**IN THE SUPREME COURT OF GUAM**

**STANLEY YANFAG, ROSEMARY YANFAG, RENSPER ALPET, IASINDA ALPET,**
Plaintiffs-Appellants,

**v.**

**CYFRED, LTD., A GUAM CORPORATION; PETER GILL, INA GILL, FLOWCO SALES AND SERVICE (PACIFIC ISLANDS), INC.,**
Defendants-Appellees.

# OPINION

**Cite as: 2009 Guam 16**

Supreme Court Case No.: CVA08-013
Superior Court Case No.: CV1466-06

Appeal from the Superior Court of Guam
Argued and Submitted May 22, 2009
Hagåtña, Guam

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BEFORE: ROBERT J. TORRES, Chief Justice; F. PHILIP CARBULLIDO, Associate Justice; KATHERINE A. MARAMAN, Associate Justice.

**TORRES, C.J.:**

**[1]** Plaintiffs-Appellants Stanley and Rosemary Yanfag ("the Yanfags") appeal a Superior Court order denying them a preliminary injunction against a private foreclosure sale of their home. The Yanfags' defense against foreclosure is nearly identical to the one successfully asserted by the Sananaps in *Sananap v. Cyfred, Ltd.*, 2008 Guam 19. However, in this case the Yanfags' mortgage and promissory note were assigned to Defendants-Appellees Peter and Ina Gill ("the Gills") prior to the commencement of any foreclosure proceedings. The Gills assert that they are holders in due course and therefore immune to any defenses the Yanfags may have to enforcement of the promissory note. Based on the record before us, we find no evidence that the promissory note was negotiated to the Gills, which is a necessary step in asserting the rights of a holder in due course. The case is therefore remanded so that the Superior Court may determine whether or not the promissory note was indorsed and delivered at the time of assignment.

## I. FACTUAL AND PROCEDURAL BACKGROUND

**[2]** The Yanfags are residents of the Gill-Baza Subdivision, which has been the subject of at least three appeals to this court. *See Abalos v. Cyfred, Ltd.*, 2006 Guam 7; *Sananap v. Cyfred, Ltd. (Sananap I)*, 2008 Guam 10; *Sananap v. Cyfred, Ltd. (Sananap II)*, 2009 Guam 13. Their situation is nearly identical to the Sananaps, who were plaintiffs in *Sananap I* and *Sananap II*. In fact, the Yanfags and their co-plaintiffs, the Alpets, may also be parties to *Sananap I* and *Sananap II* (Superior Court Case No. CV1448-02). *See Sananap II*, CVA07-006, Appellants'

Excerpts of Record ("ER"), tab 7, Ex 1, at 5 n.4 (Dec. & Order, May 5, 2006). The reason for this separate lawsuit appears to be that the lower court in CV1448-02 determined that the Yanfags' and Alpets' promissory notes and mortgages had been assigned to parties outside of the case. *Sananap II*, CVA07-006, Appellants' Corrected ER, tab 17, at 6, 8-9 (Finds. Fact & Concl. L., Jan 15, 2007). Those assignees, Peter and Ina Gill, are defendants in the present case, which puts the issue of assignment squarely before this court.

**[3]** The factual background of the Gill-Baza Subdivision dispute can be summarized as follows. Defendant-Appellee Cyfred, Ltd. ("Cyfred") sold plots in the Gill-Baza Subdivision but failed to install sewer lines. *Sananap II*, 2009 Guam 13 ¶ 2; *Abalos*, 2006 Guam 7 ¶¶ 1-2. Various owners sued, some asking for rescission of their contracts, others for damages. *Sananap II*, 2009 Guam 13 ¶ 2-3. One of the plaintiffs originally awarded a share of damages for failing to install the sewer lines was Plaintiff-Appellant Stanley Yanfag. *See Sananap II*, CVA07-006, Appellants' ER, tab 10, at 27 (Finds. Fact & Concl. L., Aug. 1, 2006). The *Sananap II* opinion expanded the eligibility for damages or rescission to *every* resident of the Gill-Baza Subdivision who was not in material breach within one year of purchasing their property. *Sananap II.* 2009 Guam 13 ¶ 51, 79.

**[4]** According to the Amended Complaint, the Yanfags purchased a lot in the Gill-Baza Subdivision from Cyfred. Appellants' ER at 51 (Amended Compl., Dec. 13, 2006). The Yanfags gave a Mortgage and Promissory Note to Cyfred on November 27, 2000. In 2002, Cyfred assigned the Mortgage and Promissory Note to the Gills, who are the parents of Cyfred officer and shareholder Francis Gill.

**[5]** In 2008, the Yanfags moved for a preliminary injunction to protect their lot from foreclosure. The motion was denied because the Yanfags failed to show that the Gills were not holders in due course, and because the Yanfags did not demonstrate a likelihood of succeeding on the merits. Soon after, the Gills purchased the Yanfags' lot at a private foreclosure sale.[1] The Yanfags then timely filed a Notice of Appeal.

## II. JURISDICTION

**[6]** This court has jurisdiction to hear interlocutory appeals pursuant to 7 GCA § 3108(b) (2005) if "provided by law." *HongKong & Shanghai Banking Corp. v. Kallingal*, 2005 Guam 13 ¶ 16; *Guam Imaging Consultants, Inc. v. Guam Mem'l Hosp. Auth.*, 2004 Guam 15 ¶ 14. Appeals from a decision granting or denying a preliminary injunction are allowed under 7 GCA § 25102(f) (2005).

## III. STANDARD OF REVIEW

**[7]** "The district court's denial of a preliminary injunction is normally reviewed for an abuse of discretion." *Sananap I*, 2008 Guam 19 ¶ 12 (quoting *E. & J. Gallo Winery v. Andina Licores S.A.*, 446 F.3d 984, 989 (9th Cir. 2006)). "Even though the 'overall review is for an abuse of discretion, [t]he district court's interpretation of the underlying legal principles . . . is subject to de novo review and a district court abuses its discretion when it makes an error of law.'" *Id.* (quoting *E. & J. Gallo Winery*, 446 F.3d at 989). "A court 'will reverse a denial of a preliminary injunction where the district court abused its discretion or based its decision on an erroneous

[1] The Gills initially purchased the lot at a private foreclosure sale held on December 11, 2006, but the sale was held at 8:00 AM, in violation of 7 GCA § 23115 (requiring sales to be conducted between 9:00 AM and 5:00 PM). In CVA1448-02, the Superior Court set aside Cyfred's October 18, 2006 foreclosure sale, in part because it occurred at 8:00 AM. *Sananap II*, CVA07-006, Appellants' Corrected ER, tab 17, at 19-21 (Finds. Fact & Concl. L., Jan 15, 2007). The Superior Court has not yet taken any action on the December 11, 2006 foreclosure sale, but the parties apparently believe it is invalid as evidenced by the attempt to hold another foreclosure sale in 2008.

legal standard or on clearly erroneous findings of fact.'" *Id.* (quoting *Sammartano v. First Jud. Dist. Ct.*, 303 F.3d 959, 964 (9th Cir. 2002)).

## IV. DISCUSSION

**[8]** The Yanfags' situation is nearly identical to the Sananaps situation in *Sananap I* and *Sananap II*.[2] The Sananaps were initially denied a preliminary injunction against foreclosure, but on appeal this court found that the Superior Court abused its discretion in denying the injunction. *Sananap II*, 2009 Guam 13 ¶ 78. We reasoned that the Sananaps were justified in suspending their mortgage payments after Cyfred failed to timely install sewer lines. *Id.* By analogy to *Sananap II*, it would appear that the Yanfags should also have been given a preliminary injunction. There is, however, a significant difference between the Yanfags' and the Sananaps' cases. Whereas Cyfred held the Sananaps' mortgage and promissory note, the Yanfags' mortgage and promissory note were assigned prior to the initiation of any foreclosure proceedings to the Gills, who are not responsible for Cyfred's breach of contract.

**[9]** In short, the Yanfangs assert that they should be excused for suspending their mortgage payments from the time that Cyfred materially breached its obligation to install the sewer lines for their lot, at least November 27, 2001. This excuse therefore should extend to any payments that would be owed to the Gills following Cyfred's February 2002 assignment to them of the mortgage and promissory note. The Gills argue that they are holders in due course ("HDCs") of the mortgage and promissory note, and they are therefore not subject to any defenses raised by the Yanfags. In response, the Yanfags argue that the mortgage and promissory note should be

[2] Unlike the Sananaps, the Yanfags were current on their mortgage payments at the time Cyfred was due to install the sewer lines, so there is no issue concerning the effect of an uncured breach of contract on the suspension of performance. *See* ER at 177 (Hr'g Transcript ("Tr."), Oct. 13, 2008).

treated separately, and that the mortgage does not receive the same protections as a negotiable instrument in the hands of an HDC. The Yanfags also argue that the Gills had notice of the Yanfags' defenses because Cyfred was acting as an agent of the Gills and therefore Cyfred's knowledge should be imputed to the Gills.

**[10]** We begin by addressing two arguments raised by the Gills: (1) that the Yanfags' case was brought after the statute of limitations for contract claims had expired; and (2) that the Yanfags waived their objections to the failure to install sewer lines by continuing their payments past the first year. Next, we examine whether the mortgage and the promissory note are to be treated as separable documents, and if the Gills can claim HDC protection against the Yanfags' contract defense to payment.

**A. Whether the Yanfags Brought Suit within the Statute of Limitations**

**[11]** Cyfred claims that the Yanfags' suit is untimely because it was not filed until December of 2006, and Cyfred breached its contract in November of 2001. Cyfred argues that the present action is based on a breach of contract, and that such actions must be commenced within four years. *See* 7 GCA § 11303(1) (2005) ("An action upon any contract, obligation or liability founded upon an instrument in writing" must be commenced within four years). The Yanfags counter that the claims against Cyfred only concern the attempts to foreclose on their property rather than a claim for damages or rescission due to Cyfred's breach.

**[12]** The Yanfags seek a preliminary injunction to halt attempts to sell the properties in private foreclosure sales. ER at 2-4 (Compl., Dec. 4, 2006). Their Complaint asks for damages and attorneys' fees relating to the attempts to foreclose. *Id.* The Yanfags do not claim damages for the breach of contract itself, which was an issue already before the court in the *Sananap* cases.

Thus, the relief sought is related to the attempts to foreclose rather than the original contract between Cyfred and the Yanfags. Nevertheless, in order to demonstrate a likelihood of success on the merits, the Yanfags must assert Cyfred's breach of contract as a defense to their obligation to pay their mortgage. We must therefore evaluate whether that defense is now unavailable due to the statute of limitations found in 7 GCA § 11303(1).

**[13]** The preliminary injunction that the Yanfags seek is an equitable remedy. As the United States Supreme Court stated, "[t]raditionally and for good reason, statutes of limitation are not controlling measures of equitable relief." *Holmberg v. Armbrecht*, 327 U.S. 392, 396 (1946). This is because suits in equity are governed by the doctrine of laches rather than the statute of limitations: "[L]aches is not, like [a statute of] limitation[s], a mere matter of time; but principally a question of the inequity of permitting the claim to be enforced -- an inequity founded upon some change in the condition or relations of the property or the parties." *Id.* (quoting *Galliher v. Cadwell*, 145 U.S. 368, 373 (1892)). Thus, an equitable claim may be barred by laches even though the statute of limitations has not yet run on the related legal claim. *Id.*; *but see Ikelionwu v. United States*, 150 F.3d 233, 238 (2d Cir. 1998) (noting that "[i]n an equity action, if the applicable legal statute of limitations has not expired, there is rarely an occasion to invoke the doctrine of laches"). Similarly, an equitable claim may be allowed to proceed even after the statute of limitations has expired. *See Dunham v. Dunham*, 528 A.2d 1123, 1135-36 (Conn. 1987) (an equitable action seeking relief from a probate decree on a tort theory was not barred by the statute of limitations for tort claims), *overruled in part on other grounds by Santopietro v. New Haven*, 682 A.2d 106, 109 n.8 (Conn. 1996)

**[14]** Nevertheless, many courts apply the "concurrent remedy rule." *See, e.g. United States v. Banks*, 115 F.3d 916, 919 (11th Cir. 1997). The rule is based on the principle that "equity will withhold its relief in such cases where the applicable statute of limitations would bar the concurrent legal remedy." *Cope v. Anderson*, 331 U.S. 461, 464 (1947); *see also Kappa Sigma Fraternity, Inc. v. Kappa Sigma Fraternity*, 587 S.E.2d 701, 108 (Va. 2003) (stating that "equity follows the law" in barring a suit in equity where equally barred at law). Given the differences between equitable and legal principles discussed above, many courts interpret the concurrent remedy rule as a guide rather than a principle to be mechanically applied. *See, e.g. Romulus City Treasurer v. Wayne County Drain Comm'r*, 322 N.W.2d 152, 170 n.34 (Mich. 1982) ("Equity will regard the statute of limitations on a parallel legal action as a guide in applying its own doctrine of laches, but the statute of limitations is not absolute in equity . . . ."); *Gould v. McKillip*, 99 P.2d 67, 73 (Wyo. 1940) ("It is familiar law that the statute of limitations is frequently regarded as supplying a guide to the courts to enable them to determine what should be regarded as laches and what should not.").

**[15]** In some cases, courts have determined that particular statutes did not intend to bar certain equitable relief after the statute of limitations had expired. *See, e.g., Bigelow v. City of Rolling Meadows*, 865 N.E.2d 221, 224-25 (Ill. Ct. App. 2007) (declaratory relief under Illinois' Tort Claims Immunity Act was not barred by statute of limitations); *Banks*, 115 F.3d at 919 (federal statute of limitations does not apply to suit under Clean Water Act for injunctive relief). In other cases, courts have allowed defensive counterclaims where the statute of limitations would have barred those claims if brought as original actions. One example is the use of fraud as a defense against a claim for liability on a debt. *See, e.g., Martin v. Martin*, 287 S.W.3d 260, 266 (Tex. Ct.

App. 2009) ("[T]he statute of limitations does not apply to a fraud claim pleaded defensively to defeat liability on an obligation induced by fraud."). Another example is where a defendant pleads recoupment, which is an equitable doctrine even though it seeks the legal remedy of damages. *See Overboe v. Brodshaug*, 751 N.W.2d 177, 182 (N.D. 2008) (untimely legal malpractice counterclaim was allowed in recoupment against a claim of attorney's fees). In *F.D.I.C. v. Notis*, the court allowed the defendant in a foreclosure action to plead recoupment despite the two year statute of limitations found in the Equal Credit Opportunity Act. 602 A.2d 1164, 1166 (Me. 1992). The court reasoned that "[t]he policy underlying statutes of limitations, that of preventing undue delay and stale claims, is not promoted by suppressing a valid defense arising out of the transaction at issue." *Id.*

**[16]** A case even more on point is *King v. Kitchen Magic, Inc.*, where plaintiffs filed a lawsuit to nullify a lien against their home and for punitive damages. 391 A.2d 1184, 1185 (D.C. Ct. App. 1978). The court found that the plaintiffs' claim was made after expiration of the three-year statute of limitations for contract actions, and equitable tolling did not make the claim timely. *Id.* at 1186. However, the court recognized that "[t]he suit unquestionably was filed as a defensive measure against the foreclosure of the [plaintiffs'] home" and "may be regarded as one for declaratory judgment that the plaintiff's intestate had a complete defense to her obligation on the note." *Id.* The court then reasoned that the failure to timely file a suit seeking damages "precludes [the plaintiffs] from attempting to recover punitive damages at this late date. However, the statute of limitations would not bar them from raising fraud as a defense to a judicial foreclosure or to a suit for payment under the contract." *Id.* at 1187. As a result, the plaintiffs were "not precluded by the statute of limitations from maintaining the equitable portion

of their suit." *Id.* One of the reasons given for this conclusion was that the party attempting to foreclose on the property may not wait until the statute of limitations has expired and then claim that the homeowner has no defense. *Id.*

**[17]** A similar reasoning would apply here. The Yanfags are in essence seeking a declaratory judgment that they are not behind in their payments. They are making this assertion based on application of contract law and in defense against imminent foreclosure. We see no reason that the Yanfags should be prevented from raising their contract arguments, especially when those arguments are used defensively and in pursuit of an equitable remedy. *See, e.g., Overboe*, 751 N.W.2d at 182; *F.D.I.C.*, 602 A.2d at 1166; *King*, 391 A.2d at 1185-87.

**[18]** Moreover, the Complaint only requests injunctive relief and damages related to the Gills' attempts to foreclose on the Yanfags' property, but the Complaint does not seek damages or rescission related to Cyfred's failure to install sewer lines. ER at 2-4 (Compl.). If the "action" running the statute of limitations is the Gills' first attempt to foreclose, then the Complaint was timely filed within months of that attempt. Although Cyfred's breach, which occurred five years earlier, was indirectly related to the later attempts to foreclose, the breach itself was not the event which triggered the foreclosures from which the Yanfags now seek protection. The Yanfags' suit is therefore timely.

**B. The Yanfags did not waive their Right to their Contract Defense**

**[19]** The Gills also argue that because the Yanfags continued to pay the Gills for approximately four years after the Promissory Note and Mortgage were assigned, the Yanfags waived any defenses they might have had to continued payments under the Promissory Note and Mortgage. The Gills cite the *B.M. Co. v. Avery*, where this court found evidence that an owner

had impliedly waived a written change order requirement with his contractor. 2002 Guam 19 ¶ 18-19. In *Avery*, the owner testified that he orally agreed to the additional work, from which we concluded that he had waived the requirement that the change be in writing. *Id.* ¶ 19. No such communication, express or otherwise, is present in the instant case.

**[20]** "A waiver occurs when a person voluntarily and intentionally relinquishes a known right or privilege." *Pfeifle v. Tanabe*, 620 N.W.2d 167, 172 (N.D. 2000). Where a material breach has occurred, "the non-breaching party may waive the claim of materiality through its actions." *Mgmt. Computer Servs., Inc. v. Hawkins, Ash, Baptie & Co.*, 557 N.W.2d 67, 78 (Wis. 1996). However, to demonstrate that a party has waived its rights, "there must be a showing of a clear, unequivocal and decisive act or acts showing an intention to relinquish the existing right." *Ducheneaux v. Miller*, 488 N.W.2d 902, 911 (S.D. 1992) (quotation omitted); *see also Harsha v. State Sav. Bank*, 346 N.W.2d 791, 799 (Iowa 1984) (stating that the intent to waive a breach of contract is essential). Consequently, "standing alone, an obligee's acceptance of less than full performance by the obligor does not prove intent to relinquish the right to enforce full performance." *Stanley's Cafeteria, Inc. v. Abramson*, 306 S.E.2d 870, 873 (Va. 1983).

**[21]** The Gills would have us believe that the Yanfags, in continuing to make their payments, were attempting to communicate their desire that Cyfred make no further efforts to connect sewer lines to their property. There are many plausible reasons one might continue to make payments on a mortgage, even after the mortgagee has failed to live up to its part of the bargain. Like all mortgagors, the Yanfags were presumably worried about the possibility of foreclosure. The Yanfags may also have held out hope that Cyfred would eventually fulfill its obligations and install the sewer lines, even after the deadline had long since passed. Finally, the Yanfags may

have simply continued making payments out of a sense of moral responsibility. Of all the possible reasons for continuing to make payments, the least likely one is that the Yanfags were intentionally absolving Cyfred of its responsibilities. We find that the Yanfags did not intentionally waive their right to defend against foreclosure by continuing to make their payments long after Cyfred's breach of contract. *See, e.g., Ducheneaux*, 488 N.W.2d at 911; *Harsha*, 346 N.W.2d at 799.

**[22]** Having found that the Yanfags suit is not barred by the four year statute of limitations applied to the breach of contract, and that they did not waive any defenses related to payments under the Promissory Note and Mortgage, we now must examine whether the Gills are entitled to the rights of an HDC. We begin by examining the legal relationship between the Promissory Note and Mortgage.

**C. The Negotiability of the Promissory Note is Imparted to the Mortgage**

**[23]** In a typical real estate transaction involving financing, a mortgagor gives a mortgagee a promissory note and a mortgage secured by the land being purchased. The promissory note is usually a negotiable instrument memorializing a promise to pay, and the mortgage is a contract securing the promise to pay and creating a mechanism whereby the secured property may be foreclosed in the event of a default. Because two separate documents are involved, it is tempting to treat the mortgage and promissory note individually. The Yanfags attempt to do just that by arguing that a mortgage, which imparts a right of foreclosure, cannot be given the same protections as a promissory note held by an HDC.

**[24]** To the contrary, the majority of American jurisdictions hold that the mortgage and promissory note are to be treated as inseparable:

> Because negotiable instruments and mortgages are so frequently linked in practice, courts have had to find a way to harmonize the laws governing them. To bridge the gap between them, *courts in all but one state hold that a negotiable instrument imparts its quality of negotiability to the mortgage.* Courts reason that because the mortgage is an incident of and dependent on the debt, it should be enforceable to the same extent as the debt. As a result, courts state that the mortgage is subject only to those defenses available against the note. If the note is held by an HDC, the mortgage--like the note--is insulated from personal defenses. Some of the courts protecting mortgages in this way express an intent to facilitate the secondary mortgage market by protecting its purchasers from defenses to the mortgages.

Ann M. Burkhart, *Third Party Defenses to Mortgages*, 1998 B.Y.U.L. Rev. 1003, 1012-13 (footnotes omitted) (emphasis added). The inseparability of the mortgage and promissory note is also a principle under Guam law, which indicates that "[t]he assignment of a debt secured by mortgage carries with it the security." 18 GCA § 36117 (2005). An identical provision still appears in California's code. *See* Cal. Civ. Code § 2936. California has interpreted its own statute in accord with the majority of other jurisdictions and the Supreme Court of the United States:

> A secured promissory note traded on the secondary mortgage market remains secured because the mortgage follows the note. Cal. Civ. Code § 2936 ("The assignment of a debt secured by mortgage carries with it the security."). California codified this principle in 1872. Similarly, this has long been the law throughout the United States: when a note secured by a mortgage is transferred, "transfer of the note carries with it the security, without any formal assignment or delivery, or even mention of the latter." *Carpenter v. Longan*, 16 Wall. 271, 83 U.S. 271, 275, 21 L.Ed. 313 (1872). Clearly, the objective of this principle is "to keep the obligation and the mortgage in the same hands unless the parties wish to separate them." Restatement (Third) of Property (Mortgages) § 5.4 (1997). The principle is justified, in turn, by reasoning that the "the debt is the principal thing and the mortgage an accessory." *Id.* Consequently, "[e]quity puts the principal and accessory upon a footing of equality, and gives to the assignee of the evidence of the debt the same rights in regard to both." *Id.* Given that "the debt is the principal thing and the mortgage an accessory," the Supreme Court reasoned that, as a corollary, "[t]he mortgage can have no separate existence." *Carpenter*, 83 U.S. at 274, 16 Wall. 271. For this reason, "an assignment of the note carries the mortgage with it, while an assignment of the latter alone is a nullity." *Id.* at

> 274, 16 Wall. 271. While the note is "essential," the mortgage is only "an incident" to the note. *Id.*

*In re Vargas*, 396 B.R. 511, 516-17 (Bankr. C. D. Cal 2008); *see also* Nelson & Whitman, *Real Estate Finance Law* 360-62 (2d ed. 1985). Thus, the assignment of the promissory note assigns the right to foreclose on the secured property, even if the mortgage documents are never themselves assigned. *See United States v. Thornburg*, 82 F.3d 886, 892 (9th Cir. 1996) (interpreting California and Oklahoma law in holding that the bank's failure to hand over a mortgage document did not effect the plaintiff's right to foreclose). In fact, the mortgage documents need not even be delivered. *Id.* While a mortgage is not itself a negotiable instrument, the HDC protections apply to enforcement of the mortgage (i.e. the power to foreclose) the same way they apply to enforcement of the promissory note. *Wilson v. Steele*, 259 Cal. Rptr. 851, 855 (Ct. App. 1989) ("While a mortgage does not of itself possess the quality of negotiability, yet, when given to secure a negotiable obligation, it will, by the weight of authority, so far partake of the character thereof that whenever the obligation is so transferred as to free it from all equities existing in favor of the maker of the note, prior indorsers, or third persons, the mortgage will also be freed therefrom'." (quoting *Hayward Lumber & Inv. Co. v. Naslund*, 13 P.2d 775, 778 (Cal. Dist. Ct. App. 1932))). *Wilson* applies this reasoning in granting HDC status to the holder of a trust deed. *Id.* at 856.

**[25]** There is no sound reason to depart from the California cases interpreting provisions identical to 18 GCA § 36117. *See Zurich Ins. (Guam), Inc. v. Santos*, 2007 Guam 23 ¶ 7 ("California case law is persuasive when there is no compelling reason to deviate from California's interpretation."). Accordingly, we hold that a mortgage given to secure a negotiable promissory note will be given the same protections as the promissory note. As a result, the

power to foreclose under a mortgage and negotiable promissory note is subject to the HDC provisions of Article 3 of the Uniform Commercial Code ("UCC"). In particular, we look to 13 GCA § 3306 which states:

> **§ 3306. Rights of One Not Holder in Due Course.**
>
> Unless he has the rights of a holder in due course any person takes the instrument subject to
>
> (1) All valid claims to it on the part of any person; and
>
> (2) *All defenses of any party which would be available in an action on a simple contract*; and
>
> (3) The defenses of want or failure of consideration (Section 3408), nonperformance of any condition precedent, nondelivery, or delivery for a special purpose . . . .

13 GCA § 3306 (2005) (emphasis added). Here, the Yanfags' defenses to payment are based in contract law—they argue that their suspension of payment was justified because of Cyfred's material breach. Under subsection 3306(2), those same defenses would also apply against the Gills unless it can be show that the Gills are HDCs. *See Sananap II*, 2009 Guam 13 ¶¶ 55-57 (holding that Cyfred, which was not an HDC, was subject to contract defenses against foreclosure).[3]

[3] Even a holder in due course takes the instrument subject to certain defenses enumerated in 3 GCA § 3305. Section 3305 provides in relevant part:

> To the extent that a holder is a holder in due course he takes the instrument free from
>
> . . . .
>
> (2) All defenses of any party to the instrument with whom the holder has not dealt except
>
> (a) Infancy, to the extent that it is a defense to a simple contract; and
>
> (b) Such other incapacity, or duress, or illegality of the transaction, as renders the obligation of the party a nullity; and
>
> (c) Such misrepresentation as has induced the party to sign the instrument with neither knowledge nor reasonable opportunity to obtain

**[26]** Of course, 13 GCA § 3306 refers to the taking of an "instrument," and would only apply if the Promissory Note were a negotiable instrument.[4] *See* 13 GCA 3102(1)(e) ("*Instrument* means a negotiable instrument.") (emphasis in original). Neither party questions the negotiability of the promissory note at issue here. In fact, it appears to be negotiable on its face according to the criteria set forth in 13 GCA § 3104(1) (2005).[5] The Promissory Note is signed by the makers, the Yanfags; contains an unconditional promise to pay a sum certain (i.e. $39,500.00 at 12% annual interest); is payable in installments due at definite times; and is payable to the order of Cyfred. *See* 13 GCA § 3104(1)(a)-(d); *see also* ER, tab 14, Ex. 2 (Promissory Note, Nov. 27, 2000). The question of whether or not the Yanfags can assert a

knowledge of its character or its essential terms; and

(d) Discharge in insolvency proceedings; and

(e) Any other discharge of which the holder has notice when he takes the instrument.

13 G.C.A. § 3305 (2005).

However, the defense asserted here based on Cyfred's material breach of contract is not one of those enumerated in § 3305, but rather a contract defense covered by 3 GCA § 3306(2) or (3).

[4] If the promissory note is non-negotiable, then the common law of contracts and mortgages would apply. In such a case, the result would be the same as applying 13 GCA § 3306 to a non-HDC. *See Inland Real Estate Corp. v. Oak Park Trust and Sav. Bank*, 469 N.E.2d 204, 209-10 (Ill. Ct. App. 1983) (citing "the general rule that the assignee of a mortgage takes it subject to the same equities it was subject to in the hands of the assignor"); *Fidelity Trust Co. v. Gardiner*, 155 A.2d 405, 409 (Pa. Super. Ct. 1959) ("The assignee of a non-negotiable note takes it subject to all equities with which it was affected in the hands of the assignor and may not enforce payment unless the maker is estopped from asserting a defense."); *see also* Nelson & Whitman, *Real Estate Finance Law, supra* at 389.

[5] § 3104. Form of Negotiable Instruments; "Draft"; "Check"; "Certificate of Deposit"; 'Note".

(1) Any writing to be a negotiable instrument within this division must:

(a) Be signed by the maker or drawer; and

(b) Contain an unconditional promise or order to pay a sum certain in money and no other promise, order, obligation or power given by the maker or drawer except as authorized by this division; and

(c) Be payable on demand or at a definite time; and

(d) Be payable to order or to bearer.

. . . .

13 GCA § 3104(1) (2005).

contract defense against the Gills' attempt to foreclose is therefore governed by 13 GCA § 3306. We must now determine whether or not the Gills qualify as HDCs.

**D. Whether the Gills are HDCs**

**[27]** Determining whether a party is an HDC is a three step process. First, one must determine whether the instrument in question is negotiable pursuant to the requirements of 13 GCA § 3104, which we have already answered in the affirmative. Second, the transferee must qualify as a holder—for instruments payable to order, this means delivery and indorsement of the note. 13 GCA § 3202 (2005). Finally, the holder must take the instrument: (1) for value; (2) in good faith; and (3) without notice that it is overdue, has been dishonored, or is subject to any defense or claim by any person. 13 GCA § 3302(1) (2005).

**[28]** "Negotiation is the transfer of an instrument in such form that the transferee becomes a holder. If the instrument is payable to order it is negotiated by delivery with any necessary indorsement . . . ." 13 GCA § 3202(1). "An indorsement must be written by or on behalf of the holder and on the instrument or on a paper so firmly affixed thereto as to become a part thereof." 13 GCA § 3202(2). A special indorsement would include a signature[6] and a specification of the person to whom the instrument is payable. 13 GCA § 3204(1) (2005). A blank indorsement would include only a signature and would make the instrument payable to the bearer. 13 GCA § 3204(2). Thus, if the Promissory Note at issue here had been negotiated to the Gills, it would contain a signature by one of Cyfred's officers or agents written either directly on the Promissory

[6] Title 13 GCA § 3204(1) does not specifically mention the requirement that a signature be affixed. 13 GCA § 3204(1). The problem arises because the pre-1990 version of the UCC still in force in Guam does not define "indorsement", while the 1990 version makes clear that an indorsement is a signature. *See* UCC 3-204 (1990) (defining "indorsement"). However, it seems to have been universally understood that an indorsement is a signature, sometimes with an additional notation, written on a negotiable instrument. *See* Black's Law Dictionary 778 (7th ed. 1999).

Note itself or on a separate paper firmly affixed to the Promissory Note. *See* 13 GCA § 3202(2). No indorsement is evident on the copies of the Promissory Note made available in the Excerpts of Record. *See* ER at 227-30 ("Promissory Note," Nov. 27, 2000). Moreover, it is unclear from the record whether the Promissory Note was actually delivered to the Gills, as required under 13 GCA § 3202(1). Cyfred office manager, Bobbie Reyes, testified that Cyfred kept a copy of the Promissory Note in its files, but she did not indicate the location of the original. ER at 163-65 (Hr'g Tr., Oct. 13, 2008).

**[29]** Although there is no evidence of indorsement or delivery, the Promissory Note and Mortgage were assigned to the Gills in a separate document. ER at 264-66 ("Assignment of Mortgage," Feb. 21, 2002). Even so, the case law indicates that assignment or transfer without negotiation is insufficient to confer HDC status to the assignee or transferee. For example, in *Yeskolski v. Crosby*, a transferee of a promissory note was held not to be a holder as there was no delivery and indorsement made by or on behalf of a person who was himself a holder. 480 S.E.2d 474, 476-77 (Va. 1997). In *Wear v. Farmers and Merch. Bank of Las Cruces*, an insurance company did not indorse a promissory note to its subsidiary, which prevented the subsidiary from becoming an HDC. 605 P.2d 27, 29-30 (Alaska 1980). The Alaska Supreme Court also considered whether the document of assignment was so firmly affixed to the note as to become an indorsement, but determined that the document of assignment only described the note and was not actually attached to it. *Id.* Finally, in *Duxbury v. Roberts* the promissee assigned a promissory note through a separate "Partial Assignment of Note and Mortgage" that was not "firmly affixed" to the promissory note. 446 N.E.2d 401, 403-04 (Mass. 1983). The

court determined that the assignment was not a negotiation and therefore insufficient to allow the assignee to assume HDC status. *Id.*

**[30]** The Gills must demonstrate that the Promissory Note was negotiated to them if they are to succeed in avoiding the Yanfags' defenses to their attempt to foreclose. There is no evidence of negotiation of the Promissory Note in the record before us. First, while it is customary to indorse a negotiable instrument on the back of the document, in this case only a copy of the front of the document has been provided. Second, we cannot ascertain from the record if the document of assignment was "so firmly affixed" to the Promissory Note as to become part of it, thus affectively indorsing the Promissory Note. 13 GCA § 3202(2). Finally, the evidence before us does not establish whether delivery occurred. For all these reasons, and because the Superior Court has not yet considered the issue of whether a negotiation has occurred, the issue of whether the Gills are entitled to the rights of an HDC must be remanded. Proof of negotiation may allow the Gills to claim status as holders of the promissory note, but in order for the Gills to be holders in due course the transaction must also have complied with the other requirements of 13 GCA § 3301. *See* 13 GCA § 3302(1). The Superior Court is therefore instructed to determine the date on which the Promissory Note was indorsed and delivered, or if it was indorsed and delivered at all.

**[31]** Because the element of negotiation has not yet been established, it is unnecessary for us to reach the issue of whether the Gills took the Promissory Note for value, in good faith, and without notice of any defenses. *See* 13 GCA § 3302. To do so would risk rendering an unnecessary decision, especially if the Gills are found not to be holders of the Promissory Note. *Cf. People v. Gay*, 2007 Guam 11 ¶¶ 6-7 (declining to answer a certified question that was

unnecessary to the decision). We therefore leave it to the Superior Court to determine, if necessary, whether the Gills took the Promissory Note for value, in good faith, and without notice of any defenses.

## V. CONCLUSION

**[32]** Unless the Gills can demonstrate that they are HDCs, denial of a preliminary injunction would be an abuse of discretion. To be granted the protections of an HDC, the Gills must first show that they are holders of the Promissory Note; that is, the Gills must demonstrate that the Promissory Note was negotiated through indorsement and delivery. Based on the record before us, we find no evidence of negotiation and therefore **VACATE** the Decision and Order denying the Yanfags a preliminary injunction. We also **REMAND** this case for further proceedings. If the Superior Court determines that a preliminary injunction is warranted, it may set aside the foreclosure sale if such action is consistent with Guam law.

**Original Signed By: F. Philip Carbullido**
F. PHILIP CARBULLIDO
Associate Justice

**Original Signed By: Katherine A. Maraman**
KATHERINE A. MARAMAN
Associate Justice

**Original Signed By: Robert J. Torres**
ROBERT J. TORRES
Chief Justice