SHERMAN WELLS SYLVESTER & STAMELMAN LLP

BANKING ALERT

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[New Jersey Supreme Court Rules That Entire Controversary Doctrine Does Not Bar A Party Who Is Successful on A Motion to Dismiss from Later Asserting Claims]

In *Bank Leumi USA v. Edward J. Kloss*, Docket No. 083372 (N.J. July 21, 2020), the New Jersey Supreme Court held that a party can file a pre-answer motion to dismiss and thereby secure dismissal of non-meritorious claims filed against it without being precluded from later asserting affirmative claims that arise from the same transactional facts.

This case was before the New Jersey Supreme Court on a question certified by the United States Court of Appeals for the Third Circuit. In the underlying case, Bank Leumi had successfully moved to dismiss baseless claims that Edward J. Kloss and his entity asserted against it in an action pending in the Superior Court of New Jersey, Passaic County. Bank Leumi subsequently filed affirmative claims that it has against Kloss and his entity in a separate suit in the United States District Court for the District of New Jersey. The District Court dismissed Bank Leumi's claims pursuant to the entire controversy doctrine, which is New Jersey's version of claim preclusion, finding that if Bank Leumi wanted to preserve its claims, it should not have moved to dismiss the state court action and should have instead filed an answer with counterclaims and asserted the affirmative defense of failure to state a claim therein.

The New Jersey Supreme Court, noting that R. 4:6-2 grants litigants two options for responding to meritless claims—(i) answer with affirmative defense or (ii) motion to dismiss—held that an expansion of the doctrine's preclusive reach would render the second option unavailable to litigants, and declined to create what the Court considered to be a "such a strong disincentive for a valid option countenanced by the court rules." The New Jersey Supreme Court further held that fairness dictates that a litigant should be able to seek dismissal of baseless claims brought against it without concern that later claims may be barred. A contrary holding, the Court explained, would incentivize plaintiffs to bring baseless actions in a time and manner most convenient to them in an attempt to prevent defendants from developing more legitimate claims as they see fit.

In This Issue

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The Court's decision effectively aligns New Jersey's entire controversy doctrine with Rule 13(a) of the Federal Rules of Civil Procedure regarding compulsory counterclaims, in that preclusion does not attach unless a responsive pleading is filed, and a motion is not a pleading.

Sherman Wells attorneys Julian W. Wells and Jordan D. Weinreich represented Bank Leumi on this issue of first impression regarding the scope of the entire controversy doctrine. The case marks the second victory that Sherman Wells has secured for a bank client before the New Jersey Supreme Court this term.

Appellate Division Affirms Denial of Additional Attorneys' Fees and Sanctions in Connection with Fair Debt Collection Practices Act

In *CitiBank N.A. v. Demetro*, A-1771-18T4 (N.J. App. Div. July 16, 2020), Slater, Tenaglia, Fritz & Hunt ("Slater") filed suit on behalf of plaintiff CitiBank against defendant Sherry Demetro ("Defendant") to recover a credit card debt. Defendant then filed a third-party complaint against Slater alleging the firm had violated the Fair Debt Collection Practices Act (the "Act") by filing the complaint against Defendant after it had received a timely dispute of the debt from Defendant, but prior to mailing verification of the debt. In 2015, the Special Civil Part granted Slater's motion to dismiss Defendant's third-party complaint, notwithstanding conflicting evidence regarding the timing of the mailing of the debt verification. Defendant appealed and the Appellate Division reversed, finding the trial court allowed Slater to rely on an inadequate certification regarding the date it filed its collection action. The Appellate Division remanded, and Slater extended an offer of judgment of $3,000, exclusive of attorneys' fees. Defendant accepted the offer.

Pursuant to the Act, Defendant then filed a motion seeking attorneys' fees and costs, requesting a total of $82,144.27. On November 9, 2018, the motion judge entered an order awarding Defendant $17,500 in attorneys' fees, plus $551.34 in costs. Thereafter, Defendant filed three additional motions: to tax fees, for supplemental attorneys' fees, and for sanctions. The trial court denied all three motions. Defendant appealed.

The Appellate Division affirmed and agreed with the trial court that Defendant's counsel had submitted unreasonable billing in light of the complexity of the case and the ultimate recovery. The Appellate Division held that it was within the trial court's discretion to award reasonable fees and held that such an award was not a cap on recovery. The Appellate Division then affirmed the trial court's denial of Defendant's motion for sanctions and additional attorneys' fees because she was not the prevailing party and she failed to show egregious conduct to warrant sanctions. The Appellate Division ruled that Defendant accepted Slater's offer of judgment, which precluded an adjudication on the merits and, therefore, Defendant was not a prevailing party.

New Jersey Supreme Court Rules Debtor Can't Affirmatively Use Fair Market Value Credit to Obtain Money Judgment Against Creditor

In *West Pleasant-CPGT, Inc. v. U.S. Home Corporation*, Docket No. 082981 (N.J. July 8, 2020), the New Jersey Supreme Court held that the debtor's affirmative use of fair market value credit to obtain a money judgment against a creditor – in the absence of a deficiency claim or objection at the time of the sheriff's sale -- was inequitable and impermissible.

In August 2005, West Pleasant-CPGT ("West Pleasant"), Four G's Land LLC ("Four G") and U.S. Home Corporation (U.S. Home) entered into a contract whereby U.S. Home agreed to purchase two contiguous tracts of land in Jackson, New Jersey. West Pleasant and Four G each owned a tract. Pursuant to the contract, U.S. Home paid West Pleasant and

Four G three advances totaling $1,500.000. As security for the advances, West Pleasant executed a mortgage and note on the West Pleasant property. Four G did not execute a mortgage on the Four G property.

In August 2016, a contractual dispute arose, and U.S. Home sought the contract's termination and the return of the $1,500,000 advance. The parties submitted to arbitration, where the arbitration panel ruled in favor of U.S. Home and found West Pleasant and Four G jointly and severally liable. U.S. Home obtained a judgment in the amount of $1,500,000, plus interest and the Appellate Division affirmed the judgment. When the judgment was not satisfied, U.S. Home commenced a foreclosure action against both properties.

In early 2010, the foreclosure actions were stayed after West Pleasant and Four G filed for Chapter 11 bankruptcy. In the West Pleasant bankruptcy action, U.S. Home and West Pleasant entered into a Consent Order, whereby West Pleasant waived a fair market valuation and its right to object to a sheriff's sale of the property due to the judgment owed to U.S. Home. In Four G's bankruptcy action, after an evidentiary hearing, the Bankruptcy Court accepted the appraisal of U.S. Home's expert and concluded the Four G property had a value of $806,000 and the West Pleasant property had a value of $412,500. Because the total amount owed (more than $1,600,000) exceeded the total value of the collateral ($1,218,500), the court determined there was no equity in the Four G property and allowed U.S. Home to proceed with foreclosure.

On November 5, 2010, U.S. Home obtained a foreclosure judgment against West Pleasant in the amount of $1,705,470.90. U.S. Home executed first on the Four G property and purchased the property for $100 as the sole bidder. U.S. Home also purchased the West Pleasant property for $100, also as the sole bidder at the sheriff's sale. After the sales, U.S. Home's deficiency totaled $1,734,485.00. U.S. Home never proceeded with a deficiency action against West Pleasant or Four G.

In July 2011, West Pleasant and Four G filed an action against U.S. Home in the Law Division seeking a declaration that the arbitration award was fully satisfied as well as compensation "in the amount of the excess fair market value of the properties obtained by defendant[] U.S. Home over the amount of its outstanding judgment." Four G then assigned its rights to West Pleasant. The trial court valued the Four G property at $2,298,000 and the West Pleasant property at $1,985,020 as of the date of the sheriff sales. Finding that U.S. Home received a value in excess of its judgment, the trial court ordered U.S. Home to compensate West Pleasant in the amount of $2,299,088.23.

On Appeal, the Appellate Division held that West Pleasant had waived its right to a fair market valuation on its property under the Consent Order, but was owed a fair market value credit for the Four G property. The Appellate Division remanded the action to the trial court for recalculation of damages.

The New Jersey Supreme Court held that the use of fair market value credit by West Pleasant to obtain a money judgment against U.S. Home – in the absence of a deficiency action or any objection at the time of the sheriff's sales – is inconsistent with sound foreclosure processes and, moreover, inequitable under the circumstances.

Here, U.S. Home had not sought a deficiency judgment or pursued West Pleasant for collection in other ways. The Court found no fault in U.S. Home's proceeding to the sheriff's sales and obtaining the properties with nominal bids when no one else bid. Moreover, the sheriff's sales were concluded without any objection ever having been raised by either West Pleasant of Four G. Indeed, West Pleasant had waived any objections to the sheriff's sale in the Consent Order. The Supreme Court noted that public policy favors finality in the foreclosure process. The Supreme Court ultimately held that, after the time for objecting to the sheriff's sale had passed, unless a deficiency action or other collection activity is pursued, later claims for fair market value credit should not be permitted to generate endless litigation.

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