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STATE OF NORTH DAKOTA

IN THE SUPREME COURT
STATE OF NORTH DAKOTA

William Kulczyk and Rhonda Kulczyk, Plaintiffs and Appellants, vs. Tioga Ready Mix Co., Scott Financial Corporation, Triple Aggregate, LLC, and all persons unknown, claiming any estate or interest in, or lien or encumbrance upon, the real estate described in the complaint, Defendants and Appellees.	**SUPREME COURT NO. 20160330** Civil No. 53-2015-CV-01313

ON APPEAL FROM JUDGMENT DATED SEPTEMBER 13, 2016
WILLIAMS COUNTY DISTRICT COURT

AND

ON APPEAL FROM ORDER DATED JANUARY 30, 2017

WILLIAMS COUNTY DISTRICT COURT
NORTHWEST JUDICIAL DISTRICT
CIVIL NO. 53-2015-CV-01313
THE HONORABLE KIRSTEN SJUE

APPELLANTS' REPLY BRIEF

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STATEMENT OF THE FACTS

[¶1] Tioga Ready Mix Co. ("TRM") asserts to close on the sale of the Subject Property to Triple Aggregate, LLC ("Triple Aggregate"), the parties entered an escrow agreement on March 22, 2016. (Tioga Ready Mix Co's Brief at ¶ 8). TRM further asserts "[s]ubsequent to this agreement, [TRM] was informed by Triple Aggregate of an assignment of its interests in the Subject Property to a holding company, Agape Holdings, LLP ("Agape")." *Id.* Allegedly, TRM then "prepared a warranty deed on April 12, 2016, to be held in escrow by Triple Aggregate's counsel, conveying the Subject Property to Agape." *Id.*

[¶2] TRM and Triple Aggregate failed to apprise the District Court and the Kulczyks of the purported transfer. The Kulczyks were not made aware of the Warranty Deed until receipt of Troy Lang's email forwarded by the District Court on October 20, 2016. (*Ex parte Email Communication,* App. 060-084). TRM did not properly disclose any information underlying the transfer. Assuming, as TRM asserts, the Warranty Deed was not delivered and recorded until after the District Court's summary judgment ruling, the transfer still took place before this case was final. The effect of the transfer is that TRM and Triple Aggregate no longer have any interest in the Subject Property and neither is a real party in interest in this litigation.

[¶3] TRM also contends the Kulczyks' argument regarding compulsory counterclaims and Rule 13 of the North Dakota Rules of Civil Procedure should be disregarded because TRM alleges it was not raised before the District Court. However, this issue was specifically raised before the District Court. (*January 30, 2017 Motion to Vacate Hearing Transcript*, 14:19-22, 15:3-6, 16:5-7; 17:20-25, App. 106-109).

LAW AND ARGUMENT

I. Res judicata does not apply to preclude foreclosure of the mortgage.

[¶4] TRM argues claim preclusion applies because the Kulczyks made a claim for interest under the Personal Guarantee against the Vculeks and because this mortgage foreclosure claim could have been raised as a counterclaim against TRM (Tioga Ready Mix's Appellee Brief at ¶ 16). TRM's arguments are based on its misinterpretation of North Dakota law concerning whether a foreclosure action must be joined with an action to enforce a personal guarantee and on what constitutes a compulsory counterclaim. .

[¶5] In the initial action the Kulczyks chose to first seek relief under the Vculeks' guarantee before foreclosing their mortgage. North Dakota law recognizes this procedure as preferred given the procedural difficulties in obtaining a deficiency judgment following a foreclosure. *First State Bank of New Rockford v. Anderson,* 452 N.W.2d 90, 92 (N.D. 1990) ("[D]eficiency judgments are one of the least favored creatures of the law, and we have often recognized the legislature's avowed public policy against deficiency judgments in real estate litigation.").

[¶6] This Court has "held that where the obligation of the guarantors was absolute and was a guaranty of payment, the guarantors could not require the creditor to first proceed against the principal debtor on the notes before bringing an action against the guarantors." *Alerus Fin., N.A. v. Marcil Grp. Inc.*, 2011 ND 205, 806 N.W.2d 160 (citing *Bank of Kirkwood Plaza v. Mueller*, 294 N.W.2d 640, 643 (N.D. 1980) (internal citation omitted). The *Alerus* Court held, in part, the plaintiff bank did not impermissibly split its cause of action by bringing an action to enforce its guaranties separately from a mortgage foreclosure action. This approach provides protection against the limitations on obtaining a deficiency judgment following a foreclosure action:

> Alerus would be "free to collect the entire amount guaranteed jointly and severally by [the guarantors] without first resorting to foreclosing on the real estate, and without limiting its recovery to the difference between the fair market value of the real estate and the amount due on the note."

Alerus, 2011 ND 205, ¶ 20, 806 N.W.2d at 169 (quotation omitted) (emphasis added).

[¶7] The only difference between this case and *Alerus* is the fact that the action to enforce the guarantee was brought as a counterclaim in a case that involved claims by and against TRM as well. According to TRM and the District Court, in addition to bringing this counterclaim to enforce the guarantee against the Vculeks as allowed under *Alerus,* the Kulczyks were also required to have added a compulsory counterclaim in the form of a foreclosure action against TRM. (Tioga Ready Mix Co.'s Appellee Brief at ¶¶ 18-19). *Alerus*, however, holds the exact opposite: that the action to foreclose the mortgage need not be joined with the action to enforce the guarantee. Accordingly, because the actions are separate, enforcing the guarantee does not preclude this foreclosure action.

A. The Kulczyks were not required to bring the foreclosure action at the same time as their action to enforce the guarantee.

[¶8] TRM contends the foreclosure action was a compulsory counterclaim that should have been included in the Kulczyks' counterclaims against TRM. A counterclaim is compulsory only if it "arises out of the transaction or occurrence that is the subject matter of the opposing party's claim." *First Nat. Bank of Belfield v. Burich,* 367 N.W.2d 148, 154; *see also* N.D. R. Civ. P. 13(a)(1)(A). TRM, however, raised no claims under the Note or Mortgage. If TRM had been successful in its claims against the Kulczyks, TRM's obligations under the Mortgage would not have changed. TRM would still have been obligated to the Kulczyks under the Note and Mortgage.

[¶9] A foreclosure action arises against the property based on the non-payment of amounts owed. Because TRM's payment obligation under the Mortgage was not the subject matter of TRM's claims against the Kulczyks in the initial action, the foreclosure action was not a compulsory counterclaim. *See First Fed. Sav. & Loan v. Scherle,* 356 N.W.2d 894, 896 (N.D. 1984) (factual claims other than those related to payment of the mortgage are unrelated to the mortgage and can be brought in a separate action). Therefore, there can be no claim preclusion.

B. <u>It is fundamentally unfair to apply res judicata to preclude the Kulczyks' mortgage foreclosure action.</u>

[¶10] Res judicata "should apply as fairness and justice require, and should not be applied so rigidly as to defeat the ends of justice or to work an injustice." *Riverwood Commercial Park, L.L.C. v. Standard Oil Co., Inc.*, 2007 ND 36, ¶ 14, 729 N.W.2d 101, 107. The procedural history of the underlying action and the continuing bad acts of TRM establish it would be unjust to apply res judicata in this case.

[¶11] TRM was sanctioned by the District Court in the prior action for seeking to amend its Complaint the morning of trial. Because of TRM's bad actions, the trial was continued and the pre-trial period for preparing the case was expedited. Adding a foreclosure claim and the necessary additional party would have further delayed resolution of the initial case. It is unjust to apply res judicata given this procedural history.

[¶12] It would also be fundamentally unfair to apply res judicata given this Court's holding in *Alerus* which holds the Kulczyks were legally entitled to enforce the guarantees separately from a foreclosure action. TRM contends it should be able to avoid paying on its obligation <u>and</u> is entitled to declaratory relief invalidating the Mortgage

based on its contentions the foreclosure action was a compulsory counterclaim in the initial action. Invalidating a valid mortgage under these facts is unjust. The District Court erred in declaring the mortgage invalid, thereby granting TRM affirmative relief.

II. The District Court erred in denying the Kulczyks' Motion to Vacate Order Granting Summary Judgment under Rule 60(b)(3).

[¶13] Rule 60(b)(3) of the North Dakota Rules of Civil Procedure provides "On motion and just terms, the court may relieve a party or its legal representative from a final judgment, order or proceeding for the following reasons: (3) fraud (whether previously called intrinsic or extrinsic), misrepresentation, or misconduct by an opposing party." N.D. R. CIV. P. 60(b)(3).

[¶14] The North Dakota Rules of Professional Conduct prohibit an attorney from knowingly making "a false statement of fact or law to a tribunal or fail[ing] to correct a false statement of material fact or law previously made to the tribunal by the lawyer." N.D. R. PROF. CONDUCT 3.3(a)(1). In addition, attorneys are prohibited from "offer[ing] evidence that the lawyer knows to be false." N.D. R. PROF. CONDUCT 3.3(a)(3). A lawyer's duty to persuasively present their client's case "is qualified by the advocate's duty of candor to the tribunal." N.D. R. PROF. CONDUCT 3.3, Comment 2. Accordingly, a "lawyer must not allow the tribunal to be misled by false statements of law or fact or evidence that the lawyer knows to be false." N.D. R. PROF. CONDUCT 3.3, Comment 2. "There are circumstances in which failure to make a disclosure is the equivalent of an affirmative misrepresentation." N.D. R. PROF. CONDUCT 3.3, Comment 3. The obligation of candor is continuing until final judgment is affirmed upon appeal or the time for appeal has expired. N.D. R. PROF. CONDUCT 3.3, Comment 13.

[¶15] At oral argument on TRM's Motion for Summary Judgment, David Smith, attorney for TRM, represented "[TRM] [was] in the process of selling the property subject to the same mortgage to Triple Aggregate." (*April 18, 2016 Summary Judgment Hearing Transcript,* 6:15-17, App. 153(emphasis added)). He further indicated the parties had not fully closed on the sale due to the pending litigation. *Id.* at 6:18-19, App. 153. On April 18, 2016, Attorney Smith knew a Warranty Deed in favor of Agape had been prepared. Attorney Smith did not disclose that the property had been transferred to Agape, a non-party.

[¶16] Whether Attorney Smith's violation of his duty of candor was intentional or not is not material. The Kulczyks are willing to give Attorney Smith the benefit of the doubt as to his intentions. A failure to disclose does not have to be intentional to satisfy the Rule. *First Nat. Bank & Trust Co. v. Scherr*, 456 N.W.2d 531, 533 (N.D. 1990) (citing *Anderson v. Cryovac, Inc.*, 862 F.2d 910 (1st Cir. 1988)). The requirements of Rule 60(b)(3) were met.

III. The newly discovered evidence would produce a different result in this case.

[¶17] TRM contends privity exists between Agape, as an assignee of Triple Aggregate, and TRM such that the newly discovered evidence would not produce a different result. However, the newly discovered evidence, the transfer of the Subject Property to Agape, a non-party to this litigation, would undoubtedly produce a different result in this case. TRM and Triple Aggregate no longer hold any interest in the Subject Property. Even assuming Agape is in privity with TRM as an assignee of Triple Aggregate, it is unclear how TRM has standing to raise the affirmative defense on Agape's behalf in the present action.

[¶18] Additionally, because the Court denied the Motion, the Kulczyks were not allowed to develop the record as to the contractual relationship between TRM, Triple Aggregate, and Agape.

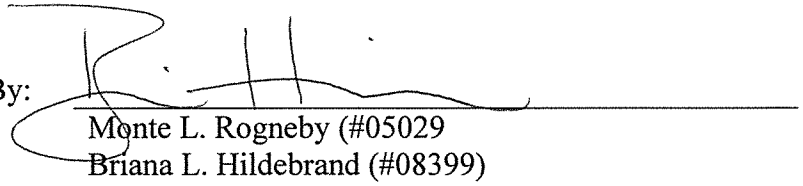
[¶19] TRM claims that Agape, a non-party, acquired the property with notice of the Mortgage and is still entitled to an Order declaring the Mortgage invalid and that Agape need not bring an action to receive the requested relief. Instead, non-owner TRM is entitled to maintain the action for Agape and the Kulczyks are not entitled to any discovery concerning the transaction. Not surprisingly, neither the District Court nor TRM cite any law in favor of these novel positions.

CONCLUSION

[¶20] The Kulczyks request this Court reverse the District Court's Order and enter an Order providing the Kulczyks have a right to maintain a mortgage foreclosure action and remand with instructions to allow the Kulczyks to conduct additional discovery and add Agape as a proper party to the case.

Respectfully submitted May 8, 2017.

VOGEL LAW FIRM

By: 

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AFFIDAVIT OF SERVICE

STATE OF NORTH DAKOTA)
) SS
COUNTY OF BURLEIGH)

I hereby certify that I am of legal age and not a party to the above-entitled matter. Affiant states that on May 8, 2017, the following document:

Appellants' Reply Brief

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Subscribed and sworn to before me this 8 day of May, 2017.

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My Commission Expires March 05, 2019