

NOT FOR PUBLICATION WITHOUT THE
APPROVAL OF THE APPELLATE DIVISION

SUPERIOR COURT OF NEW JERSEY
APPELLATE DIVISION
DOCKET NO. A-0193-11T2

SEA VILLAGE MARINA, LLC,
and BAYWATCH MARINA, LLC,

Plaintiffs-Appellants,

v.

PATRICIA ANN BEST,

Defendant-Respondent.

Argued May 23, 2011 - Decided September 5, 2012

Before Judges Lihotz, Waugh, and St. John.

On appeal from the Superior Court of New Jersey, Chancery Division, Atlantic County, Docket No. C-0112-09.

Stephen Hankin argued the cause for appellants (Hankin Sandman & Palladino, attorneys; Mr. Hankin, on the briefs).

Daniel J. Gallagher argued the cause for respondent (Miller, Gallagher & Grimley, attorneys; Mr. Gallagher, on the brief).

PER CURIAM

Plaintiffs Sea Village Marina, LLC (LLC), and Baywatch Marina, LLC (Baywatch), appeal from the General Equity Part's August 18, 2011 order dismissing plaintiffs' complaint on a motion for summary judgment. We reverse.

I.

We discern the following facts and procedural history from the record on appeal.

At some point prior to 1994, John Best and his wife, defendant Patricia Ann Best,¹ created Sea Village Marina, a community of floating homes and a boatyard in Northfield. The boatyard provided rack storage and launching sites for boats, as well as boat repairs and sales. According to Patricia, she and John had "made significant capital contributions in turning the subject marina into a working entity."

In April 1994, Patricia and John transferred a twenty-five percent interest in the LLC to their son Mark. Patricia owned a seventy-percent interest, and John retained the remaining five-percent. The record contains an unsigned document entitled "Operating Agreement of Sea Village Marina LLC adopted December 8, 2001." The operating agreement identified Patricia and John as managing members and gave them the power to "make decisions regarding the usual affairs" of the LLC and to bind the LLC through agreements, including the assumption of debt and disposition of assets.

¹ Because the Bests and their son share the same last name, we refer to them by their first names for the sake of convenience.

In the fall of 2003, John was diagnosed with a terminal illness. He began working on an estate plan with his attorney. The plan regarding the LLC was premised on John being the sole owner. John apparently intended to acquire Mark's twenty-five-percent interest in exchange for a \$200,000 mortgage, which would be subordinate to a \$1.6 million mortgage that the LLC would give to Patricia and John with rights of survivorship. Neither mortgage would accrue interest, and both were to be paid off prior to any sale of the LLC. Any value remaining in the LLC after payment of the mortgages was to be divided equally among John's four children.

In October 2003, Patricia assigned her seventy-percent-interest in the LLC to John. On the same day, the LLC executed a \$1.6 million note and mortgage to John and Patricia as joint tenants with rights of survivorship. The note specifically provided that the funds were to be repaid prior to any sale of the LLC. The mortgage recited that it was given to John and Patricia "[i]n return for loans received and unpaid services that Sea Village Marina, LLC has received from" them. According to Patricia, John left handwritten notes listing the various capital contributions that he and she made to the LLC. The total listed in those documents is \$1,931,264. Patricia maintains that the issuance of the mortgage and her transfer of

her seventy-percent interest in the LLC to John "was a package deal."

John executed his will in December 2003. With respect to the LLC, John directed his executors to "hold my interest" in the LLC "until such time as the [two mortgage] debts . . . are satisfied in full." Although John's will refers to the "two debts," John had not actually acquired Mark's twenty-five-percent interest in the LLC or issued a mortgage to Mark at the time the will was executed. John directed that Patricia be appointed to manage the LLC until the debts were paid in full. John's son-in-law, Stephen Green, and Patricia were designated as co-executors. Patricia was the residuary legatee.

John died on December 22, 2003. Shortly before his death, John asked Mark to transfer his interest in the LLC to him, but Mark refused. Consequently, ownership of the LLC was split between Mark and John's estate at the time of John's death.

Patricia recorded the \$1.6 million mortgage on December 30. According to Mark, he had not known that John and Patricia had executed such a mortgage prior to its recordation. He maintains that he would not have consented to the mortgage, primarily because he did not believe that there was any underlying debt owed to John or Patricia.

In July 2004, Patricia obtained an appraisal valuing the fair market value of the LLC at \$2.75 million, as of May 2004. The estimate was broken down as follows: \$2.27 million for the real property, \$180,000 for chattels, and \$300,000 for the business. That is the only appraisal contained in the record.

In early 2007, Patricia and Green applied to the Probate Part for permission to resign as co-executors of John's will. Patricia also requested permission to resign as manager of the LLC. In May 2007, the probate judge granted their applications and named Barbara Lieberman, an attorney, as administrator CTA and manager of the LLC.

In July 2007, Lieberman filed an application in the Probate Part for a determination of the validity of Patricia's \$1.6 million mortgage. The judge declined to address the issue in that manner, but ordered that any of John's heirs who wished to challenge the mortgage should do so prior to October 15, 2007. Because none of the heirs challenged the mortgage, the parties proceeded as if the mortgage was a valid debt of the LLC. As the judge later observed, "there was a general understanding within the estate litigation . . . that [Patricia's mortgage] was not going to be subject to attack in the most general sense." However, the judge did not enter an order declaring that the mortgage was valid or precluding the LLC itself or

anyone not a beneficiary of the will from challenging its validity in the future. The December 2007 order limiting the time for the heirs to challenge the mortgage was not recorded and, consequently, a search of the title to the real property would not have disclosed it.

In November 2008, Lieberman filed a verified complaint in the Probate Part requesting directions on how to proceed with the LLC and other assets owned by John. The verified complaint reflected that Patricia did not want to manage the marina, and that none of John's children, including Mark, wanted to own the LLC. Lieberman informed the judge that, when Patricia and Green were serving as executors, they attempted to sell the LLC at a price of \$3.2 million, which would have been enough to pay the LLC's debts and provide a "modest profit" for the estate. The two offers received were for \$1.2 and \$1.6 million.

According to Lieberman, it did not appear "possible to realize a sale price that will allow [the LLC] to satisfy the secured obligations of the marina including the \$1.6 million mortgage." Lieberman outlined several alternatives, including selling the marina subject to Patricia's mortgage or requiring Patricia to accept less than \$1.6 million in satisfaction of the mortgage. Lieberman estimated that the LLC's debts were approximately \$2.267 million, including Patricia's mortgage.

Following a conference on December 8, 2008, the judge issued a preliminary decision:

The decedent's will deals with the disposition of the Marina in fairly specific terms. In essence, the will provides that the decedent's stock in the LLC is to be distributed equally to his four children. It also provides that the executor is to hold the stock until the \$1.6 million dollar mortgage due from the LLC to Patricia Best has been paid. It contemplates that Patricia Best will operate the LLC in the interim. I think it is clear that the decedent anticipated the LLC would have substantial value over the amount specified in that mortgage. I am also satisfied that the decedent specifically intended that his wife's interests, reflected in the mortgage, would be superior to the claims of any other potential beneficiaries.

Based on the information before him, the judge concluded that "there is no chance anyone would pay any substantial sum for" the LLC. In a December 17, 2008 order, the judge ordered the estate to attempt to find a buyer for the LLC.

Two proposals for the purchase of the LLC were subsequently submitted, one from Daniel Wong and the other from Baywatch. Wong proposed to (1) payoff the \$200,000 first mortgage held on the property by a bank, (2) pay Patricia \$700,000 in complete satisfaction of her mortgage, and (3) purchase Mark's twenty-five-percent interest in the LLC for \$100,000. Wong would also undertake responsibility for remedying a potable water issue on the property, addressing the operating needs and marina

liabilities, and pending litigation involving Sea Village Marina.

Baywatch proposed to (1) deposit \$100,000 into the LLC's operating account to pay for operational expenses, (2) pay Mark \$100,000 for his interest, (3) pay the \$200,000 first mortgage, and (4) incur the cost of the LLC's pending litigation. Although the Baywatch proposal recognized the existence of Patricia's mortgage, it did not agree to pay it and, in fact, specifically reserved the right to challenge its validity after purchasing the LLC.

In a March 24, 2009 letter brief to the judge, Patricia acknowledged that Baywatch "intend[ed] to challenge [her] mortgage on the subject property." She urged the judge to approve Wong's proposal, arguing primarily that John's will made it clear that he wanted Patricia to receive \$1.6 million from Sea Village Marina. While Wong's proposal did not provide for full satisfaction of her mortgage, Patricia argued that, because Wong agreed to pay a specific amount to satisfy her mortgage, it was more consistent with John's intent than was the Baywatch proposal. In fact, Patricia argued that, if the LLC's debt to her was not satisfied as part of the sale, the only alternative to the Wong offer would be for the judge (1) to declare that satisfaction of the condition precedent to the sale of the

estate's interest in the LLC was impossible and (2) to determine that the estate's interest in the LLC passed to Patricia as residuary legatee. She would then accept the Wong offer as majority owner. The letter did not take the position that any challenge to the mortgage was precluded by the September 2007 order.

On March 27, the judge sent a letter to the parties outlining the issues and reiterated his belief that John had intended to provide for Patricia by way of the mortgage. Additionally, the judge expressed his belief that John would have wanted the LLC to be transferred to an owner that was acceptable to Mark because of his twenty-five-percent interest in the LLC. The judge pointed out that John did not anticipate that the LLC would be "virtually worthless" and still indebted to Patricia. The judge requested Mark to notify him which proposal he preferred, noting that Mark's preference would strongly influence his decision.

At a proceeding held on March 31 to review the purchase offers, Mark told the judge that the Baywatch proposal was acceptable to him, but Wong's was not. He did not explain why. Patricia reiterated the arguments in favor of the Wong proposal set forth in her letter brief.

The judge authorized the sale to Baywatch, explaining that the proposal "kind of loses its viability" if Mark was not willing to transfer his interest. On the same day, the judge entered an order directing Lieberman to transfer the estate's interest in the LLC to Baywatch in accordance with its proposal, which was attached to the order. The order also denied Patricia's application for a stay. On May 13, Patricia filed a notice of appeal.

Following the transfer of ownership, Baywatch and the LLC filed a complaint seeking to invalidate Patricia's mortgage. The complaint, as amended in October, alleged that Patricia's mortgage was invalid because it was (1) issued without Mark's knowledge and consent, (2) issued contrary to the LLC Operating Agreement; (3) not based on any debt, and (4) created to avoid creditors. Patricia answered the amended complaint in January 2010. The judge subsequently dismissed the estate as a defendant, without prejudice.

Patricia withdrew her appeal of the order requiring the sale to Baywatch in January 2010.

On February 25, 2010, Patricia filed a motion for summary judgment, arguing that Baywatch and the LLC could not challenge the validity of the mortgage because John's heirs had waived their right to challenge the validity of her mortgage when they

failed to do so in response to the judge's October 2007 order. She further argued that Mark and the estate could only transfer to Baywatch the interest they held, which no longer included the right to challenge the mortgage. Patricia also argued that Baywatch would receive an unjust windfall at her expense if her mortgage were declared invalid.

In March, prior to consideration of Patricia's motion, the LLC filed a petition in bankruptcy and requested that the judge dismiss the amended complaint challenging Patricia's mortgage so that the bankruptcy court could decide the issue. The judge granted Baywatch's request and dismissed the action without prejudice.

In November 2010, the bankruptcy judge refused to consider the issue of the validity of the mortgage and remanded the issue to the Superior Court. In January 2011, Patricia filed a complaint seeking a declaration that her mortgage was valid. A case management conference was held on January 26, resulting in an order reinstating the amended complaint filed by Baywatch and the LLC, setting forth a discovery schedule, and setting a schedule for summary judgment motions.

On July 29, the judge heard oral argument on the cross-motions for summary judgment. Before hearing oral argument, the judge had informed counsel that he was inclined to grant

Patricia's motion for summary judgment and outlined his reasons. After counsel made their arguments, the judge placed a brief oral opinion on the record, essentially adopting his earlier tentative decision.

In granting summary judgment to Patricia, the judge concluded that it would be unfair to allow Baywatch to challenge Patricia's mortgage for several reasons. First, John's heirs forfeited their right to challenge the mortgage, and they could not transfer to Baywatch any greater rights than they had. Second, if the mortgage had been declared invalid during the probate action, he would have restructured the will to provide Patricia with the funds that John clearly wanted her to have. Finally, because the amount secured by Patricia's mortgage exceeded the value otherwise remaining in the LLC, declaring the mortgage invalid would give Baywatch a windfall at Patricia's expense. However, the judge declined to address the issue of whether Patricia could foreclose on the mortgage absent a further sale of the LLC, leaving that issue for resolution in connection with any future foreclosure action or by the bankruptcy court. A final implementing order was entered on August 18. This appeal followed.²

² Patricia filed a cross-appeal with respect to unrelated issues. It was subsequently withdrawn.

II.

On appeal, plaintiffs argue that the judge erred in granting Patricia's motion for summary judgment because (1) she failed to record the September 2007 order setting a certain time frame in which John's heirs were required to challenge her mortgage, (2) principles of res judicata and collateral estoppel weigh in plaintiffs' favor, (3) Baywatch Marina was a bona fide purchaser for value because it purchased Sea Village Marina without knowledge of the September 2007 order, and (4) Patricia never established that her mortgage was valid.

It is well-established that our review of a trial judge's conclusions of law is de novo. Manalapan Realty, L.P. v. Twp. Comm. of Manalapan, 140 N.J. 366, 378 (1995) ("A trial court's interpretation of the law and the legal consequences that flow from established facts are not entitled to any special deference."). Consequently, we review a grant of summary judgment de novo, applying the same standard as the trial court under Rule 4:46-2(c). Brill v. Guardian Life Ins. Co. of Am., 142 N.J. 520, 539-40 (1995); Chance v. McCann, 405 N.J. Super. 547, 563 (App. Div. 2009) (citing Liberty Surplus Ins. Corp. v. Nowell Amoroso, P.A., 189 N.J. 436, 445-46 (2007)).

The judge articulated the essence of his reasons for precluding Baywatch's challenge of Patricia's mortgage as follows.

I will offer just one very brief additional comment and that is to again emphasize that I accept for purposes of this analysis that Baywatch was unaware of the prior arrangement as of the time it closed and that on that level one can certainly make out a case that it's going to suffer a loss that in the most general sense it's unfortunate, if you will, undeserved if you will, perhaps. By the same token, if I were to permit the attack on the mortgage largely because [counsel for Baywatch] may be right, the attacks are pretty well founded, [Patricia] would suffer a fairly obvious loss, at least if one compares it to the result that I think would have been likely had the attack been presented during the earlier probate proceeding which would have been that kind of reformation [of the will to transfer the estate's interest in the LLC to Patricia].

While we understand the judge's concern about Patricia, his reasoning ignores the facts attendant to his earlier decision authorizing the sale to Baywatch over her objection.

On March 31, 2009, all of the parties before the judge knew that Baywatch's offer made no provision for payment of Patricia's mortgage and, in fact, specifically reserved the right to challenge its validity. That was in contrast to Wong's proposal, which recognized Patricia's mortgage and proposed to satisfy the obligation for \$700,000. Nobody, including the

judge, told Baywatch that the right to challenge the mortgage had been extinguished or even raised the issue that it might have been. Indeed, our reading of the record suggests that, at the time, no one, including the judge, interpreted the September 24, 2007 order as having that effect.

Patricia opposed the sale to Baywatch, arguing that it would be improper because acceptance of the Baywatch proposal would leave the issue of the LLC's debt to her unresolved and would also violate the provision of the will requiring satisfaction of the mortgage prior to sale of the estate's interest in the LLC. She forcefully argued that the judge should either require the estate to sell its interest to Wong or reform the will so that she would receive the estate's interest in the LLC. Either way, she would receive the \$700,000 to discharge the mortgage offered by Wong. Patricia never argued that the judge should strike Baywatch's reservation of the right to challenge the mortgage if he intended to approve the sale to Baywatch.

The judge disregarded Patricia's arguments and ordered the sale to Baywatch. The decision to order the sale to Baywatch was based on his belief that John would not have wanted the estate's interest in the LLC sold to someone who was not acceptable to Mark. That reasoning ignored the fact that John

had sought to obtain Mark's interest in the LLC so that the estate would own all of the LLC, and that Mark had refused his father's requests for such a transfer. It also ignored John's clear direction that the estate's interest in the LLC not be sold until the mortgage had been satisfied. In addition, Mark never articulated a reason for preferring the sale to Baywatch or why he would have any particular interest in the choice. Both Wong and Baywatch had proposed to buy his interest in the LLC for \$100,000.

Instead of ordering the sale to Wong or reform the will so that Patricia could receive the \$700,000 for which she was willing to compromise her claim, the judge ordered the sale to Baywatch with the right to challenge the mortgage. The judge's March 31, 2009 order directed Lieberman to transfer the shares of the LLC to Baywatch "under the terms and conditions previously set forth in the Transfer of Shares Agreement," a copy of which was attached to the order. The agreement attached to the order included the following language: "The existence of the Best Mortgage in no way shall be construed as [an] acknowledgment that it is a valid mortgage. Buyer expressly reserves the right to challenge the validity of the Best Mortgage and any alleged underlying indebtedness which it purports to secure." Consequently, the reservation of

Baywatch's right to challenge the mortgage was incorporated into the judge's order by reference. By failing to pursue her appeal of the judge's order directing the sale to Baywatch, Patricia waived her opportunity for appellate review of that decision.³

The possibility that Patricia would suffer a significant loss if the mortgage were invalidated was well known at the time the judge made the decision to order the sale to Baywatch. It was, in fact, inherent in Patricia's argument against acceptance of the Baywatch offer. She wanted the certainty of Wong's \$700,000 agreement to compromise the amount and satisfy the mortgage, rather than the uncertainty of a sale to an entity that intended to challenge the mortgage.

In any event, Patricia's potential loss was not the result of misconduct by Baywatch, which had clearly stated its intention to challenge the mortgage when it offered to purchase the LLC. Baywatch was taking a calculated risk that the mortgage would be upheld and it would be required to pay up to the entire amount of the note to satisfy the mortgage. If the mortgage is ultimately invalidated, Baywatch will have been

³ As noted, Patricia filed and then withdrew a notice of appeal. Even if her reason for doing so was the interlocutory nature of the order, she could have moved for leave to appeal or perfected her appeal once the order became final. She could also have sought a stay from this court after the trial judge denied her application for one.

successful in taking that risk. Such success does not constitute a "windfall" in the sense of getting something for nothing. There was consideration for the purchase, as set forth in the agreement attached to the order. To the extent it can be considered a windfall, it was specifically authorized by the judge's March 31, 2009 order, which Patricia chose not to appeal.

We reject any argument that Baywatch's challenge to the validity of the mortgage is barred by the doctrines of res judicata or collateral estoppel. "Res judicata is an ancient judicial doctrine which contemplates that when a controversy between parties is once fairly litigated and determined it is no longer open to relitigation." Lubliner v. Bd. of Alcoholic Beverage Control, 33 N.J. 428, 435 (1960) (citations omitted). Similarly, "[c]ollateral estoppel bars a party from relitigating any issue which was actually determined in a prior action, generally between the same parties, involving a different claim or cause of action, where the burden of proof is the same." Div. of Youth & Family Servs. v. R.D., 412 N.J. Super. 389, 400 (App. Div. 2010) (citations omitted), rev'd on other grounds, 207 N.J. 88 (2011).

The issue of the validity of the mortgage was never adjudicated on its merits. The judge declined Lieberman's

request that he adjudicate that issue. Instead, he ordered any of the heirs interested in challenging the mortgage to do so by a date certain. None of them did so. According to Mark, he did not have the funds to litigate the issue. At the July 2011 hearing, the judge opined that the other heirs had not challenged the mortgage because they were concerned that a successful challenge would result in a reformation of the will and exclude their bequest. Consequently, the heirs' failure to challenge the mortgage was by no means an indication that they thought it was valid.

Baywatch, which was not before the court in 2007, bought Mark's and the estate's interest in the LLC. That the heirs themselves may have been precluded from challenging the mortgage by virtue of their inaction in 2007 does not mean that Baywatch, the new owner of the LLC, is also precluded. The transaction at issue was the sale of the membership interest in a limited liability company, not the assignment of a contract or other assignable instrument in which the assignee does not receive more rights than those possessed by the assignor. See General Accident Ins. Co. v. N.Y. Marine & General Ins. Co., 320 N.J. Super. 546, 554 (App. Div. 1999) (citing Mayo v. City Nat'l Bank & Trust Co., 56 N.J. 111, 117 (1970)). In addition, the judge never entered an order validating the mortgage, precluding the

LLC itself from challenging its validity, or barring non-parties from doing so. Patricia cites no law holding that a limited liability company is barred from taking an action that a prior owner of an interest in the entity has been barred from taking.

We reject the suggestion that Baywatch had a duty to search the records of the Probate Part to determine whether there were any prior orders that could be interpreted as precluding the right of any future owner of the LLC to challenge the validity of the mortgage. Patricia's reliance on Petras v. Zaccone, 125 N.J. Super. 474 (App. Div. 1973), is misplaced. That case involved a creditor who made a personal loan to someone who subsequently gave him a mortgage on property belonging to an estate of which the debtor was a fiduciary. In reversing an order of foreclosure on the mortgage, we held that the creditor, having received a mortgage signed in a fiduciary capacity, had a duty "to make inquiry into the propriety of a transaction when it appears that the security offered is not being applied for the benefit of the estate." Id. at 477 (citations omitted). It was the creditor's knowledge that the mortgage was signed in a fiduciary capacity by someone who wanted to secure a personal debt that triggered his "duty to make a full and complete inquiry." Ibid. (citations omitted). The facts of Petras bear no resemblance to the facts of this case.

Patricia's estoppel arguments are also unpersuasive. In Miller v. Miller, 97 N.J. 154, 163 (1984) (citations omitted), the Supreme Court outlined the requirements of equitable estoppel as follows:

To establish a claim of equitable estoppel, the claiming party must show that the alleged conduct was done, or representation was made, intentionally or under such circumstances that it was both natural and probable that it would induce action. Further, the conduct must be relied on, and the relying party must act so as to change his or her position to his or her detriment.

Baywatch never advocated the validity of the mortgage, having specifically reserved the right to challenge its validity. Patricia never changed her position on the basis of Baywatch's representation or action and, as noted, it was Baywatch's reservation of the right to challenge the mortgage that prompted Patricia's opposition to its offer in the first place.

"A court of equity must administer equitable relief upon equitable terms and not as punishment." De Vita v. Loprete, 75 N.J. Eq. 418, 422 (Ch. 1909), aff'd, 77 N.J. Eq. 533 (E. & A. 1910). Our review of the record convinces us that there is no equitable basis for the judge's decision to preclude Baywatch from exercising the right to challenge the validity of the mortgage that it had openly made a condition of its offer to purchase and that the judge had included by reference in his

order directing the sale to Baywatch. In challenging the mortgage, Baywatch did nothing more than act in conformity with its clearly stated intentions.

Nobody, including the judge, took the position that the mortgage could not be challenged when the sale was being considered in March 2009. Baywatch acted in reliance on the judge's acceptance of its offer and his inclusion of its conditions in his implementing order. That order could have been appealed, but it cannot now be circumvented by retroactive elimination of a court-approved condition on which Baywatch has relied in going through with the purchase.

For all of these reasons, we reverse the order on appeal and remand to the Chancery Division for consideration of the challenge to the validity of the mortgage, an issue on which we express no opinion. We direct that the case be assigned to a different judge.

Reversed and remanded.

I hereby certify that the foregoing
is a true copy of the original on
file in my office.



CLERK OF THE APPELLATE DIVISION