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Are You Really Junior? — It Sure Matters!

By Bruce J. Bergman

It should be obvious. A junior mortgage is a junior mortgage. Or is it? If a borrower refinances what had been a first mortgage, the existing second mortgage becomes a first — easy when thought about. But the issue of confusing mortgage priorities probably arises most often not from baffling concepts, but from incomplete or lost files, sometimes resulting from sales of mortgage portfolios. And such disarray can be absolutely fatal to the mortgage investment — the dismaying message of a recent case.[1]

Here is how the problem came about. Of the scores, hundreds or thousands of papers and documents that come into a lender's or servicer's office every day, many of them may be summons and complaints in mortgage foreclosure actions. If a particular foreclosure action lists your mortgage as being in a second or more junior position — particularly if your portfolio consists primarily of mortgages intended to be subordinate — the ready reaction is to send it along to counsel to attend to in the "usual" fashion. What exactly that typical methodology might be is subject to some variation, but there are usually three general choices. The junior mortgagee could interpose an answer. In fact, many a transmittal to an attorney says "answer for us." But an answer is designed to contest the action and, absent a legitimate defense, the answer serves to prolong the case, increase the accrual of interest and create greater legal fees burdening the senior debt. So, most often, the sophisticated junior lender will not opt to put in an answer.

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Alternatively, a notice of appearance and waiver will preserve to the subordinate mortgagee notice of whatever aspects of the foreclosure cases are deemed critical, while waiving notice of those stages of the case where there is not much value in imposing detainment. Which stages of the case truly require notice may also vary from state to state, but in typical judicial foreclosure jurisdictions, notice of the actual computation together with notice of sale and notice of surplus money proceedings would be the most critical. Sometimes application for judgment of foreclosure and sale is meaningful too if a cross motion can be made to shortcut the surplus money proceeding — as is the case in N.Y.

Still another alternative response to the summons and complaint is the general notice of appearance which reserves to the junior mortgagee notice of every step in the senior foreclosure action. While that does impose some delay, it engenders considerably less protraction than an answer creates and yet it serves the reasonable purpose of affording scrutiny of each step in the senior foreclosure action. Not incidentally, it also provides more time for the borrower to rescue his or her position, which obviously can be helpful to all mortgagees regardless of their position if the equity is in the property.

Assuming the subordinate mortgagee elects some form of appearance — which is the most likely — the ultimate result of the mortgage foreclosure will, of course, be the extinguishment of the junior mortgage. If there is a surplus, the junior mortgagee can claim against it but if there is none, then the investment has certainly turned out poorly. But what if someone made a mistake? What if the senior mortgagee was wrong in naming you as the junior? What if the apparently junior mortgage really was senior? Naturally, in such an instance the junior would indeed wish to contest the claimed superiority of the senior mortgage and assure that the claim of the apparently first mortgagee is rejected. It depends, though, *when* the party asserted to be junior realizes that a contest on the issue is in order.

That was just the problem exposed in the case which elicited this discussion. There, what appeared to be a junior mortgage was held by "X" and the mortgage was assigned to"Y". "Z"

1 *Chemical Bank v. Vazquez*, 234 A.D.2d 253, 650 N.Y.S.2d 773 (2d Dept. 1996)

then succeeded to ownership of that mortgage as successor by merger with "Y." Plaintiff began a mortgage foreclosure and the typical notice of appearance was interposed on behalf of the claimed junior mortgagee "Z". Ultimately, although how it happened is not clear, "Z" recognized that its mortgage was in actuality superior to that of Plaintiff bank. Because this was discovered after the judgment of foreclosure and sale issued, a motion was made to vacate the judgment and allow "Z" to replace its notice of appearance with an answer. Although justice might seem to require giving that opportunity, both the trial court and the appeals court disagreed.

The appeals court observed its discretion to relieve a party from a default upon proof of both a meritorious claim (or defense) and a reasonable excuse for default[2] or, proof that the default was the result of the fraud, misrepresentation or misconduct of an adverse party.[3]

The junior's problem, though, was its mere assertion that its mortgage was really superior. The facts to support that, however, were part of the public record, the court observed, and were available going back to, at the latest, October of 1991. And, the court said, the belated discovery of the facts was a result of failure to have made the necessary inquiries until long after the action had been commenced and the time to answer had expired. Because there was no reasonable excuse presented for this failure to inquire — nor was there any indication that all this resulted from fraud, misrepresentation or misconduct of the senior mortgagee — the court properly denied the application to overturn the foreclosure and provide an opportunity to submit an answer. In other words, said the court, "Z" was in a position to know where it stood so failure to protect itself was no one else's fault.

That all this happened in this unfortunate way is not so surprising given the vicissitudes of mortgage commerce and mortgage litigation. But it does offer a salutary lesson, which is that in each case where a senior claims some other mortgage is junior, the junior should be sure of its priority as part of formulating its response to the foreclosure action. ■

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2 *Chemical Bank v. Vazquez*, 234 A.D.2d 253, 650 N.Y.S.2d 773 (2d Dept. 1996), citing CPLR 5015[a][1]; *Putney v. Pearlman*, 203 A.D.2d 333, 612 N.Y.S.2d 919; *Household Fin. Realty Corp. v. Delmerico*, 202 A.D.2d 636, 609 N.Y.S.2d 310; Schiavetta v. McKeon, 190 A.D.2d 724, 593 N.Y.S.2d 303.

3 CPLR5015[a][3]; *Oppenheimer v. Westcott*, 47 N.Y.2d 595, 419 N.Y.S.2d 908, 393 N.E.2d 982; *Putnam County Natl. Bank of Carmel v. Simpson*, 204 A.D.2d 297, 614 N.Y.S.2d 149; *Christ-Mitch Realty Corp. v. Clarkson Realty Corp.*, 122 A.D.2d 245, 505 N.Y.S.2d 440.