IN THE NEW MEXICO SUPREME COURT

KENNETH B. ZANGARA AND
KATHY S. ZANGARA,
HUSBAND AND WIFE,

Petitioners-Petitioners,

v. No. S-1-SC-39679

LSF9 MASTER PARTICIPATION
TRUST,

Respondent-Respondent.

Consolidated With:

LSF9 MASTER PARTICIPATION
TRUST,

Plaintiff-Respondent.

v. Ct. App. No. A-1-CA-38169

KENNETH B. ZANGARA; KATHY S.
ZANGARA,

Defendants-Petitioners.

PETITIONERS REPLY BRIEF

APPEAL FROM THE NEW MEXICO COURT OF APPEALS
Ct. App. No. A-1-CA-38169

[ORAL ARGUMENT REQUESTED]

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INTRODUCTION

The District Court decision dismissing LSF9's second foreclosure action should be affirmed and the decision in *CitiMortgage, Inc. v. Garcia*, No. A-1-CA-38418, 2022 WL 2836770 (N.M. Ct. App. July 20, 2022), should be overuled. LSF9 has no assignment of the right to enforce the lost instrument and the second action is untimely. The Savings Statute is unavailable to allow a second action as a continuation of the first because the first case was filed without prudential standing to enforce the lost Note. Allowing a second action as a continuation of the first would essentially permit amendment of the first claim contrary to the holding in *Deutsche Bank Nat'l Tr. Co. V. Johnston,* 2016-NMSC-013. LSF9 was also negligent in prosecution of the first case resulting in unavailability of the Savings Statute.

The plain language of §309 does not allow assignment of enforcement rights of a lost negotiable instrument and expansion of the statute beyond the plain language to allow assignment should only result from legislative action and not judicial decision. LSF9's claim of unjust enrichment was not pleaded and unjust enrichment is not appropriate in the circumstances of this case.

ARGUMENT

I. THE FIRST FORECLOSURE CLAIM FILED BY LSF9 WAS NO CASE AT ALL AND LSF9 WAS NEGLIGENT IN PROSECUTING THE CLAIM RESULTING IN THE SAVINGS STATUTE BEING UNAVAILABLE

Although LSF9's foreclosure claim fails without a valid assignment of the right to enforce the lost note as well as acceptance by this Court of an expansion of N.M. UCC §309 beyond its plain language, LSF9 filed its first foreclosure claim relying solely upon delivery of a copy of the lost Note to support its assignment claim. LSF9 now concedes that it initially obtained no assignment of enforcement rights and therefore, logically, it had no claim or right to enforce the lost negotiable instrument whatsoever. LSF9 also now observes in its argument for expansion of §309 beyond the section's plain language that upon loss of a negotiable instrument "possession goes out the window" and that there is "nothing to physically transfer" and "nothing to physically hold." Therefore, the first LSF9 foreclosure action was filed with, by admission, no argument that LSF9 had any right to pursue the claim. Answer Brief at p. 15.

In these circumstances the District Court found that LSF9 was not the real party in interest to enforce the Note and that the claim of enforcement was made without prudential standing to enforce the note and was no claim at all and could not support a six-month extension to file a second action as an extension of the first under the Savings Statute. RP 417.

The District Court decision was correct. If LSF9 is allowed an extension under the Savings Statute to file a second action after the Statute of Limitation has expired, foreclosure plaintiffs will be free to file groundless claims where there exists not even an argument to support a claim of prudential standing to enforce the Note. The foreclosure plaintiff will thereby extend the Statute of Limitations to allow a second claim to be filed as a continuation of the groundless initial action contrary to the holding in *Johnston*, which is precisely what has occurred in this case.

LSF9's acknowledgement of the obvious fact that a lost negotiable instrument cannot be transferred by endorsement and negotiation also demonstrates negligence in pursuit of LSF9's first foreclosure claim precluding availability of the Savings Statute.

The negligence exception to the extension allowed by the Savings Statute prevents abuse of the Statute by preventing the filing of a groundless claim at the end of the limitations period solely to preserve the right to file a second claim as a continuation of the first action. But for the negligence exception, any foreclosure claimant could file a groundless or fabricated claim to enforcement at the end of the limitations period safe in the knowledge that an additional six months will be available to file a second action. If such a result is permitted there will be no check on such conduct and foreclosure plaintiffs in the future will be free to manipulate

the Savings Statute and the sound policies articulated by this Court in *Deutsche Bank Nat'l Tr. Co. v. Johnston*, 2016-NMSC-013, requiring prudential standing be shown when the case is filed, will be defeated.

In *Johnston* this Court required a judgement of foreclosure be vacated where plaintiff failed to show prudential standing when the case was filed although the plaintiff produced the Note at trial. Allowing an extension to file a second action where the first case was filed without prudential standing will in effect allow the plaintiff to cure the defect and proceed as thought the initial action was properly filed with prudential standing shown to enforce the Note by bootstrapping the stale second case upon the faulty first action.

In *FV-I, Inc. v. Kallevig*, 301 P.3d 789, the Kansas Supreme Court, relying upon this Court's decision in *Johnston*, disallowed a post-petition cure of the faulty petition which did not demonstrate prudential standing when the claim was filed stating:

> We agree with the sound reasoning of the Deutsche Bank court and hold that standing in a foreclosure action is predicated on the plaintiff's ability to demonstrate – either in the pleadings, upon motion for summary judgment, or at trial – that it was in possession of the note with enforcement rights at the time it filed the foreclosure action. Allowing a lack of standing to be cured by a post-petition assignment granting enforcement rights in the note after the foreclosure action has been filed would defeat any incentive for a note holder to ensure that it has enforcement rights prior to filing the action.

The language of the *Kallevig* Court is instructive. Allowing LSF9 to file a second action as a continuation of the first action which was filed without prudential standing would "defeat any incentive for a note holder to ensure that it has enforcement rights prior to filing the action."

The analysis of the negligence exception of the Savings Statute by the Court of Appeals is also erroneous. The exception is for negligence in prosecution irrespective of the particular legal right in the case and whether that right can be waived. LSF9 was negligent in claiming that delivery of a copy of a lost negotiable instrument was effective as an assignment of enforcement rights for that lost instrument and the conduct was no less negligent than the conduct of a plaintiff who files a federal court action which on the face of the complaint defeats any claim of subject matter jurisdiction. *Barbeau v. Hoppenrath*, 2001 NMCA 77, 131 N.M. 124. LSF9, by its present admissions, knew or should have known delivery of a copy of a lost negotiable instrument grants LSF9 no right to enforce the lost instrument. *Foster v. Sun HealthCare Grp., Inc.*, 2012-NMCA-072.

Furthermore, even if the negligence exception turned on whether the legal right at issue could be waived as the Court of Appeals concluded, the requirement that prudential standing must be shown when the case is filed supports important policy considerations set out by this Court in *Johnston* and this Courts holding in *Johnston* establishes also that the absence of prudential standing cannot be waived

through trial. The Court of Appeals inexplicably held otherwise notwithstanding the abundantly clear language of *Johnston* and LSF9 in its Answer Brief without citation to authority inexplicably represents to this Court that the Court of Appeals comments on the issue are accurate.

II. LSF9 HAS NO ASSIGNMENT OF THE RIGHT TO ENFORCE THE LOST NEGOTIABLE INSTRUMENT IN THE PRESENT ACTION

Although LSF9 represents in footnote seven to its Answer Brief that it is undisputed that LSF9 has an assignment of enforcement rights in its second foreclosure action, as pointed out at page 30 of Zangaras Response Brief before the Court of Appeals, LSF9 obtained only an "Assignment of Lost Note Affidavit" which by its terms nowhere assigns to LSF9 the right to enforce the lost Note.

The assignment of lost Note affidavit provides:

"***

> WHEREAS, Assignor, as the present legal and equitable owner and holder of the Lost Note Affidavit, hereby desires to assign to Assignee, its successors and assigns all of the Assignor's rights, title and interest held pursuant to and under the Lost Note Affidavit.
>
> NOW, THEREFORE, in consideration of the premises above set forth and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged and agreed, Assignor and Assignee hereby covenant and agree as follows:

> 1. Assignment. Assignor does hereby transfer, assign, grant and convey to Assignee, its successors and assigns all of the right, title, interest and benefit of the Assignor in and to the following documents and does hereby grant and delegate to Assignee, its successors and assigns, any and all of the duties and obligations of Assignor under the following documents from and after the date hereof:
>
> (a) The Lost Note Affidavit.
>
> ***" RP 408.

Even though the entire claim of LSF9 rests upon an assignment of enforcement rights as well as persuading this Court to expand the rights granted by §309 beyond the plain language of the Statute, and even after full briefing of the issues in LSF9's first foreclosure claim, LSF9 obtained from Bank of America an Assignment of Lost Note Affidavit only which does not assign the right to enforce the lost Note.

This Court should not construe the document to be an assignment of enforcement rights because it does not assign these rights. The District Court recognized this fact when it noted at footnote 14 of its Opinion that "The Assignment of Lost Note Affidavit does not purport to assign the lost Note or the right to enforce the lost Note. Rather it purports to assign: (Court quotes Lost Note Affidavit). RP 408.

The District Court also recognized in these circumstances it is unknown who truly has the right to enforce the lost Note and in its Order granting Zangaras

request to Quiet Title against Bank of America and LSF9, the District Court correctly observed that "Bank of America is not asserting any claims against anyone, therefore, it is largely in a state of limbo. If, however, Bank of America retains the right to enforce the Note or might re-obtain the right to enforce the Note in the future, an action In Rem for foreclosure is barred by the Statute of Limitations." RP 418. The potential for uncertainty of ownership of enforcement rights which will be created if assignment is permitted is illustrated by the failed attempt at assignment present in this case.

III. EQUITABLE TOLLING IS NOT AVAILABLE TO TOLL THE STATUTE OF LIMITATIONS

LSF9 advances its equitable tolling argument "in the event the Savings Statute does not apply for any reason." Answer Brief at 36. However, no argument is made that the Savings Statute does not apply due to the presence of a specific statute of limitations which makes the Savings Statute unavailable. See NMSA 1978 §37-1-17. Absence such as statute, the Savings Statute does apply but it grants to LSF9 no extension to file a second action because LSF9 filed its first foreclosure claim without prudential standing to enforce the note and with no claim of right to enforce the lost Note resulting in no case at all and also because LSF9 was negligent in its prosecution of its first foreclosure claim by filing the action without any claim whatsoever to enforce the lost Note. Therefore, there was no

first case to support the second action as a continuation of the first and the absence of prudential standing to enforce the Note and the negligence exception in the Savings Statute makes the extension allowed by the Savings Statute unavailable to LSF9. Furthermore, even if equitable tolling were available, equitable tolling is subject to the same exceptions and limitations which apply to statutory tolling and equitable tolling is therefore of no assistance to LSF9. *Gathman-Matotan Architects and Planers, Inc. v. State, Dept. of Finance and Admin., Property Control Div.*, 1990-NMSC-787.

IV. THIS COURT SHOULD NOT EXPAND THE RIGHTS GRANTED BY §309 BEYOND THE PLAIN LANGUAGE OF THE STATUTE

LSF9 in its Answer Brief goes to great lengths to explain why a lost promissory note cannot be negotiated in compliance with the requirements of Article III of the NM UCC. Although such conclusion is compelled by simple logic, it appears LSF9 ignored this fact when it filed its first foreclosure action in reliance upon delivery of a copy of the lost Note to support its claim of assignment. The fact that a lost Note may not be endorsed and negotiated is not in dispute and LSF9's argument misses the point.

The question is not whether the right to enforce a lost Note may be transferred by endorsement and negotiation, the issue is how far from endorsement and negotiation may the right to enforce a lost Note extend. New Mexico UCC 309

allows a person in possession of the Note with rights of enforcement when the Note is lost the right to enforce the lost instrument. The 2002 amendment to §309, which has not been adopted in New Mexico and which was introduced in the New Mexico legislature and not adopted, allows expansion of that right by assignment to a third party. Consistent with the holding in *Johnston* and this Courts admonition that strict compliance with Article III and the requirements of prudential standing be observed in a foreclosure case for sound policy reasons, this Court should limit enforcement rights to the persons identified by the plain language of §309 and avoid the uncertainty of ownership of enforcement rights and the possibility of "intentional destruction of Notes" and the "unnecessary creation of lost Note affidavits" which assignment of the right granted by §309 would permit. *Deutsche Bank Nat'l Trust Co. v. Johnston*, supra.

To be sure there is a split in jurisdictions on the issue of allowing assignment of the right to enforce a lost note granted by §309. Although there may be a greater number of jurisdictions which have adopted the 2002 amendment to §309 or which have extended by judicial decision the right granted by §309 to enforce a lost note by assignment, the jurisdictions which have disallowed assignment do so for the sound policy reasons consistent with this Courts decisions requiring strict compliance with Article III and a demonstration that plaintiff had prudential standing to enforce the negotiable instrument when the foreclosure case is filed.

The Court's which have refused to allow the assignment of the rights granted by §309 also rely upon the cardinal directive that the unambiguous plain language of the Statute must be observed.

Thus in *Kemp v. Contrywide Homes,* 440 B.R. 624, (U.S. Bankruptcy Court, D. New Jersey, 2010), the bankruptcy Court for the District of New Jersey dissallowed enforcement of a lost promissory note by a claimed assignee stating:

> "Because the claimant acknowledged that he was never in possesion of the Note, he was precluded from reliance on Section 3-309A of the Massachusetts UCC which permits enforcement of a lost, destroyed or stolen instrument but requires possesion of the instrument at some point."

The Court in *Kemp* issued its decision notwithstanding the fact that it was acknowledged that conflicting enforcement claims were not a concern in the case before the Court.

And in *Fannie Mae v. Hicks,* 35 N.E.3d 37, 2015 Ohio 1955, the Ohio Court of Appeals dissallowed enforcement by the assignee of the person who had lost the promissory note first quoting *Dennis Joslin Co. v. Robinson Broadcasting Corp.,* 977 F. Supp. 491 (D.D.C. 1997), and then noting the presence of the 2002 amendment to §309 the Uniform Commercial Code. The Ohio Court of Appeals stated:

> "However Ohio has not adopted the 2002 amended verson of Section 3-309." ... "Thus, in Ohio a party is

> not entitle to enforce a lost Note unless it was entitled to enforce the intrument when the loss occured."

And in *In Re Harborhouse of Gloucester, LLC*, 505 B.R. 365, 374 (Bankr. D. Mass.), *aff'd*, 523 B.R. 749 (B.A.P. 1st Cir. 2014), the Court rejected the argument that assignment of the rights granted by §309 should be permitted stating:

> "Actual possession at the time of loss as a requirement for enforcement of a negotiable instrument under §3-309 provides an objective method to determine a party's right to enforce a negotiable instrument and provides a reliable means to determine the parties' rights. By setting an actual possession requirement, parties on both sides have a clear and established standard. The maker of the note is protected from multiple claims of its ownership and enforcement of the note is still possible by the party who lost it."[1]

So too in *Seven Oaks Enterprises, L.P. v. Devito,* 198 A.3d 88 (Conn. App. Ct. 2018), the Appellate Court of the state of Connecticut rejected the arguments which LSF9 advances in this litigation stating:

> "We also note that although the UCC has been revised by The American Law Institute and the National Conference of Commissioners on Uniform State Laws, and the revision has been available for the legislature to adopt for sixteen years, our legislature has thus far not acted on the proposed revision. This court is 'not

[1] LSF9 in it's Answer Brief notes that a change in the law precluding assignment of the right to enforce a lost instrument may be pending in the state of Massachusetts. LSF9 also correctly points out that the change in the rights granted by §309 is a potential legislative change and not a judicial expansion of the right §309 to enforce a lost instrument.

> permitted to supply statutory language that the legislature may have chosen to omit.'" …
>
> " '[C]ourts may not by construction supply omissions … or add exceptions merely because it appears that good reasons exist for adding them.… It is axiomatic that the court itself cannot rewrite a statute to accomplish a particular result. That is a function of the legislature.'" (Citation omitted).

The Supreme Court of Rhode Island also rejected the arguments advanced by LSF9 in this litigation in that Court's decision in *SMS Financial XXV, LLC v. Corsetti,* 198 A.3d 88 (Conn. App. Ct. 2018). In the *Corsetti* decision the Supreme Court of Rhode Island held that the rights granted to enforce a lost Note by §309 may not be assigned stating:

> "Under the plain language of § 6A-3-309(a), it is clear that SMS is not entitled to enforce the note because the note was in the possession of Sovereign Bank, not SMS when it was lost." …
>
> "[W]hen the language of a statute is clear and unambiguous, this Court must interpret the statute literally and must give the words of the statute their plain and ordinary meanings." ..
>
> "While some states followed suit and amended their codes to purport with §309 of the UCC Rhode Island has not done so. The remedy for situations such as the present matter where a party to an instrument can 'escape liability' fall squarely within the purview of the legislature."

In *Emerald Portfolio, LLC v. Outer Banks/Kinnakeet Associates, LLC*, 790 S.E.2d 721 (N.C. Ct. App. 2016), the North Carolina Court of Appeals also rejected the arguments advanced by LSF9 in this litigation first quoting §309 of the

North Carolina UCC which is identical to New Mexico UCC and continuing stating:

> "This statute is current; it has not been revised since 1995. Our legislature could have revised it to coincide with the UCC revision in 2002, but it did not do so. We must conclude from this distinction that our legislature intended to exclude the additional language of the UCC, and as such intended not to provide this avenue of recovery to parties not in possession of the relevant instrument. Accordingly, we hold that where a party who would otherwise have a right to enforce a lost note under N.C. Gen. Stat. §25-3-309 subsequently assigns that note, the assignee does not acquire the right to enforce the note unless the assignee is in actual possession of the note."

And in *Benkahla v. White*, 82 Va. Cir. 116 (2011), the Fairfax County Circuit Court applied the version of the Virginia §309 which is identical to the New Mexico version of §309 and rejected the assignment argument stating:

> "The plain text of this provision provides that lost negotiable instruments are only enforceable by persons who were in possession of the instrument when it was lost."

Expansion of the right to enforce the lost Note to an assignee of a person who lost the Note while in possession of the Note with rights of enforcement should not occur by Judicial decision. There are sound policy reasons to disallow assignment and the New Mexico legislature has not adopted the expansion of §309 urged by LSF9. The Court should defer to the New Mexico legislature and refrain from Judicial expansion of the right to enforce a lost negotiable instrument granted

by NM UCC §309. This Court should therefore overrule the decision in *CitiMortgage, Inc. v. Garcia*, 2022 No. A-1-CA-38418, 2022 WL 2836770 (N.M. Ct. App. July 20, 2022), and disallow judicial expansion in this case of the right to enforce a lost instrument granted by §309.

V. THE COURT SHOULD NOT BE INFLUENCED BY LSF9'S CLAIMS OF UNJUST ENRICHMENT

LSF9's claim of Unjust Enrichment was not pleaded in its Complaint for Foreclosure. For this reason alone, LSF9's claim of unjust enrichment should not be considered by the Court. See *Hydro Conduit Corp. v. Kemble*, 1990-NMSC-061, ¶ 19 (explaining that a claim for unjust enrichment is distinct from a claim made in tort or contract and, therefore, must be pleaded separately). This Court should also not allow sympathy for LSF9 to influence its decision in this case. *Garcia v. Marquez*, 1984-NMSC-074, ¶ 1 (holding that the "clean hands" doctrine requires a party who seeks equity to have been equitable in the litigation itself). A review of the procedural history of this case in instructive.

Bank of America, after the banking crisis of 2008 and federal bank relief, attempted to sell rights to enforce a lost note notwithstanding the clear language of §309 of the New Mexico UCC and the absence of precedent in New Mexico to so proceed. LSF9 purchased the loan in spite of the plain language of §309 and New Mexico case law requiring that prudential standing be shown when the case is filed

with not even an assignment of the claimed right to enforce the Note. [RP 19, FN 14] Not surprisingly, LSF9's first foreclosure case was dismissed on the express findings that LSF9 had no right to enforce the Note and that New Mexico UCC §309 did not support the claim.

LSF9 then obtained from Bank of America an "Assignment of Lost Note Affidavit" which Judge Butkus correctly observed transferred no rights to enforce the lost note. [RP 408, FN 14]. LSF9 then filed its second foreclosure case on the day the six-month extension under the New Mexico Savings Statute expired. LSF9's position in this litigation was created entirely by LSF9 and the Court should not relieve LSF9 from the results of its own missteps.

CONCLUSION

This Court should find that the Saving Statute does not apply and LSF9's second suit is untimely and this Court should also overrule the Court of Appeals decision in *CitiMortgage, Inc. v. Garcia*, and hold in this case that §309 does not allow assignment of enforcement rights to a lost note. The Court should affirm the District Court's dismissal of LSF9's second foreclosure suit and affirm the District Court's grant of Quiet Title to the Zangara's against LSF9 and Bank of America.

DATED: April 20, 2023

Respectfully submitted,
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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that the foregoing pleading was filed via "Odyssey File and Serve" on the 20th day of April, 2023, which caused all counsel of record to be served by electronic means. I hereby further certify that a true and correct copy of the foregoing was also served via e-mail this 20th day of April 2023 as follows:

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