EFiled: Oct 23 2023 08:21AM EDT
Filing ID 71158129
Case Number 306,2023

IN THE SUPREME COURT OF THE STATE OF DELAWARE

REO TRUST 2017-RPL1, Plaintiff Below, Appellant, v. **SHORT SALE, LLC,** Defendant Below, **FSC LENDING LLC** Interested Party, Below Appellees.	No. 306, 2023 On Appeal from the Superior Court of the State of Delaware in C.A. No.: N20L-10-029 DJB

APPELLANT'S CORRECTED OPENING BRIEF

McCABE, WEISBERG & CONWAY, LLC

Janet Z. Charlton, Esquire (No. 2797)
Chase N. Miller (No. 5363)
1415 Foulk Road, Suite 100
Foulkstone Plaza
Wilmington, DE 19803
(302) 409-3520 [tel]
(855) 425-1980 [fax]
Attorneys for Appellant REO Trust 2017-RPL1

Dated: October 23, 2023

TABLE OF CONTENTS

TABLE OF CITATIONS

Page #

Cases

Statutes

Rules

Other Authorities

NATURE OF PROCEEDINGS

This is an appeal from a ruling of the Superior Court following post execution motions filed by 1) a Defendant in a junior mortgage foreclosure action and 2) an Interested Party holder of a senior mortgage on the property foreclosed upon. The Defendant moved to invalidate the sale, and the Interested Party sought to participate in the distribution of the proceeds. The Plaintiff opposed both motions The Superior Court denied the motion to invalidate the sale and granted the Interested Party's motion to participate in the distribution of proceeds. Plaintiff appeals both decisions.

SUMMARY OF ARGUMENTS

1. The Superior Court erred in holding that Short Sale did not waive its right to assert defenses, when it asserted defenses in a manner not permitted by the Rules of Civil Procedure.

2 The Superior Court erred in holding that the Estate was a necessary party to REO's foreclosure of the property when its interest was completely divested by the prior HOA judgment sale.

3 The Superior Court erred in holding that first mortgage holder FCS was entitled to distribution of sheriff sale proceeds after the foreclosure sale brought by the second mortgage holder REO, misapprehending established law and upending long standing practice by the Sheriff.

STATEMENTS OF FACTS

The recitation of facts by the Superior Court in are not in dispute. Property at 313 S. Broom Street, Wilmington, Delaware 19805 ("Property") owned by the late Roberta Ziefert was sold by its Homeowners Association, Towne Estates ("HOA") to satisfy a judgment docketed in the Superior Court on August 16, 2019, against her estate (the "Estate") for failure to pay condominium fees. (A014-016)

At the time of the December 10, 2019, HOA execution sale, the property had two outstanding mortgages, a first priority mortgage held by Pettionero Enterprises which was recorded in the Office of the Recorder of Deeds in and for New Castle County, State of Delaware on January 5, 1991 (A017-020)[1] and second priority mortgage of Plaintiff REO Trust 2017-RPL1 ("REO") which was recorded on September 27, 2004[2]. (A023-031)

Appellee Short Sale LLC ("Short Sale") bought the property at the HOA execution sale (A070) Neither the first nor second mortgage were paid from the proceeds of that HOA execution sale. The lack of distribution to the mortgage holders was consistent with the procedures that the sheriff, REO, and apparently

---

[1] FSC Lending, LLC ("FSC") was assigned the mortgage on February 12, 2020(A021-022)

[2] The original mortgage was in favor of Beneficial Delaware, Inc. and was assigned to REO. (A032-038)

the first mortgage holder Pettinaro Enterprises and its assignee FCS believed to be the long standing law in Delaware. No party disputes that both mortgages had lien priority over the HOA judgment that brought the property to sale.

On October 30, 2020, REO filed a foreclosure action against Short Sale, the now current owner of the property. (A039-061) Short Sale was properly served but filed no answer. A default judgment was entered in the amount of $88,254.71, (A063-067) the property sold at sheriff sale in May 2021 (A084) and the county records reflect that the property was sold to FCS for $92,303.00. (A068) No deed has yet been issued by the sheriff.

After the sale, Short Sale filed a motion to set aside the sale. (A069-085) Short Sale alleged that necessary parties to the complaint were missing, namely the Estate. Short Sale has never alleged that it did not have notice of the foreclosure, nor offered any explanation for its failure to participate in the action prior to the May, 2021, sheriff sale.

Simultaneously, FCS moved to confirm the sale and claimed that it is entitled to have the sheriff distribute proceeds of the foreclosure sale first to it, before any other lienholder because it holds the first mortgage on the property. (A086-106)

REO objected to both motions. REO opposed Short Sale's motion, arguing first that the Estate was no longer a necessary party after its interest was

extinguished at the HOA judgment sale (A108), and second that Short Sale waived its right to assert the absence of necessary parties since it did not file an answer to the foreclosure complaint asserting this or any other defense. (A167-168)

REO opposed FCS' motion and argued that FCS is not entitled to participate in the distribution of proceeds from the REO's sale, under both well-established law and custom in the Delaware sheriff sale process. (A169-171) The Sheriff of New Castle County joined in this opposition and confirmed its understanding of the law and its practice of not distributing proceeds of sale to any non-foreclosing senior mortgage. (A118-119)

After full briefing, (A120-198) the Court issued its Opinion dated June 1, 2023. (A210-224) The Superior Court denied Short Sale's motion, holding that although the Estate was a necessary party rendering the foreclosure a defective *sci fa sur* mortgage foreclosure (A219)[3] there was no prejudice to any party, so this defect did not warrant vacating the sale. (A219-221) It granted FCS' motion and held that as the first mortgage holder, FCS is entitled to distribution of the sheriff sale proceeds (A223), rather than its mortgage lien continuing to attach to the

[3] "Therefore, the Estate should have been noticed and as a result there has been a defect in the *sci facias* process." (A219)

property as has been understood by the sheriffs and real estate practitioners in this State for many years.

The Superior Court also held that to the extent there were not proceeds sufficient to satisfy REO mortgage, the mortgage lien would not be extinguished. (A224)

FCS and Short Sale moved for reargument on this last issue. (A225-238) On August 1, 2023, the Court issued a revised opinion, (A240) rendering the motion for reargument moot. (A239-254)

REO files its notice of appeal on August 28, 2023. (A255-256) Short Sale and FCS have cross appealed. This is REO's opening brief.

ARGUMENT

I. THE SUPERIOR COURT INCORRECTLY HELD THAT SHORT SALE COULD ASSERT DEFENSES FOR THE FIRST TIME AFTER THE SALE

A. Question Presented

Did the Superior Court err in holding that Short Sale did not waive its right to assert defenses, when Short Sale did not enter its appearance, filed no answer to the foreclosure complaint or participate in the foreclosure process in any manner prior to the foreclosure sale? (A167-168)

B. Scope of Review

The interpretation of statutes is question of law that this Court reviews *de novo. Eastern Savings Bank v. CACH*, 55 A.3d 344, 347 *(*Del. Supr. 2012) *citing Le Van v. Independence Mall, Inc*,. 940 A2d 929, 932 (Del. Supr. 2007).

C. Merits of Argument

1. Short Sale waived its rights to assert defenses when it did not participate in the underlying foreclosure action.

Short Sale waived the defense that the foreclosure failed to name a necessary party. Short Sale did not assert any defenses to the foreclosure and allowed a default judgment to be entered against it. It belatedly asserted that Plaintiff failed to name a necessary party, rendering the foreclosure defective, after foreclosure judgment and the sheriff sale to execute on that judgment.

The failure to join a party is a defense that must be asserted once the complaint is served. Superior Court Civil Rule 12(b).[4] Short Sale waived this defense, *see Tydings v. Loewenstein*, 505 A.2d 443, 446 (Del. Supr. 1986); *City of Wilmington v. Spencer*, 391 A.2d 199, 203 (Del. Supr. 1978) (affirmative defenses must be pled or the defense is waived), by failing to assert it in the matter set forth in Superior Court Rule 12(h), prior to judgment[5]. Under Rule 12 (h) this defense could have been asserted in the answer, a motion for judgment, or at trial.[6] Rule 12(h) does not permit this defense post trial after execution. Short Sale sat silent

---

[4] (b) How presented. -- Every defense, in law or fact, to a claim for relief in any pleading, whether a claim, counterclaim, cross-claim, or third-party claim, shall be asserted in the responsive pleading thereto if one is required, except that the following defenses may at the option of the pleader be made by motion: (1) Lack of jurisdiction over the subject matter, (2) lack of jurisdiction over the person, (3) improper venue, (4) insufficiency of process, (5) insufficiency of service of process, (6) failure to state a claim upon which relief can be granted, (7) failure to join a party under Rule 19. A motion making any of these defenses shall be made before pleading if a further pleading is permitted. (emphasis added)

[5] Superior Court Civil Rule 12(h). Waiver or preservation of certain defenses. - ...(2) A defense of failure to state a claim upon which relief can be granted, a defense of failure to join a party indispensable under Rule 19, and an objection of failure to state a legal defense to a claim may be made in any pleading permitted or ordered under Rule 7(a), or by motion for judgment on the pleadings, or at the trial on the merits.

[6] Superior Court Civil Rule 7(a). (a) Pleadings. There shall be a complaint and an answer; a reply to a counterclaim denominated as such; an answer to a cross-claim, if the answer contains a cross-claim; a third-party complaint, if a person who was not an original party is served under the provisions of Rule 14; and a third-party answer, if a third party complaint is served. No other pleading shall be allowed, except that the Court may order a reply to an answer or a third-party answer.

during all these stages of the foreclosure proceedings.

It is not in the interest of judicial economy for a defendant to fail to defend an action, then wait until after the judgment is entered, appeal periods expire and execution process is almost concluded, before coming forward for the first time to assert defenses to essentially reopen the case. Rule 12(h) was designed to prevent such dilatory tactics. *See Plummer v. Sherman*, 861 A.2d 1239, 1243 (Del. Supr. 2004).

Short Sale argued in the Court below that this was a challenge to the jurisdiction of the Superior Court in that failure to name the Estate deprived the Superior Court of jurisdiction. The Superior Court agreed that there was a defect in the *Scire Facias* process (A219). It then inconsistently retained jurisdiction and applied part of the analysis normally applied in a motion to dismiss a complaint if necessary parties cannot be joined, *see e.g. Hart v. Parker*, 2021 Del. Super. LEXIS 633 (Del. Super 2021):

> the Court must inquire into the second prong, whether "in equity and good conscience the action should proceed among the parties before it, or should be dismissed, the absent party being thus regarded as indispensable[?]" The Court should consider the following factors:

(1) to what extent a judgment rendered in the person's absence might be prejudicial to the person or those already parties; (2) the extent to which, by protective provisions in the judgment, by the shaping of relief, or other measures, the prejudice can be lessened or avoided; (3) whether a judgment rendered in the person's absence will be adequate; and (4) whether the plaintiff will have an adequate remedy if the action is dismissed for nonjoinder

The Superior Court correctly found no prejudice, (A219-221) but its belated consideration of the issue opens the door for future litigants to stand back and wait until judgment or later to assert defenses that should and could have been raised in a responsive pleading to the complaint. This is especially relevant in a foreclosure action, where the Defendant normally has ample reasons to try to delay a final result, i.e., ouster from the property, as long as possible.

ARGUMENT

II. THE SUPERIOR COURT INCORRECTLY HELD THAT THE FORELCOSURE WAS DEFICIENT FOR FAILURE TO INCLUDE THE ESTATE AS A NECESSARY PARTY

A. Question Presented

Did the Superior Court err in holding that the Estate was a necessary party to REO's foreclosure of the property when its interest was completely divested by the prior HOA judgment sale? (A108)

B. Scope of Review

The interpretation of statutes is question of law that this Court reviews *de novo. Eastern Savings Bank v. CACH*, 55 A.3d 344, 347 *(*Del. Supr. 2012) *citing Le Van v. Independence Mall, Inc,*. 940 A2d 929, 932 (Del. Supr. 2007).

C. Merits of Argument

10 Del Code § 5061 provides:

Occasion for suing out writ; parties and notice [For application of this section, see 82 Del. Laws, c. 30, § 3].

(a) Subject to the provisions of §§ 5062A, 5062B, 5062C and 5062D of this title, upon breach of the condition of a mortgage of real estate by nonpayment of the mortgage money or nonperformance of the condition stipulated in such mortgage at the time and in the manner therein provided the mortgagee, the mortgagee's heirs, executors, administrators, successors or assigns may, at any time after the last day whereon the mortgage money ought to have been paid or other conditions performed, sue out of the Superior Court of the county wherein the mortgage premises are situated a writ of scire facias upon such mortgage directed to the sheriff of the county commanding the sheriff to make known to the mortgagor, and those persons described in subsection (b) of this section and such mortgagor's heirs, executors, administrators or successors that the mortgagor or they appear before the Court to show cause, if there is any, why

> the mortgaged premises ought not to be seized and taken in execution for payment of the mortgage money with interest or to satisfy the damages which the plaintiff in such scire facias shall, upon the record, suggest for the nonperformance of the conditions.

Short Sale argued that because Section 5061 states that the mortgagor is to be brought to appear before the Court, that Roberta Ziefert (the mortgagor)'s Estate, was required to be a Defendant and the failure to name it rendered the foreclosure defective.

Naming the mortgagor is the normal practice, but there are instances where mortgagors are not named Defendants in a foreclosure action. Foreclosure is a *in rem* proceeding, and the remedy sought is to sell the property to recover the amount due. It is not unheard of for a mortgagor to die before a foreclosure. The estate and heirs are typically named as defendants since they are now the legal owners of the property by operation of law. At times, however, the mortgagor's interest does not pass to an estate or heirs. The property may have been held as joint tenants with rights of survivorship with both joint tenants signing the mortgage, but one dying prior to foreclosure. In that circumstance, the surviving joint tenant is the sole party with an interest in the property and is the only defendant. The deceased mortgagor is not a necessary party.

This Court has considered and rejected the argument that a deceased party's estate must be named when the decedent was a mortgagor, but no longer has an

interest in the property. In *Wilmington Savings Fund Society v. Gillette*, 2017 Del Super LEXIS 157,. (Del Supr. Ct. 2017), *affirmed, Gillette v. Wilmington Saving Fund Society*, 245 A. 3d 498 (Del. Supr. 2017), the surviving mortgagor sought to invalidate a foreclosure using the same argument as Short Sale. "Defendant [Gillette] claims the [the Estate of Pamela] Slingluff must be joined to the suit because she was one of the Mortgagors responsible for the Mortgage, making her a necessary party. Defendant [Gillette] fails to understand a key point: she became the sole owner of the property by operation of law upon Slingluff's death; therefore, she is the only defendant in the suit. …there is no need for Slingluff's estate to be joined to this action." Id. at * 4 and 5.

Similarly here, once Short Sale became the sole owner of the Property by operation of law after the HOA execution sale, there was no need for the Estate of Ziefert to be joined in this action. It would serve no purpose, as the Estate had no interest in the property.

III. THE SUPERIOR COURT INCORRECTLY GRANTED FCS' MOTION FOR DISTRIBUTION OF PROCEEDS

A. Question Presented

Did The Superior Court err in holding that first mortgage holder FCS was entitled to distribution of sheriff sale proceeds after the foreclosure sale brought by the second mortgage holder REO, misapprehending established law and upending long standing practice? (A169-171)

B. Standard of Review

The interpretation of statutes is question of law that this Court reviews *de novo. Eastern Savings Bank v. CACH*, 55 A.3d 344, 347 *(*Del. Supr. 2012) *citing Le Van v. Independence Mall, Inc,*. 940 A2d 929, 932 (Del. Supr. 2007).

C. Merits of Argument

1. The Superior Court erred in holding that first holder FCS is entitled to distribution of proceeds at a second mortgage foreclosure sale.

Simultaneously, the same firm representing Short Sale to overturn the sale, filed a conflicting motion on behalf of FCS to collect the proceeds of the foreclosure sale because its mortgage was first in priority. FCS conflates lien priority to priority in the distribution of sale proceeds. It argued that because Delaware is a "pure race" statute, a first priority mortgage has first priority over sale proceeds. (A134)

To the contrary, FCS's "first in time, first in right" mortgage only entitles it to retain its first priority mortgage lien on the property, which cannot be extinguished by those who record later in time. Its mortgage lien remains in first position. For the same reasons, FCS's mortgage was not extinguished when the HOA sold the property at execution sale.

Delaware law preserves a first priority mortgage lien position but does not give a first mortgage holder the right to proceeds when the second lien or mortgage holder forecloses. The first source for this long-standing practice is 10 Del. C. § 4985:

Discharge of liens upon execution sale; exceptions.
Real estate sold by virtue of execution process shall be discharged from all liens thereon against the defendant, or against one or more of the defendants, if there is more than one, whose property such real estate is, except such liens as have been created by mortgage or mortgages prior to any general liens; and with respect to such, the sale shall be a discharge to the extent to which the proceeds thereof may be legally applicable to a judgment or judgments obtained for the debt, to secure the payment of which the mortgage or mortgages respectively, if there is more than one, appear to have been given, and the real estate shall also be discharged from all right of dower and curtesy therein of any defendant in the execution. (emphasis added)

Section 4985 makes two things clear: First, mortgages that have priority over a judgment are not discharged by the execution process. Second, proceeds from the execution sale is only distributed if the mortgage was reduced to judgment. ("proceeds thereof may be legally applicable to a judgment or judgments obtained for the debt") *Id. The* statute dictates the result that the

Property is not discharged from FCS' mortgage, and is sold subject to FCS' mortgage, which has not been reduced to judgment.

The learned Delaware treatise, 2 *Woolley's Practice in Civil Actions,* §1140 elaborates on the statute, offering an example to support the conclusion that first priority mortgages do not have first priority in the distribution of proceeds. *Woolley* examines the situation where there is a mortgage lien followed by a general lien or liens as an example. When execution is on the general lien "the first lien being a lien created by mortgage, and being *prior* to a general lien, is within the exception, and is not discharged by the sale and does not share in the distribution of the proceeds." *Woolley* § 1140 (emphasis added) Again, under our facts, FCS, as the holder of a lien created by mortgage, is not discharged and does not share in the distribution of proceeds.

The Superior Court has had occasion to confirm *Woolley's* interpretation of Section 4985, in *Cedar Inn, Inc. v. King's Inn, Inc.* 269 A. 2d 781 (Del. Super. 1971. In that case, the property being foreclosed upon by Cedar Inn was subject to the following liens in order of priority: First, Delaware Trust mortgage, second Cedar Inn mortgage, third Delaware Trust judgment bond. Delaware Trust's attorney announced prior to the sale that the sale was subject to its mortgage. In a dispute regarding the distribution of proceeds, the Superior Court held that only the junior judgment bond was entitled to participate in the distribution of proceeds:

"It is the further opinion of the Court that Delaware Trust Company, although it announced that the sale was to be made subject to its first mortgage, is still entitled to participate in the sale proceeds as first general lienholder under its judgment bond given to secure the same indebtedness as the mortgage. Had no announcement been made at the sale such participation in the proceeds would clearly have been proper under 10 Del.C. § 4985 and in accordance with Judge Woolley's construction of the statute. The proceeds of the sale remained "legally applicable" to the judgment of the Delaware Trust Company within the meaning of 10 Del.C. § 4985 and without regard to any announcement." (emphasis added) *Id* at 786-787

Thus, if Delaware Trust had not had a judgment lien, it would not have been entitled to share in the proceeds of the sale. Making an announcement at the sale was legally irrelevant. Applying the facts in *Cedar Inn* would yield the result advocated by REO and the sheriff. The sale was subject to FCS's (Delaware Trust) mortgage and FCS, not being a judgment holder, is not entitled to participate in the distribution of proceeds when the junior mortgage holder, REO (Cedar Inn) forecloses.

More recently, this Court has endorsed the interpretation of Section 4985 given by the Court in *Cedar Inn, Inc. v. Kings Inn, Inc.* and advocated by REO noting that the *Cedar Inn* analysis is correct. *see Eastern Savings Bank v. CACH,* 55 A.3d 344, 350 *(*Del. Supr. 2012).:

"we note that our statutory interpretation is consistent with *Cedar Inn v. King's Inn, Inc.* Cedar Inn involved sheriff's sale property with encumbrances in the following order of priority: (1) Delaware Trust Company mortgage, (2) Cedar Inn, Inc. mortgage, and (3) Delaware Trust Company judgment lien. Cedar Inn foreclosed on the property subject to the Delaware Trust Company mortgage,

meaning that the Delaware Trust Company's first mortgage remained on the property after the foreclosure sale. In setting the order of distribution for the remained two liens, the judge held that the sheriff sale proceeds be paid first to Cedar Inn's mortgage, then to the Delaware Trust Company's judgment lien")(emphasis added).

Eastern Savings Bank v. CACH itself presented facts different than the those before the Court today. There, the order of liens was first, judgment lien in favor of CACH, second mortgage in favor of Eastern Savings Bank. The Court held that the judgment of CACH would be extinguished after the sale. *CACH* at 349. This holding is consistent with both Section 4985 and *Cedar Inn, Inc. v. Kings Inn, Inc.*.

Section 4985 then goes on to require that proceeds be distributed to "judgments obtained for the debt". *Cedar Inn, Inc.* required that a general judgment lien is entitled to payment before a mortgage.

CACH reached the correct result: a judgment that must be discharged is entitled to participate in the distribution of proceeds from a sheriff sale, but it is entitled to participate not because it was recorded before the foreclosing mortgage, but because it is being discharged. The race recording statute only comes into play to determine, of the liens being paid, which is paid first. Section 4985, *Woolley's* and *Cedar Inn* all state that a first priority mortgage is not discharged after the sale and as specially noted by *Woolley's* "does not share in the distribution of proceeds" *Id*. The race recording statute would only come into play to determine the order of priority of payment **of the liens being discharged by the sale**. The first to record,

either the foreclosing mortgage, or any judgment would have priority in the distribution of proceeds. The *CACH* judgment would be distributed proceeds even if the *CACH* judgment was recorded after the foreclosing mortgage, but would be paid second in line to the foreclosing mortgage which is also discharged by the sale. 10 *Del. C. Section* 5066.

As noted by the Sheriff of New Castle County, the sheriff has followed Section 4985, *Cedar Inn* and Professor Woolley's guidance for decades and countless sheriff deeds have conveyed title accordingly.

2. This Court should decline to interpret the laws in a manner inconsistent with Delaware practice.

"It has often been said that it is almost as important that the law be settled, as it is that the law be right. A rule of property long acquiesced in should not be overthrown except for compelling reasons of public policy or the imperative demands of justice. Courts must avoid unsettling rules which affect the devolution of property in the absence of a strong public policy to the contrary." *Abbott Supply Company v. Shockley,* 128 A. 2d 794 (Del. Super. 1956), aff'd 135 A. 2d 607 (1957) [internal citation omitted]; *Acierno v. Fulsom*, 337 A2d 309, 314 (Del Supr. 1975).

If this Court were to affirm the decision of the Superior Court, it will throw into question decades of sheriff sales conducted against surviving joint tenants and

surviving spouses and on behalf of second mortgage holders.

When a property is owned joint tenants with rights of survivorship and spouses and one of them dies, typically, only the surviving owner is named in the foreclosure. *See Slinghuff, supra*. If the ruling of the Superior Court becomes the law, these foreclosures are now invalid, having violated 10 Del. C. Section 5061.

Similarly, there have been many foreclosures by junior mortgage holders over the years. Many were likely credit bid by the foreclosing junior lender, with no proceeds being remitted to the sheriff. None of these foreclosure sales distributed proceeds in accordance with the novel rule propounded by the Superior Court. The validity of all these sales and sheriff deeds in chains of title could have far reaching ramifications for the titles of Delaware property owners.

CONCLUSION

The proper result is that this sale was valid. FCS, as the winning bidder at the sheriff sale, must remit its bid amount to the sheriff, who then will distribute the net proceeds first to REO, the foreclosing lender, followed by any junior judgment liens which are otherwise discharged from the Property (of which there appear to be none). The first priority mortgage continues to attach to the property, is not extinguished and does not share in the proceeds. Proceeds go to the foreclosing lender, in this case, REO.

Dated: October 23, 2023 McCABE, WEISBERG & CONWAY, LLC

/S/ Janet Z. Charlton

Janet Z. Charlton, Esquire (No. 2797)
Chase N. Miller Esquire (No. 5363)
1415 Foulk Road, Suite 100
Foulkstone Plaza
Wilmington, DE 19803
(302) 409-3520 [tel]
(855) 425-1980 [fax]
Attorneys for Appellant REO Trust 2017-RPL1