FOR PUBLICATION

IN THE SUPREME COURT OF THE
COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS

IGNACIO VILLANUEVA,
Plaintiff-Appellee,

v.

CITY TRUST BANK
Defendant-Appellant.

OPINION

Cite as: *Villanueva v. City Trust Bank*, 2002 MP 01

Appeal No. 2000-13
Argued and submitted December 13, 2000

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BEFORE: MIGUEL S. DEMAPAN, Chief Justice, ALEXANDRO C. CASTRO, Associate Justice and JOHN A. MANGLONA, Associate Justice

MANGLONA, Associate Justice:

INTRODUCTION

¶1 City Trust Bank appeals the trial court's order grant of summary judgment which quieted title in a parcel of real property to Ignacio Villanueva. We have jurisdiction pursuant to N.M.I. Const. art. IV, § 3 (amended 1997) and 1 CMC § 3102(a). We affirm.

FACTUAL AND PROCEDURAL BACKGROUND

¶2 In 1987, Ignacio Villanueva ("Villanueva"), the fee simple owner of Lot No. 003108 ("lot") in San Antonio, Saipan, leased the lot to Young J. Oh ("Oh") for a period of 55 years. The lease provides that Oh had the right to sublease, assign or transfer his interest without Villanueva's consent. On February 9, 1993, Oh mortgaged his 55-year leasehold interest to City Trust Bank ("City Trust"). On May 19, 1993, Oh assigned his interest to the lot to Sung Chul Kim ("Kim"). The assignment acknowledged the mortgage with City Trust. All those documents were duly filed with the Commonwealth Recorder's Office.

¶3 On October 19, 1994, Villanueva notified Kim that he was in default for failing to pay the rent. Consequently, Villanueva filed an action seeking to evict Kim and regain possession of the lot. Neither Oh nor City Trust were named as co-defendants in the action and no notice was given to them.

¶4 Villanueva concedes that he provided no notice to either Oh or City Trust of the default in the rent. On March 28, 1996, the trial court entered judgment in favor of Villanueva and ordered Kim to vacate the premises. The judgment did not include an order or declaration terminating the lease agreement.

¶5 On August 18, 1997, City Trust sued Oh and his wife seeking to foreclose on its leasehold mortgage. Villanueva received a copy of the notice of default and intent to foreclose. At Villanueva's

attorney's request, City Trust provided a copy of the mortgage and its summons and complaint. Villanueva did not appear in City Trust's suit to contest the foreclosure. On April 29, 1998, City Trust obtained a default judgment against Oh and his wife. The default judgment provided that the leasehold interest would be sold at a public auction.

¶6 On August 24, 1998, without notice to City Trust and more than two years after the entry of the original judgment, Villanueva succeeded in getting the trial court to amend the March 28, 1996 Order, nunc pro tunc, declaring the termination of Kim's leasehold interest in the lot.

¶7 Before seeking the amendment of the order, Villanueva filed this quiet title action. After the amended order was issued, he moved for summary judgment in the quiet title action asserting that he was not required to notify City Trust of Kim's default and of the subsequent termination of the lease. The trial court agreed and granted the motion in his favor.

QUESTIONS PRESENTED AND STANDARDS OF REVIEW

¶8 I. Whether the trial court erred in ruling as a matter of law that the CNMI mortgage statute is based on the lien theory of mortgage law, and as such, that no privity of estate was created between a landowner-lessor and a bank, holding leasehold mortgage, that would have required the landowner to notify the bank of lessee's default and lease termination.

¶9 II. Alternatively, whether the collateral estoppel doctrine bars a lessor from attacking a default judgment entered in favor of a bank holding a leasehold mortgage.

¶10 Since both questions arise from the trial court's grant of summary judgment, they are reviewed de novo. *See Santos v. Santos*, 4 N.M.I. 206, 209 (1994).

ANALYSIS

I. Notice to Bank

A. Mortgage Law Theory

¶11 We consider two pertinent statutory provisions in examining City Trust's argument that our mortgage statutes are founded, not on the lien theory of mortgage law, but on the title theory, or alternatively, intermediate theory.[1]

¶12 Section 4514, Title 2 of the Commonwealth Code reads: "[a] mortgagee is not entitled to possession of mortgaged property unless the mortgage expressly grants a right of possession."[2] 2 CMC § 4514. Section 4533 of Title 2 requires that in the event of a default, a mortgagee may choose to institute foreclosure proceedings against the mortgagor.[3] Having placed our statutes in proper prospective, we now determine which of the three theories best describes our mortgage law system.

¶13 On one side of the conceptual spectrum, the lien theory of mortgage law recognizes that title remains in the mortgagor and that the mortgagee holds only a lien as security. *See* 12 THOMPSON ON REAL PROPERTY § 101.01(b)(2) (David A. Thomas ed. 1994). Both legal and equitable title remain with the mortgagor, while the mortgagee is relegated to lienholder status. *Id*. Until the interest of the mortgagor is extinguished through foreclosure, all the usual legal incidents of ownership, including the right of possession, belong to the mortgagor. *Id*. While some lien theory jurisdictions provide by statute that mortgagees can

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[1] *See* 12 THOMPSON ON REAL PROPERTY § 101.01(a) and (b), for an overview on the history of mortgage law in England and the United States and the emergence of the three theories.

[2] 2 CMC § 4514 provides: "The mortgagee is not entitled to possession of mortgaged property unless the mortgage expressly grants a right of possession. However, after the execution of the mortgage, the mortgagor may deliver possession to the mortgagee without additional consideration."

[3] 2 CMC § 4533(b) reads: "The mortgagee may, if authorized by the terms of the note or mortgage, bring an action to foreclose or satisfy the mortgage in accordance with the provisions of this chapter."

take possession only through foreclosure, there are lien theory-based statutes allowing the parties to agree that the mortgagee may be entitled to possession before foreclosure. *Id*.

¶14 By contrast, title theory views a mortgage as transferring, among other things, the "usual incidents of ownership of an estate," including a right of possession in mortgagees, unless otherwise agreed to by the parties. *Id*. §101.01(b)(1). In the middle of the spectrum lies the intermediate theory of mortgage law which regards mortgagees as holding mere liens. Under this theory, the lien ripens into a legal interest only after a default has occurred. *See id*. § 101.01(b)(3). In other words, a mortgagee is not entitled to possession until default.

¶15 In comparing the principles of the three theories to our system of mortgage law, it is apparent that our statutes are akin to the lien theory. The title theory is unworkable because of its inapposite view that a mortgage agreement automatically confers a right of possession on a mortgagee.[4] Neither are we an intermediate theory jurisdiction since our statutes compel a foreclosure action when a default occurs and the mortgagee seeks possession. *See* 2 CMC §§ 4531 and 4533. Because possessory rights are not transferred automatically to the mortgagee except by the parties' agreement and because, absent such agreement, a mortgagee must file a foreclosure action to acquire possession, we find no error in the trial court's ruling that, as a matter of law, our system of mortgage law is based on the lien theory.[5]

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[4]The common law, as expressed by the Restatements of Law, only applies to the Commonwealth where there is no written or local customary law to the contrary. *See* 7 CMC §3401. As indicated, because our mortgage law is based on the lien theory, we cannot apply, as City Trust urges us to do, the title theory even if it is the "common law" theory of mortgage law.

[5]Having confined our analysis strictly on the mortgage statutes, we need not consider Villanueva's constitutional argument that the title theory is unworkable in this jurisdiction in light of Article XII of the N.M.I. Constitution.

B. Notice Requirement

¶16 City Trust's contention that it is entitled to notice in the eviction proceeding requires that we take into account the nature of such a proceeding. A landlord files an eviction action to recover possession of real property from a tenant in wrongful possession. *See Glendale Federal Bank v. Hadden*, 87 Cal. Rptr. 2d 102, 104 (Cal. Ct. App. 1999) (examining unlawful detainer action analogous to eviction or ejectment proceeding). "In fact, possession is the fundamental issue in an unlawful detainer action and an action does not lie against a defendant who is not in possession of the premises at the commencement of the lawsuit."[6] *Id*. (citing *Briggs v. Electronic Memories & Magnetics Corp*., 126 Cal. Rptr. 34 (Cal. Ct. App. 1975)). As such, to defeat Villanueva's summary judgment motion, City Trust should have disputed the issue of who had possession of the lot at the time of the eviction proceeding. Having failed to do so, the only available recourse, as we shall explain, is to uphold the trial court's ruling.

¶17 Addressing a situation strikingly similar to the facts here, the court in *Glendale Federal Bank* refused to set aside a judgment in an unlawful detainer action. The trial court had ordered the eviction of tenants, who had mortgaged their leasehold interest in favor of a bank, for failure to pay rent, and declared the forfeiture of the lease. Since the bank was not in possession of the premises, the court ruled that it was not an indispensable party in the unlawful detainer action.

¶18 The court explained that the bank acquired its deed of trust with notice of the provisions in the lease, including the clause providing for forfeiture in the event of nonpayment. *See* 87 Cal. Rptr. 2d at 104. "By accepting a leasehold as collateral, a lender takes subject to all the terms of the lease; the collateral may become worthless if the lease terminates in accordance with its terms." *Id.*; *See also 61 Associates*

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[6]The rationale is that the summary character of the action would be defeated since issues irrelevant to the right of immediate possession could be introduced. *Id.* (citing *Knowles, supra*).

v. 425 Fifth Avenue Realty Assocs., 615 N.Y.S.2d 687, 688 (N.Y. App. Div. 1994). The court found that the bank could have protected its interest by obtaining a contractual right to receive notice of the tenant's defaults and the opportunity to cure the defaults. 87 Cal. Rptr. 2d at 104-05. This could have been effectuated by separate agreement with the landlords, by amending the lease, or by obtaining an option for a new lease. *Id*. (citing 1 RUDA, ASSET-BASED FINANCING: A TRANSACTIONAL GUIDE § 8.03(f)(a) (Matthew Bender 1999) and 1 FRIEDMAN ON LEASES § 7.801). The court also noted that "[t]he normal lender-protective agreement includes provisions requiring the landlord to give notice to the lender of any defaults and providing time for the lender to cure those defaults."[7] *Id*. By failing to follow such common procedures to secure an agreement with the landlord, the court concluded that the bank must bear the cost of its mistake. *Id*.

¶19 Here, as indicated, by operation of 2 CMC § 4514, City Trust had no right to possession by virtue of its mortgage on Oh's leasehold interest. The lease agreement, moreover, did not confer on City Trust any possessory right; nor is there any evidence in the record that City Trust, at the time Villanueva filed the eviction action against Kim, was in possession of the lot. Indeed, City Trust does not dispute that Kim, to whom Oh assigned the lease, was in possession of the property. Accordingly, absent the requisite possessory right or any evidence demonstrating City Trust's actual possession of the lot, we are unable to hold that City Trust was entitled to be notified of the eviction action and that consequently, the judgment entered there is unenforceable. Like Glendale Federal Bank, City Trust must also face the consequence of its failure to protect its interest in the leasehold.

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[7] That such procedures are considered normal practices in the mortgage lending business leaves us somewhat baffled at City Trust's failure to secure an agreement on such a provision with the landlord.

II. Collateral Estoppel

¶20 Alternatively, City Trust argues that Villanueva's express knowledge of its foreclosure suit against Oh bars him from challenging the default judgment entered against Oh. According to City Trust, Villanueva is collaterally estopped from attacking its foreclosure judgment when he stood idly as it obtained an order authorizing the sale of the leasehold estate.[8]

¶21 Collateral estoppel generally prevents a party from relitigating an issue that the party has litigated and lost. *See Catholic Social Servs., Inc. v. I.N.S.*, 232 F.3d 1139, 1152 (9th Cir. 2000); *In re Roussos*, 251 B.R. 86, 92 (9th Cir. 2000); *Estate of Guerrero v. Quitugua*, App. No. 98-010 (N.M.I. Sup. Ct. Feb. 10, 2000) (opinion at 2) ("Under the doctrine of collateral estoppel, a judgment in a prior suit precludes relitigation of issues actually litigated and necessary to the outcome of the first action.") (quotation and citation omitted); RESTATEMENT (SECOND) OF JUDGMENTS § 27 (1982). The general rule on collateral estoppel consists of five elements: (1) the issue sought to be precluded from relitigation must be identical to that decided in a former proceeding; (2) the issue must have been actually litigated in the former proceeding; (3) it must have been necessarily decided in the former proceeding; (4) the decision in the former proceeding must be final and on the merits; and (5) the party against whom preclusion is sought must be the same as, or in privity with, the party to the former proceeding. *Roussos*, 251 B.R at 92.

¶22 Where a default judgment has been entered, it is generally recognized that none of the issues are deemed "actually litigated" for purposes of invoking collateral estoppel. RESTATEMENT (SECOND) OF

[8]The trial court's order does not examine this question but City Trust asserts that it was raised in its opposition memorandum and at the hearing below. We shall consider the question since Villanueva does not dispute that it was properly preserved for our review.

JUDGMENTS § 27 cmt. e. "Therefore, the rule of [§ 27] . . . does not apply with respect to any issue in a subsequent action." *Id*.

¶23 Not only was Villanueva a non-party to the foreclosure action, but the judgment he seeks to have set aside was entered by default. As indicated, in a default judgment, none of the issues are "actually litigated" under the collateral estoppel doctrine. Since the doctrine is inapplicable here, it was appropriate for Villanueva to attack the foreclosure judgment by way of this quiet title action. Consequently, even if the trial court had considered City Trust's collateral estoppel argument, it would not have affected the substance of its ruling that Villanueva is entitled to summary judgment.

CONCLUSION

¶24 Based on the foregoing reasons, the trial court's grant of summary judgment in favor of Villanueva is **AFFIRMED**.

SO ORDERED THIS 6TH DAY OF FEBRUARY 2002.

/s/
MIGUEL S. DEMAPAN, CHIEF JUSTICE

/s/
ALEXANDRO C. CASTRO, ASSOCIATE JUSTICE

/s/
JOHN A. MANGLONA, ASSOCIATE JUSTICE