

BANKING ALERT

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New Jersey Appellate Division Reinstates Borrowers' Claim to a Fair Market Value Credit

In *Brunswick Bank & Trust v. Affiliated Bldg. Corp.*, the Appellate Division reversed the trial court's dismissal of the borrowers' claim to a fair market value credit in an extensive twelve-year litigation over five construction and development loans.

Four of the loans were made to defendant Heln Management, LLC ("Heln"), and a fifth loan was made to Affiliated Building Corp. ("Affiliated"). The loans were guaranteed by Jeffrey Miller, a principal in both entities, and his daughter Melanie Miller. The promise to repay was supported by mortgages held by Brunswick Bank & Trust ("Plaintiff") on several different properties. Upon default, Plaintiff commenced a Law Division Action and obtained a money judgment for \$175,000.00 against Affiliated and a money judgment for \$1,884,141.84 against Heln. Additionally, Plaintiff commenced four separate foreclosure actions, three in Middlesex County and one in Monmouth County. Three of the four actions were filed in 2010 before the judgments were entered in the Law Division Action, and the fourth action was filed in 2013. Final judgments of foreclosure were entered in 2012 and 2013 in the foreclosure actions and the mortgaged properties were sold at sheriff's sales.

In a prior appeal filed after the properties had been sold, the Appellate Division remanded the matter to the trial court to determine whether Plaintiff, through the sale of the mortgaged properties, had fully collected on its judgments.

When the matter was appealed for a second time after disposition in the trial court after the first remand, the Appellate Division again remanded, restating that Plaintiff was only allowed to collect on what was collectively owed by the defendants. In remanding the matter again, the Appellate Division noted that the trial court had determined that Plaintiff was owed at least \$2,700,000 and had already received \$2,599,208.51. Accordingly, the Appellate Division remanded the matter to ascertain the fair market value of certain properties possessed by Plaintiff to determine whether there was any shortfall.

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Thereafter, the parties stipulated and agreed to the fair market value of one of the properties which, at the stipulated value and per the Appellate Division's ruling, would have required the trial court to enter judgment that Plaintiff was fully compensated and an award in favor of the defendants in the amount that had been overpaid. However, the matter remained dormant for over two years until April 2021 when the trial court dismissed the defendants' claim for a fair market value credit based on its application of a subsequent Supreme Court decision.

Defendants appealed the trial court's dismissal arguing, among other things, that the Appellate Division's decision about their entitlement to fair market value credits was the law of the case and binding on the trial court.

The Appellate Division reversed the dismissal and applied the law of the case doctrine, finding that although the trial court's decision to sidestep its mandate was based on a recent Supreme Court decision, it was still required to comply with the mandate provided by the Appellate Division. Further, the Appellate Division noted that it was not for the trial court to determine whether the Appellate Court's prior decision had been undermined by a more recent, higher authority.

The Appellate Division further held that, because the total amount due and owing to Plaintiff on the relevant dates was never accurately fixed, the matter needed to be remanded to the trial court for that determination. In the event that the amount due to Plaintiff was less than the stipulated fair market values of the properties that were foreclosed, the Appellate Division held that Plaintiff should be disgorged of that windfall and that amount should be paid to the defendants.

New Jersey Appellate Division Rules That Debtor's Chapter Seven Bankruptcy Discharge Does Not Prevent Creditor From Seeking to Foreclose on Real Property

In *Vadim Chepovetsky and Svetlana Nashatik v. Louis Civello, Jr.*, No. A-0476-21 (N.J. App. Div. June 16, 2022), the Appellate Division held that a debtor's discharge in bankruptcy does not preclude a creditor from foreclosing a mortgage on real property.

In January 2007, defendant Louis Civello ("Defendant") agreed to sell his automobile dealership in South Amboy and its inventory of vehicles to Artem Boguslavskiy for \$196,500. Boguslavskiy paid Defendant \$12,500 upon execution of the agreement and gave Defendant a promissory note for \$184,000 payable in sixty monthly installments. Boguslavskiy was a relative of plaintiff Vadim Chepovetsky and the promissory note was secured by a mortgage on Chepovetsky's residence in Old Bridge, as well as a personal guaranty by Chepovetsky. After making four of the monthly installments, Boguslavskiy defaulted and made no further payments.

In 2011, plaintiffs Vadim Chepovetsky and Svetlana Nashatik ("Plaintiffs") filed for Chapter Seven bankruptcy. During the proceeding, the bankruptcy trustee abandoned his interest in Plaintiffs' residence as it would provide no value to the bankruptcy estate. Plaintiffs were ultimately granted a discharge in bankruptcy, which included Chepovetsky's obligation under his personal guaranty, on September 29, 2011.

On January 29, 2019, Plaintiffs filed an action against Defendant seeking, among other things, quiet title on their residence and a declaratory judgment barring Defendant from pursuing claims under the mortgage, promissory note or guaranty. Plaintiffs alleged that the applicable six-year statute of limitations on enforcement of the mortgage has passed since the mortgage matured on February 22, 2012. Defendant answered the complaint and filed a counterclaim for breach of contract, quantum meruit and breach of the covenant of good faith and fair dealing. Plaintiffs answered the counterclaim, denied the substantive allegations therein, but did not assert any affirmative defenses. After a one-day bench trial, which Plaintiffs

did not attend, the trial court ruled in favor of Defendant, dismissed Plaintiffs' complaint and found that Plaintiffs waived and were estopped from asserting the affirmative defenses of statute of limitations and any other affirmative defense that could have been pleaded in response to Defendant's counterclaim. The trial court also found that Defendant could proceed to enforce the note and guaranty against Chepovetsky. The trial court entered judgment against Chepovetsky in the amount of \$410,800 (comprised of \$184,000 principal, \$216,000 interest and late fees of \$10,800).

On July 21, 2021, Plaintiffs filed a motion to (1) vacate the judgment and (2) vacate the dismissal of their complaint to quiet title. In support of their motion, Plaintiffs provided their bankruptcy filings which showed the claims related to Chepovetsky's guaranty were discharged. Plaintiffs also argued that their action in quiet title should proceed because an action to foreclose a mortgage was subject to a six-year statute of limitations. On September 3, 2021, the court issued an order vacating the judgment and its prior dismissal of the quiet title action. The trial court found that Chepovetsky's personal debt to Defendant was discharged in the bankruptcy and the discharge was not waived by Plaintiffs' failure to plead it as a defense. The trial court also reinstated the action to quiet title finding that the statute of limitations had run.

Defendant subsequently appealed the trial court's decision to vacate the judgement and reinstate the quiet title action. In his appeal, Defendant argued that Plaintiffs waived the affirmative defense of discharge in bankruptcy by failing to assert it in their answer to his counterclaim and at trial. The Appellate Division ruled that under the Supremacy Clause, the nature, extent and enforceability of a discharge is controlled by the Bankruptcy Code and federal case law. The Appellate Decision further recognized that Section 524 of the Bankruptcy code makes it "entirely unnecessary for a debtor to do anything at all in post-discharge collection action." Consequently, Plaintiffs' failure to plead discharge as an affirmative defense did not waive the defense or estop Plaintiffs from later asserting the defense.

The Appellate Division next considered the impact of a discharge on the mortgage lien. The Court held that a discharge in a Chapter Seven bankruptcy only discharges the personal liability incurred by a debtor, and the accompanying liens remain enforceable against real property. A debtor's Chapter Seven discharge does not deprive a mortgagee of its right to collect on its debt *in rem* against a debtor's property. Thus, Plaintiffs' bankruptcy discharge did not preclude Defendant from seeking to foreclose the mortgage or obtaining a judgment fixing the amount of the mortgage lien, so long as the judgment does not impose any personal monetary liability.

The Appellate Division ultimately ruled that Defendant was entitled to the judgment on its counterclaim fixing the amount of the mortgage lien on Plaintiffs' residence. However, the bankruptcy discharge precluded Defendant from obtaining a judgment against Chepovetsky personally. Accordingly, the Appellate Court held that the judgment against Chepovetsky was properly vacated by the trial court.

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