leading, conclusory question by plaintiff River Run's attorney of defendant Kappedahl on cross-examination at the Second Trial :

> Q: And when Jim Hoag [River Run's principal] came to look at your house, he looked at the entire house, <u>just like a buyer</u> ?
>
> A: Yes

Testimony, Second Trial (emphasis added).

Well, we have already noted earlier in this present Memorandum, when discussing another area of his cross-examination, "Mr. Kappedahl's ability to be directed or controlled." More important, what exactly are the hallmarks of a person's conduct, demeanor, and statements that would lead to the conclusion that he's "looking at the entire house, just like a buyer" ? Does he look at it differently than a lender ? And, how is it that Kappedahl, with his limited real estate experience, would be able to discern the difference ? River Run hasn't answered any of those questions.

Further, I do not believe that Hoag looked at the house "just like a buyer" if, by that characterization is meant someone who's carefully inspecting the house as a place to outright buy and eventually live in. Rather, the evidence at Both Trials was that Hoag made a very cursory walk-through of Kappedahl's house. The cursoriness of his one-and-only walk-through became clear in the evidence : he overlooked some significant details about the house's structure and, in some instances, was mistaken about what he did see in the house during his walk-through.

In **Item 3** on the River Run List, it says that "[River Run] paid a commission to a real estate agent and had him at the showing [i.e. Hoag's walk-through of Kappedahl's house]." River Run is referring here to Mark Kneer, a realtor who did some independent contractor work for River Run in connection with about 20 other "warranty deed sale/contract for deed back" transactions. I guess River Run includes mention of realtor Kneer on the List because the deals that realtors usually help put together are sales of property, not loans of money.

But, Kneer's involvement in this particular deal with Kappedahl appears to have been minimal. The "showing" (the walk-through of Kappedahl's home) on which he accompanied Hoag was the very first time he had been "out" on one of these transactions, and it sounds like he was there just to "learn the

ropes" of such transactions. As he himself acknowledged in his First Trial testimony, during the walk-through he "just sat there at Kappedahl's house with Hoag who did all the talking."

In **Item 5**, River Run says that "[River Run] bought low [$85,000] and sold for a higher price [$117,000] back to [Kappedahl]. If it had been a mortgage, then there would not be a price increase, only a loan on the amount owing." We disagree. This "buy low/sell high" circumstance is hardly evidence that the parties engaged in the kind of genuine arms-length sales transaction where price increases are generated by forces of the open market. In genuine arms-length sales transactions, a property doesn't magically experience a $32,000 price increase within the 15 minutes it takes for the closing to occur. Hence, the $32,000 is not evidence of a price increase during a genuine sales transaction ; rather, that $32,000 was simply the usurious amount of interest River Run charged Kappedahl for the loan of $85,000.

That leaves us with River Run **Items 20, 21, 22, 26, and 31** -- all having to do with the parties' post-transaction conduct, related : either to the history of River Run's cancellation of the Contract for Deed, e.g., that River Run "completed proper statutory cancellation procedures" which defendant Kappedahl "did not challenge" ; or to the unlawful detainer action, e.g., "[Kappedahl] never treated the transaction as an 'equitable mortgage' before [River Run] brought this unlawful detainer action."

There's no blinking the fact that this post-transaction conduct by the parties, especially in regard to the cancellation of the Contract for Deed, is evidence that they considered the Contract for Deed to be an integral part of a genuine back-and-forth sales transaction. But, it's the <u>*only*</u> such evidence that River Run is able to muster. That evidence of the parties' post-transaction conduct does not begin to overcome all of the many other facts and circumstances that indicate the parties intended the opposite -- that the 6/9/03 transaction was a loan-and-security transaction, not a sales transaction.

CONCLUSION **:**
Sale vs. Loan ;
Presumptions ; and
the Burden of Proof

Defendant Kappedahl has some imposing obstacles to hurdle in his effort to establish that his 6/9/03 transaction with plaintiff River Run was really a loan-and-security transaction, and not the sales transaction it appeared to be.

From the very outset of that effort, Kappedahl faces a <u>*presumption*</u> -- the "controlling legal principle governing our resolution of all of these cases . . . that a deed absolute in form is presumed to be, and will be treated as, a conveyance unless both parties in fact intended a loan transaction with the deed as security only." *Ministers Life*, 239 N.W.2d at 210.

Further, Kappedahl has the difficult *psychological task*, not just of getting inside his own head at the time of the transaction, but also of getting inside the head of River Run as well : "Testimony as to the intention of one party only is insufficient as proof that a transaction in form a sale was in fact an equitable mortgage ; it must appear that *both* parties so intended." *Id.* (emphasis by the Supreme Court).

And finally, during all of that effort, Kappedahl must carry a heavy *burden of proof*, that of "clear and convincing" evidence. (No authority need be cited for that proposition). "Clear and convincing" evidence may be a little short of the "proof beyond a reasonable doubt" standard that prevails in criminal cases, but it certainly is heavier than the "preponderance of the evidence" standard that prevails in almost all other civil cases.

This Court's careful review of the evidence in this case shows that defendant Kappedahl has hurdled all those obstacles : He has shown by clear and convincing evidence that both he and River Run intended at the time of the 6/9/03 transaction that it would really constitute a loan/security arrangement (an equitable mortgage), thereby overcoming the presumption that it was an outright sale.

Burden of Proof on the Usury Issue : As a segue to the next section where we will discuss defendant Kappedahl's other affirmative defense (usury), and as long as we're talking here about burden of proof, we'll briefly discuss the burden of proof on the usury issue.

Stated simply, the burden of proof on the usury issue is the usual civil one of "preponderance of the evidence" -- period. There was suggestion in some ancient Minnesota Supreme Court decisions that "[a] party attempting to show usury has the burden of proving usury by a stricter preponderance-of-the-evidence standard than in ordinary civil actions." *Pl. River Run's Post-2d Tr. Memo* at p. 16, citing one of those ancient cases, *Yellow Medicine County Bank v. Cook*, 63 N.W. 1093, 1096 (Minn. 1895).

But, after many years of sending mixed messages about the burden of proof in usury cases, the Supreme Court unequivocally discarded that "stricter" baggage from the formulation :

> In view of the apparent conflict in our opinions, we take this occasion to clarify the rule. The degree of proof of usury, whether asserted defensively or as the basis for affirmative relief, shall be the same as the degree of proof in the ordinary civil case, that is, proof by a fair preponderance of the evidence.

Dege v. Produce Exchange Bank of St. Paul, 2 N.W.2d 423, 425 (Minn. 1942).

Once we get into our discussion of the usury issue in the next section, we will conclude that defendant Kappedahl has also met his burden of proof -- this time by a preponderance of the evidence -- on his affirmative defense of usury.

* * * * *

USURY : DEFENDANT KAPPEDAHL'S OTHER AFFIRMATIVE DEFENSE

Defendant Kappedahl's other affirmative defense (or claim) -- usury -- is not really a separate defense. It fits hand in glove with Kappedahl's affirmative defense of equitable mortgage. That's so, because if we find that the parties' actual intention was that the 6/9/03 transaction constituted a loan, with the Warranty Deed being security (or an equitable mortgage) for that loan, then the amount of interest River Run charged Kappedahl on that loan may have been excessive (usurious).

Elements of a Defense or Claim for Usury

The elements necessary to find that a loan was usurious are well-established in Minnesota. There are four such elements that the trial court must find :

1. A loan of money or forbearance of a debt;
2. An agreement between the parties that the principal shall be repayable absolutely;
3. The exaction of a greater amount of interest or profit than is allowed by law; and
4. The presence of an intention to evade the law at the inception of the transaction.

Rathbun v. W.T. Grant Co., 219 N.W.2d 641, 646 (Minn. 1974).

Elements 1 (a loan) and 2 (agreement to repay) are not controverted and have already been established, assuming that the Court finds -- as we have -- that there was an equitable mortgage. That is : if the 6/9/03 transaction was an equitable mortgage, then River Run actually made a loan to Kappedahl, and Kappedahl agreed to repay the principal of that loan absolutely.

Element 3 : Excessive Amount of Interest

This third element of a usury claim or defense is much more difficult to analyze than elements 1 and 2. It's the heart of any usury claim or defense, and requires some painstaking calculations and some careful tracking of applicable statutes. Defendant Kappedahl's attorney has already done that analysis and we adopt it. For the sake of convenience and continuity, we set forth his analysis here, taken nearly verbatim from defendant Kappedahl's Post-2d Trial Memorandum at pp. 10-13 :

> Regarding the extraction of a greater amount of interest or profit than is allowed by law, we must first determine the amount of interest actually recovered and compare that amount to the amount allowed by law.

The Defendant borrowed $85,000 and the Defendant received those funds by the payoff of the first mortgage through the redemption paid to the Anoka County Sheriff [$83,955.85], the paying of closing costs, and a check at closing for $20.65. This was the total of what the Defendant received in these transactions with River Run Properties. This is confirmed by the testimony of James Hoag in the first trial. . . .

Nevertheless, the Defendant agreed to pay River Run Properties $117,785.88 together with interest at 8.5% (Exhibit 109, the Contract for Deed). The difference between what Defendant received and what the Defendant agreed to repay is $33,830.03, more than 40% of the amount originally borrowed. [$117,785.88 minus $83,955.85 equals $33,830.03.]

To calculate the interest rate actually charged by River Run Properties requires a two-step process. The first step is to calculate an amortization of the Contract for Deed, using the payments called for in the contract. The payment obligations along with the interest rate and the duration are recited on the first page of the Contract for Deed (Exhibit 109). Those terms are incorporated into an amortization schedule (Exhibit 111) [which attorney Kallas put together, with the aid of a computer program].

The second step of the calculation is to utilize the exact same payments required by the Contract for Deed but to substitute the amount of the actual loan ($85,000) instead of the amount reflected in the Contract for Deed. Further, instead of inserting a fixed interest rate of 8.5%, the interest rate is calculated by the amortization [computer] program based upon the principal amount of $85,000 and the payments as recited in the Contract for Deed, As a result of that calculation, the amortization [computer] program has calculated an annual percentage rate of 26.031% (Exhibit 112).

In the case of *Redmond v. McClelland* [an unpublished decision, cited at p. 25 of the Court's present Memorandum], the court of appeals finds that usury limits apply to equitable mortgages. In that case, the court found an equitable mortgage to exist and reversed the trial court's dismissal of a claim of usury. In the court's discussion of the usury claim, the court identified the 8% interest rate specified in Minn. Stat. § 334.01, subd. 1 (1998) as the relevant rate of interest.

Minn. Stat. § 334.01, subd. 1, provides that:

> No person shall directly or indirectly take or receive in money, goods, or things in action, or <u>in any other way</u>, any greater sum, or any greater value, for the loan or forbearance of money, goods, or things in action, than $8 on $100 for one year.

This statute describes broadly the items to be received that will constitute interest, including money, goods, things in action, or "in any other way." In this case, River Run Properties lent $85,000 and received a fee of $33,830.03 together with 8.5% interest, partly in the form of a higher resale price.

In addition to the above interest limitation of 8% set forth in Minn. Stat. § 334.01, subd. 1, Minn. Stat. § 47.20, subd. 4(c) also limits the interest rate on

> conventional mortgages and contracts for deed. Interest rates applicable to conventional loans and contracts for deed with a duration of ten (10) years or less are set forth in Minn. Stat. § 47.20, subd. 4(c). That section refers to a rate three percentage points above a rate described in a formula set forth in Minn. Stat. § 47.20, subd. 4(a), or 15.75% per year, whichever is less. That formula adjusts monthly. The Minnesota Department of Commerce publishes a schedule of interest rates (previously supplied to the Court) calculated pursuant to the formula set forth in the statute cited. The published rates indicate that in June, 2003, the rate is 12.42%. This rate (and the outside limit of 15.75% and the 8% limit of Minn. Stat. § 334.01) is significantly less than the rate of 26.031% charged by River Run Properties in this transaction.

Def. Kappedahl's Post-2d Tr. Memo at pp. 10-13 (emphasis is Kappedahl's).

Plaintiff River Run's Arguments
Against Defendant Kappedahl's Claim
of Excessive Interest in Element 3

Plaintiff River Run raises a number of arguments against defendant Kappedahl's calculations of excessive interest in element 3. However, none of those arguments by River Run are persuasive.

Usury Does Not Apply to Sales : This italicized argument may be correct in the abstract, but it lacks the requisite concrete factual premise : The 6/9/03 transaction was not a sale. In our analysis of the "sale vs. loan" issue, when discussing defendant Kappedahl's equitable mortgage defense or claim, we found that the parties themselves intended the 6/9/03 transaction to be a loan -- not a sale.

Interest Must Be Calculated on the $117,758.55 Payable Under the Contract for Deed, Not on the $85,000 Warranty Deed : We disagree with this italicized argument by plaintiff River Run, pretty much for the same reason we disagree with River Run's first argument. Again, this issue -- regarding the amount upon which interest must be calculated -- was effectively resolved when we found the parties really intended the Warranty Deed transaction to constitute a loan. Once we found that to be so, the relevant loan figure for purposes of calculating interest is the $85,000 River Run lent to Kappedahl, not the $117,785.88 in payments under the Contract for Deed.

Exception for Loans Exceeding $100,000. This italicized argument by River Run is really a variant of its two previous arguments -- that if there really were an equitable mortgage, the amount lent was the $117,785.88 in payments called for by the Contract for Deed. Here, this variant argument takes the form of a resort by defendant River Run to Minn. Stat. § 334.03, subd. 2, which provides an exception (from the reach of a usury claim) for loans that exceed $100,000. However, the § 334.03 exception is expressly subject to its own exception -- "an exception within an exception", in other words. Defendant Kappedahl explains why plaintiff River Run cannot avail itself of the $100,000 exception :

> The exception for loans exceeding $100,000 contained in Minn. Stat. § 334.03, subd. 2, specifically provides that it applies except as stated in Section 58.137. The cited section provides that a lender's fee in a residential loan transaction must not exceed 5% of the loan amount. Therefore, since the exception to the exception was not met, Plaintiff does not have the benefit of this $100,000 exception, even if the amount of the loan exceeded $100,000.

Def. Kappedahl's Post-2d Tr. Memo at p. 15 (emphasis is defendant Kappedahl's).

No Interest Has Actually Been Paid by Defendant Kappedahl : As support for this italicized argument, River Run relies on a decision by a federal district court for the District of Minnesota. See : *Egge v. Healthspan Services Company*, 115 F. Supp. 2d 1126 (D. Minn. 2000). *Egge* has no binding precedential effect on this Minnesota state court. Further, *Egge* did not deal directly with any purported requirement that a usury claimant must have paid interest to maintain a claim for usury. Rather, Egge dealt directly with the statute-of-limitations provision in Minn. Stat. § 334.02.

Most importantly, as defendant Kappedahl points out, the statute that *is* squarely applicable on this issue -- § 334.03 -- voids any loan in which, among other things, an excessive amount of interest is "reserved" (that is, where the obligation to pay interest is not even "secured" or "taken" up front, as it indeed was in our case).

Attorney-Witness Kallas' Amortization Schedules Are Not Admissible : At both the First and Second Trials, plaintiff River Run objected to the Court's receipt into evidence of Exhs. 111 and 112, the two amortization schedules, on various evidentiary grounds. We overruled those objections, and confirm those evidentiary rulings here.

First, lawyer Kallas was not prohibited by Rule 3.7, *Minn. R. Prof. Conduct*, from being a witness in the same case in which he was also acting as an "advocate", because the Court found that "disqualification of the lawyer would work substantial hardship on the client [defendant Kappedahl]." Further, attorney Kallas was legally-enabled by his experience over the years of his law practice to give an expert opinion about interest rates. Finally, his testimony really did not constitute an "opinion." Rather, the two amortization schedules (Exhs. 111 and 112) were simply arithmetical computations, aided by a computer software program.

Element 4 : Presence of an Intention to Evade the Law

This last element of a usury defense or claim is obviously a critical element. But it is not difficult for a usury claimant (like defendant Kappedahl) to establish this last critical element -- assuming that the parties' provision for excessive interest was intentional.

The Conclusive Presumption of Intent to Evade : In that situation, where the parties intentionally provide for an excessive amount of interest, a conclusive presumption is set up that they intended to evade the law :

> Intent to exact an excessive rate of interest is essential to usury. (Citation omitted). This principle will save a contract which is, on its face, usurious, though not so in fact. The principle means simply that "the appearance is not conclusive *** that it is the fact alone which constitutes usury." (Citation omitted). But, where the parties intentionally provide for a greater interest than the law allows, the law conclusively presumes that they intended the necessary consequences of their act.

Patterson v. Wyman, 170 N.W. 928, 930 (Minn. 1919) (emphasis added). To the same effect, see : *Rathbun v. W.T. Grant Co.*, 219 N.W.2d 641, 650 (Minn. 1974) where the Court quotes verbatim that underscored language from *Patterson*.

This "conclusive presumption" -- premised solely on the parties' intention -- is very powerful. And that conclusive presumption operates without any need to show guilty knowledge. In that regard, see : *Adjustment Serv. Bureau v. Buelow*, 265 N.W.659 (Minn. 1936) (intention of doing something which when carried out, results in usurious compensation for a loan, is "usury", regardless of whether lender, when making the loan, considered it as usury) ; *Dege v. Produce Exch. Bank of St. Paul*, 2 N.W.2d 423 (Minn. 1942) ("Corrupt intent", required to constitute usury, is intent to take or receive more than law permits for forbearance of money, regardless of whether taker knows that he is violating usury law).

No Showing of Any Mistake or Inadvertence : There are only three circumstances that can overcome the effect of the conclusive presumption. The first two such circumstances are a showing that it was a mistake or inadvertence (and not intent) that caused a usurious amount of interest to be provided for. But that didn't happen here, as shown by all of the facts and circumstances in the case, and as succinctly acknowledged by River Run's principal, James Hoag, during cross-examination at the First Trial :

> Q: The fact that you bought the property for eighty-five thousand in the first half of this closing on June 9th, and turned around and sold the property for a hundred and seventeen thousand in the second half thereafter, same closing, was not a mistake or was not somehow inadvertent, correct?
>
> A: That's correct. I think it followed the purchase agreement lines, including closing costs and delinquent taxes and all of the costs associated with it.

First Trial Transcript, p. 50, lines 2-11 (emphasis added).

No Good Faith Precautionary Actions : The third such circumstance (that can overcome the effect of the conclusive presumption) is a showing of good faith. But, the "good faith" referred to here is not some vague generic *bona fidei*, but rather consists of the lender having taken some very specific precautionary actions :

> However, a finding of good faith is limited to situations where the lender has taken reasonable precautionary actions prior to the making of the loan in order to comply with the usury law. *See, e.g., Wetsel*, 195 Minn. at 511-12, 263 N.W. at 606 (holding that mortgage company acted with good faith in relying on schedules from certified public accountants and advice from reputable counsel); *Washington*, 374 N.W.2d at 788 (holding bank had good faith belief that it met the requirements of a HUD insured loan).

Trapp v. Hanuch, 530 N.W.2d 879, 886 (Minn. App. 1995). In our case, there was no evidence that River Run took any such good faith precautionary actions prior to making (what we have found to be) its loan to defendant Kappedahl.

Circumstantial Evidence of Intent to Evade : Aside from sitting back and passively relying on the conclusive presumption, defendant Kappedahl actively launches some arguments -- in the form of circumstantial evidence -- that show plaintiff River Run's intent to evade the usury law. Here they are :

> The way the transaction was structured demonstrates Plaintiff's intent to evade the usury laws; nothing but Plaintiff's own volition caused the transaction to be structured as a purchase from Kappedahl for $85,000 with an immediate resale to Kappedahl for $117,000.
>
> Why did Plaintiff not resell the property back to Kappedahl for $85,000 together with interest at approximately 26%? (Selling back for the same price as the purchase price would have made sense. Nothing had happened to the property to increase its value between the instant Plaintiff had purchased and sold it back.) The financial result would have been the same. However, an interest rate of about 26% would have been blatantly usurious. By arbitrarily selecting a resale price of $117,000 Plaintiff was able to effect the result of an excessive return on its investment while remaining facially within the usury limits by having a rate of 8.5% on the contract for deed.
>
> Had River Run Properties fashioned this transaction legitimately, River Run Properties would have loaned the Defendant the funds necessary to redeem from the sheriff's sale and taken back a first mortgage for the amount of the loan ($85,000) plus reasonable fees and expenses and interest, maybe even the highest interest allowed by law. Instead, because of River Run Properties' manipulations, the Defendant has been required to pay more than 40% of the original amount borrowed.

Def. Kappedahl's Post-2d Tr. Memo at p. 14 (emphasis is defendant Kappedahl's). Those arguments are persuasive. They are also supported by the Restatement :

> However, there can be other reasons for using this device. One such reason can be found in state usury law. For example, a lender may seek to characterize the difference between the "sale" price and the repurchase amount as simply being part of the repurchase price and not as the usurious interest that it actually is.

Restatement Third, Property (Mortgages) § 3.3 "The Conditional Sale Intended as Security" at p. 138. Admittedly, the "device" referred to here by the Restatement is not "The Absolute Deed Intended as Security" (§ 3.2) which was the "device" used by River Run in our case. Nonetheless, I think at least the spirit of the Restatement comment on the Conditional Sale device also applies -- in this context of usury -- to the Absolute Deed devise used by River Run.

Conclusion : Intent to Evade the Usury Law : Plaintiff River Run has not overcome the conclusive presumption of its intent to evade the usury law. In addition to that presumption, there is circumstantial evidence of such an intent on River Run's part.

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THE WINDFALL AND HARSH RESULT THAT FOLLOW A FINDING OF USURY

The public policy of this state is to discourage the practice of usury with some very harsh laws : "[T]he usury law is a harsh one. It was intended by the legislature to stop usury." *Seegold v. Eustermann*, 13 N.W.2d 739, 748 (Minn. 1944, Chief Justice Loring's dissenting opinion). To achieve that public policy end, Minnesota law is unforgiving of usury when it occurs. Minnesota law first voids the underlying transaction, and then wipes out the lender's entitlement -- just not to the interest -- but to the principal itself as well.

Usury Law Voids the Underlying Transaction : The legislature's intent that an underlying transaction, tainted by usury, must be voided and cancelled and given up -- is clear from the legislature's broad and all-encompassing language, in Minn. Stat. §§ 334.03 and 334.05 :

> All bonds, bills, notes, mortgages, and all other contracts and securities, and all deposits of goods, or any other thing, whereupon or whereby there shall be reserved, secured, or taken any greater sum or value for the loan or forbearance of any money, goods, or things in action than prescribed . . . shall be void. . . . *Minn. Stat.§ 334.03* (emphasis added).
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> When it satisfactorily appears to a court that any bond, bill, note, assurance, pledge, conveyance, contract, security, or evidence of debt is void under the provisions of this chapter, it shall declare the same to be void, enjoin any proceeding thereon, and order it to be canceled and given up. *Minn. Stat. § 334.05* (emphasis added).

To make sure there would be no doubt as to its intent, the legislature cast those statutory provisions in mandatory language -- "shall."

Translating that statutory language to our case means that *the underlying 6/9/03 transaction -- River Run's loan of money to Kappedahl and the resulting equitable mortgage -- is voided and canceled.* It necessarily follows, then, that the *Warranty Deed* from Kappedahl to River Run is likewise voided and canceled, since the Warranty Deed and the equitable mortgage are one and the same. (The parties intended the Warranty Deed to be the security or equitable mortgage for the loan). Hence, with the voiding/canceling of the Warranty Deed, River Run's rights under the Warranty Deed have been eliminated and, so, defendant Kappedahl never divested himself of title to and ownership of the Property.

That result -- voiding and canceling the Warranty Deed/equitable mortgage -- is mandated by usury law, not equitable mortgage law. The law of equitable mortgages, in our case, simply had the effect of converting the Warranty Deed into the security (equitable mortgage) the parties themselves intended in the first place. If the 6/9/03 underlying transaction had *not* been tainted with usury, Kappedahl would still have retained title to and ownership of the Property -- subject, however, to River

Run's equitable mortgage. In that non-usurious scenario, River Run could have done a six-month foreclosure in the usual way (if Kappedahl were to default). But the fact that the 6/9/03 underlying transaction *was* tainted with usury causes the equitable mortgage to be voided and canceled, along with any and all rights River Run had under the equitable mortgage (including River Run's right to foreclose on it).

As noted, §§ 334.03 and 334.05 also voided and canceled the *loan* (the $85,000 River Run lent Kappedahl). We will discuss the full implications -- the much harsher implications -- of vacating/canceling the loan, immediately below.

Usury Law Causes River Run's Forfeiture of the Interest -- and the Principal Too : You would think that, if a lender charges excessive (usurious) interest, then the lender should be penalized by at least forfeiting the usurious interest -- but not the principal too. In fact, forfeiture-of-interest-only is the way usury law operates in most states. But not in Minnesota. In its unrelenting policy of discouraging usury, Minnesota law penalizes the usurious lender with forfeiture of the principal as well, and does *not* require the borrower to "restore the money [the principal] actually received" :

> The general rule over the country is that a borrower on usury when he comes to a court of equity asking affirmative relief by way of the cancellation of an obligation or surrender of securities must restore the money actually received. . . . Our own rule, often announced, is that restoration need not be made. . . . It results from our statute that a usurious loan is void and that it may be so declared and evidence of it and securities pledged for its payment cancelled. G. S. 1913, §§ 5807-5809.

Trauernicht v. Kingston, 195 N.W. 278, 279 (Minn. 1923) (citations omitted).

That rule, mandating forfeiture by the usurious lender of both interest and principal, has been announced in other Minnesota appellate decisions :

> As we have here a usurious contract, void under the statute, it follows that the one guilty of usurious exaction must bear the legal consequences flowing from such violation. As such he must lose not only the interest on the money risked, but also the principal, including as well all security given to secure performance.

Midland Loan Finance Co. v. Lorentz, 296 N.W. 911 (Minn. 1941). See also : *Phalen Park State Bank v. Reeves*, 251 N.W.2d 135, 139 (Minn. 1977) ("If the mortgage is usurious, it is void, and the bank has no right to either the interest accrued or the principal"), citing *Midland Loan*.

This particular piece of harshness (forfeiture of the principal) is not explicitly articulated by the legislature in §§ 334.03 and 334.05. Rather, forfeiture of the principal has been read into those statutory provisions by the Minnesota Supreme Court in (what that Court sees as) simply "doing its duty." And a

Minnesota court must "do its duty", even if a windfall to the borrower is at the other end of the harsh result of forfeiture by the lender :

> The statute imposes a drastic penalty for usury. The plaintiffs get some $7,000 or $8,000 for nothing without merit in themselves. There can be no judicial quarrel with legislative policy. The court does its duty when it carefully inquires whether there is a violation of the statute and if there is gives to it the effect prescribed by the Legislature.

Trauernicht, 195 N.W. at 279. The reader will note that in *Trauernicht* the borrower reaped a windfall of "some $7,000 or $8,000" -- back in 1923 -- which, adjusting for inflation over the course of 80 years, probably exceeds even the $85,000 windfall defendant Kappedahl will reap in our case.

Whether Equity Can Rescue Plaintiff River Run From the Forfeiture : Forfeiture of $85,000 in principal would be a harsh result in any case, but especially in this case. After all, it was that $85,000, advanced by plaintiff River Run at the eleventh hour, that saved defendant Kappedahl from losing his home (and the $190,000 equity in it) to the bank's foreclosure. In the face of that in-equity, shouldn't the Court exercise its equitable power and require Kappedahl to pay that $85,000 back to River Run ?

The short answer to that question is "No." Earlier in the case, the Court did exercise its equitable power to determine that the Warranty Deed was really the equitable mortgage the parties themselves intended it to be, as security for the $85,000 loan. But the Court has no equitable power at this point in the case : the Court has now voided the equitable mortgage, not as a matter of equity, but as a matter of law under the substantive statutory provisions of the state's usury law. As support for that proposition, we can turn to the United States Supreme Court itself, as quoted by the Minnesota Supreme Court in *Trauernicht*, supra :

> In [a United States Supreme Court case], where the claim was that there must be restoration of the money received before relief would be given, the [U.S.] court, referring to the Minnesota statute, and the state adjudications upon it, said:
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> > "We think it a satisfactory reply to such a proposition that the complainants in the present case were not seeking equity, but to avail themselves of a substantive right under the statutory law of the state."

Trauernicht v. Kingston, 195 N.W. 278, 279, quoting the United States Supreme Court in *Missouri, etc. Co. v. Krumseig*, 172 U.S. 351 (1899).

Hence, at this point in the case, the Court no longer takes its direction from equity, but from the legislature. At this point in the case, the Court "does its duty when it carefully inquires whether there is a violation of the [legislature's usury] statute and if there is gives to [that violation] the effect prescribed by the Legislature." *Trauernicht* at 279.

We have "done our duty" and have given to that violation (the usurious amount of interest charged by River Run) the effect prescribed by the legislature -- voiding the equitable mortgage. If, at this point in the case, we were to turn around and require defendant Kappedahl to re-pay the $85,000 principal secured by that equitable mortgage, we would effectively be "un-voiding" (reinstating) the very equitable mortgage the legislature tells us it is our duty to void in the first place.

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D.M.K.

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