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IN THE COURT OF APPEALS OF THE STATE OF NEW MEXICO

COURT OF APPEALS OF NEW MEXICO
ALBUQUERQUE
FILED
OCT 20 2009

No. 29,243

O'BRIEN & ASSOCIATES, INC.,

Petitioner/Plaintiff/Appellee,

vs.

Sierra County Cause
No. D-0721-CV 2006-24

CARL KELLEY CONSTRUCTION, LTD., CO., a New Mexico Limited Liability Company, J.D. BEHLES & ASSOCIATES, P.C., a New Mexico Professional Corporation, RON MILLER, CPA, a New Mexico Professional Corporation,

Respondents/Defendants/Appellees

and

LUBBOCK NATIONAL BANK, a Texas Banking Corporation,

Respondent/Defendant/Appellant.

REPLY BRIEF OF APPELLANT LUBBOCK NATIONAL BANK

APPEAL FROM THE SEVENTH JUDICIAL DISTRICT COURT,
THE HONORABLE KEVIN SWEAZEA

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STATEMENT REGARDING TAPE RECORDED TRANSCRIPT

In citing to the digitally recorded transcript of proceedings, counsel for Appellant is using the monitor's official log.

CERTIFICATE OF COMPLIANCE

Pursuant to Rule 12-213(F) NMRA, I hereby certify that the foregoing Brief complies with the applicable type-volume limitation in that the body of the Brief contains 2,679 words as indicated by the word-count total of the word processing system used to prepare the same, which is Microsoft Office Word 2003.

I. Lubbock National Bank's Mortgage is Not Void for Lack of Consideration

Defendants-Appelles, J.D. Behles and Associates, P.C. and Ron Miller CPA ("Behles and Miller")[1], continue to argue that there is no consideration to support Lubbock National Bank's mortgage. However, the Bank's willingness to agree to future extensions of the loan on a pre-existing debt is consideration for the transfer of an interest in property, including by a mortgage. Further, failure of consideration is a defense to the contract only by a party to the contract. Non-parties to the contract, such as Behles and Miller have no standing to assert failure of consideration in order to void Lubbock National Bank's mortgage.

A. A Pre-Existing Debt is Sufficient Consideration for a Mortgage.

Contrary to the arguments raised by Behles and Miller, a pre-existing debt is consideration for a mortgage to secure the debt. A pre-existing debt is sufficient to support the granting of a mortgage. *McAllister v. Farmer's Development Co.,* 40 N.M. 101, 55 P.2d 657 (1936); *Royal Indemnity Co. v. McLendon,* 64 N.M. 46, 323 P.2d 1090 (1958); *Consolidated Placers v.*

[1] Although there is an additional appellee in this case, Carl Kelley Construction, Ltd. Co., the only answer brief was filed by Defendants-Appellees, Behles and Miller. Therefore, all issues on appeal relating to Carl Kelley Construction, Ltd. Co. should be resolved in favor of Lubbock National Bank.

Grant, 48 N.M. 340, 151 P.2d 48 (1944). Pre-existing indebtedness is sufficient consideration to uphold either a conveyance of real property or a mortgage. *Lehrenkrauss v. Bonnell,* 199 N.Y. 240, 92 N.E. 637 (Ct. App. NY 1910).

Behles and Miller argue that, although *Clovis National Bank v. Harmon,* 102 N.M. 166, 692 P.2d 1315 (1984), stands for the proposition that a pre-existing debt can be collateralized by a later mortgage, Behles and Miller argue that the case isn't applicable to the issues on this appeal. The *Clovis National Bank v. Harmon* case, however, clearly supports the existence of consideration for the mortgage in the form of preexisting debt. The *Harmon* Court recognized that a real estate mortgage, created *after* the indebtedness it secures is valid. 102 N.M. at 169, 692 P.2d at 1318.

B. A Closely Held Corporation May Create a Mortgage to Secure Personal Indebtedness of the Corporate Principal.

It is Lubbock National Bank's position that the loan to Michael O'Brien was not a personal loan. At a minimum, genuine issues of material fact exist as to whether the loan was personal. See, R.P. 963, 1004-1007. Behles and Miller contest whether this was a loan to the closely held corporation in their statement of facts. (Response Brief at p. 19). However, Behles and Miller do not present any support for their position in the legal argument portion of the Response Brief. Even if it was a personal loan, the

fact that the mortgage was given by his closely held corporation, O'Brien & Associates, as security for the debt does not render the mortgage void for lack of consideration.

Behles and Miller do not dispute that a third party, such as a closely held corporation, may execute a mortgage for purposes of securing a loan to another. See, e.g., *Continental Bank of Pennsylvania v. Barclay Riding Academy,* 93 N.J. 153, 459 A.2d 1163, 1172 (N.J. 1983); *Arkansas Iron and Metal Co. v. First National Bank of Rogers,* 16 Ark. App. 245, 701 S.W. 2d 380 (Ct. App. Ark. 1985); *U.S. v. Quaintance,* 665 NYS 2d 191, 244 A.D.2d 915 (N.Y.A.D. 1997); *In re Janis,* 151 B.R. 936, 938 (Bankr. Ariz. 1992). The fact that the mortgage is given to secure another's loan does not mean that there is a lack of consideration. *Patterson Bank v. Langendorf,* 483 N.E.2d 279 (Ct. App. Ill. 1985); *Carlisle v. Commodore Corp.,* 190 S.E.2d 703 (Ct. App. N.C. 1972). The closely held corporation could properly give a mortgage as security for the debt, even if the loan was a personal loan in this case.

C. The Bank's Willingness to Make Future Extensions is Sufficient Consideration.

Behles and Miller also argue, without support, that Lubbock National Bank's decision not to seek to accelerate the note and to grant future extensions is not consideration for the mortgage. Contrary to Behles and

Miller, however, the law clearly establishes that the Bank's forbearance and extensions constitute consideration for the mortgage. *Continental Bank of Pennsylvania v. Barclay Riding Academy,* 93 N.J. 153, 459 A.2d 1163 (1983). The most common forms of consideration are (1) the creditor's forbearance in suing on an overdue debt, and (2) renewal or extension of the debtor's original note. And only a minimal, intangible, benefit need pass to satisfy the consideration requirement for third-party mortgages of existing debts." 459 A.2d at 1173; *Arkansas Iron and Metal Co. v. First National Bank of Rogers,* 16 Ark. App. 245, 701 S.W. 2d 380, 384 (Ct. App. Ark. 1985),

After the giving of the mortgage by the corporation, Lubbock National Bank extended the Note numerous times. (R.P. 597, 897-925). The Bank's actions in taking the mortgage as additional security and extending the note are standard banking practices. The Bank's forbearance and extension of the loan create, at a minimum, genuine issues of material fact. It was error for the District Court to conclude the mortgage was void for lack of consideration as a matter of law.

D. Behles and Miller Lack Standing to Claim Failure of Consideration to Void the Mortgage.

Behles and Miller claim to have standing to contest the validity of the mortgage in this case. The issue, however, is not whether they have

standing to contest the mortgage, but, instead, whether they may raise lack of consideration. Consideration is generally an issue as between the parties to a contract. See, UJI 13-801 and 13-814 NMRA. It is not an issue that can be raised by an outsider to the contract in order to void the contract.

Because a stranger has no legally enforceable interest in the contract, in order to void a contract involving a transfer of interest in property, the non-party must prove something more than a failure of consideration. Instead, a third-party creditor must establish that the transfer was fraudulent as to present or future creditors. NMSA 1978, § 56-10-18(A).

As set out, above, it is Lubbock National Bank's position that there is clearly sufficient consideration for the mortgage. However, lack of consideration is not a basis that Behles and Miller can raise in order to void the mortgage. Instead, Behles, Miller, as alleged creditors claiming an interest to the funds from sale of the property, must prove that the mortgage was a fraudulent conveyance under New Mexico's law. Behles and Miller however, have failed to adduce any evidence showing that the giving of the mortgage to Lubbock National Bank by O'Brien & Associates was fraudulent as to creditors.

The District Court erred in holding that there was a failure of consideration and, therefore, the Lubbock National Bank mortgage was

void. This Court should reverse the ruling of the District Court and remand the case for a determination as to the validity and priority of all competing claims to the funds held in the Court Registry.

II. The Marshalling Ruling is Properly Before the Court for Review

Behles and Miller argue that the District Court's ruling on marshalling is not properly before this Court for review. (Response Brief at pp. 26-27). First, Behles and Miller contend that the question of marshalling is moot because the District Court subsequently granted summary judgment on the grounds that the mortgage is void for lack of consideration.

Lubbock National Bank does not dispute that, if this Court does not reverse the District Court's ruling on lack of consideration for the mortgage, then there is no need for the Court to reach the question of the District Court's ruling on marshalling of assets. As noted in the Brief in Chief, Lubbock National Bank is asking the Court to review the marshalling issue only if the Court determines to reverse the summary judgment. (Brief in Chief at 15-16).

Behles and Miller also argue that the Court should not consider the marshalling question because the District Court's ruling on marshalling of assets was interlocutory in nature and, therefore, cannot be reviewed on appeal from a final order. (Response Brief at pp. 32-34). There is no

question that the appeal by Lubbock National Bank is taken from a final, appealable order granting summary judgment. (R.P. 511-1514). When an appeal is properly taken from a final order, it is clear that this Court may consider other interlocutory issues and rulings as part of the appeal from the final order. See, *Griego v Grieco,* 90 N.M. 174, 176, 561 P.2d 36 (Ct. App. 1971). This Court may properly review the District Court's interlocutory ruling on marshalling of assets as part of the appeal from the final summary judgment.

Last, Behles and Miller also argue that the question of marshalling wasn't properly raised because Lubbock National Bank's arguments were not raised or briefed until the first hearing on the summary judgment motion and the filing of the Motion for Reconsideration. (Response Brief, p. 30). The Bank's position on marshalling of assets was, however, raised at a point in the proceedings where Behles and Miller had full opportunity to respond to the arguments. The arguments were clearly before the Court for determination based on the parties' submissions, including Behles and Miller's Motion for Accounting. (See, Tr. 7-30-2008/ 2:24:12 PM; 3:27:48 PM; R.P. 1331-1342; R.P. 1292-1301; 1343-1347). The issues were properly raised and preserved for review by Lubbock National Bank. Rule 12-216(A) NMRA.

III. The Court Should Reverse the Ruling Requiring Lubbock National Bank to Marshal Assets

A. Marshalling would be Inequitable in this Case.

Behles and Miller argue that Lubbock National Bank should be required to marshal assets before it can assert a claim against the proceeds from the sale of the property in this case, even if the requirement of marshalling would be detrimental to the parties. Marshalling of assets, however is an equitable doctrine and is not to be applied to bring about injustice or an inequitable result. *Seasons, Inc. v. Atwell,* 86 N.M. 751, 527 P.2d 702 (1974). The doctrine should be applied only when it can be equitably employed as to all parties with an interest in the property. *Meyer v. United States,* 375 U.S. 233, 237 (1963); *In re United Retail Corp.,* 33 B.R. 150 (Bankr. D. Haw. 1983).

Marshalling is not to be applied against the debtor or to the prejudice of the debtor. In applying marshalling, the court must consider the rights of all who have an interest in the property, including the debtor, and the doctrine should be applied only when it can be equitably fashioned as to all of the parties. *In re United Retail Corp.* 33 B.R. 150, 153 (Bankr. D. Haw 1983); *In re Carson,* 174 B.R. 247 (10th Cir. BAP (Kan)2007); *In re Bame,* 279 B.R. 833 (8th Cir. BAP (Minn.) 2002); *Herzog v. NBD Bank of Highland Park,* 203 B.R. 80 (N.D. Ill. 1996).

In this case, if Lubbock National Bank is required to marshal assets, O'Brien's personal stock would have to be liquidated, causing O'Brien to incur substantial capital gains taxes. (R.P. 1341-1342). The marshalling of assets would cause inequitable harm to Mr. O'Brien. The Court should not require marshalling of assets in this case.

B. There is No Common Debtor: As a prerequisite for application of the doctrine of marshaling of assets there must be a common debtor between the two creditors. *Janke v. Chace,* 487 N.W.2d 301 (Ct. App. Neb. 1992). Behles and Miller contend that there is a common debtor in that Green and Riverside were indebted to O'Brien and Green and Riverside were indebted to Behles and Miller. (Response Brief at pp. 30-31).

The issue isn't, however, whether there is a common debtor between Behles and Miller on the one hand and O'Brien on the other hand. Whether third parties Green and Riverside were indebted to both O'Brien and Behles and Miller is irrelevant to the issues on appeal. Instead, the question is whether there is a common debtor as between Lubbock National Bank and Behles and Miller.

There simply is no party that is indebted to both Lubbock National Bank, on the one hand, and Behles and Miller on the other hand. O'Brien, the Bank's debtor, is not a common debtor between them. To the contrary,

O'Brien is indebted only to Lubbock National Bank, not to Behles and Miller. The claims of Behles and Miller arise from a debt incurred by non-parties, Ron Green or Riverside Properties, not from any debt of O'Brien to Behles and Miller. O'Brien is not and has never been a debtor of Behles and Miller.

O'Brien is a debtor of Lubbock National Bank, not a debtor of Behles and Miller. There is no common debtor involved as to the claims of Behles and Miller. The District Court erred in requiring marshalling of assets in these circumstances. *Janke v. Chace,* 487 N.W.2d 301 (Ct. App. Neb. 1992).

Nor are the funds at issue owned by the same debtor and in the hands of the debtor or superior creditor. *In re Harold's Hatchery,* 17 B.R. 712, 716 (M.D. Ga. 1982); *In re Francis Construction Co,, Inc.,* 54 B.R. 13 (D.S.C. 1985). The stock securing the indebtedness to Lubbock National Bank is held personally by Michael O'Brien. The second source of funding—the proceeds from sale of the property—is held by the District Court and is, in part, claimed by O'Brien and Associates. Therefore, there should be no marshalling of assets required in this case.

Last, there are issues as to the validity and priority of the claims asserted by Behles and Miller. Although not before this Court, the

proceedings in the trial court have raised substantial questions about the validity of Behles and Miller's claims. Until Behles and Miller prove up their claims, they cannot be considered to be competing creditors of Lubbock National Bank. Therefore, there should be no requirement of marshalling of assets.

CONCLUSION

The District Court erred in holding that Lubbock National Bank's mortgage is void for lack of consideration. The mortgage was properly given by O'Brien and Associates as security for the pre-existing debt owed to the Bank by its corporate shareholder, Michael O'Brien. Further, at a minimum, there are genuine issues of material fact as to whether the multiple extensions of the loan given by the Bank constitute sufficient consideration to support the mortgage. The District Court erred in granting summary judgment based on the existence of genuine issues of material fact and because summary judgment was not proper as a matter of law.

Further, the Court erred in applying the equitable doctrine of marshalling of assets to Lubbock National Bank. Application of the doctrine will work inequitable prejudice to the debtor, Michael O'Brien. Further,

O'Brien is not a common debtor as between Lubbock National Bank and Behles and Miller

Therefore, the Appellant, Lubbock National Bank, would respectfully request the Court reverse the Order of the District Court granting summary judgment on the grounds that the mortgage is void for lack of consideration and dismissing the claims of Lubbock National Bank for lack of standing. Further, in the event the Court reverses the summary judgment, Lubbock National Bank would also request the Court reverse the District Court's ruling requiring Lubbock National Bank to marshal assets, and remand the case for adjudication of the validity and priority of all claims to the funds in the Court Registry.

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