BERGMAN ON MORTGAGE FORECLOSURES . . .

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How Carefully Drawn Do Your Mortgage Documents Need to Be?**

Even absent digesting this inaugural column with unparalleled gusto, you already know the answer to the question posed by the title: "very carefully." Obviously, it is axiomatic from a mortgagee's[1] perspective that consummate care is warranted in preparation of the mortgage to assure enforcement of the obligation and all that entails. How particularly a lender can suffer diminution of its rights — sometimes quite severely — is the lesson of two recent cases.

The first dealt with the issue of future advances.[2] As is so often true, the facts make the case.

Mr. and Mrs. Bilinsky (defendants) wanted to help their son's business. So, in turn for what apparently was supposed to be a $100,000 line of credit to the son's corporation, defendants executed a $100,000 collateral security mortgage. The mortgage contained the usual future advance provision, that the mortgage was intended to "secure any more debts now or in the future owed by [defendants] to [plaintiff]." But the clause also said that "[t]his instrument is given to secure a promissory note dated May 16, 1985 signed by [son's corporation]." That promissory note mentioned was a 60-day note in the amount of $25,000. (The facts to this point should immediately expose the lender's dilemma. Did the mortgage secure up to $100,000 of advances or only the $25,000 note?)

In the next year, corporation renewed the $25,000 note several times and was advanced $40,000, evidenced in three separate notes executed by the corporation. Later, in an attempt to consolidate the four then outstanding loans, corporation executed a five-year note for $65,000 (the total outstanding principal). A few years thereafter, the corporation borrowed another $30,000.

Default on the $65,000 and $30,000 borrowings ensued, and the lender sought to foreclose defendants' mortgage.

Both the trial court and the Appellate Division found against the lender, concluding that the mortgage secured only the initial $25,000 note. The ultimate problem was the clash between the standard future advance language and the more specific verbiage that the mortgage secured the initial $25,000 note. Moreover, plaintiff's subsequent advance of $70,000 to the corporation was held not to be within contemplation of the future advances clause which addressed monies advanced to **defendant**.

In the end, the court acknowledged what the intent of the parties may very well have been — a $100,000 credit line for son's corporation to be secured by the mortgage — but the documents clearly provided to the contrary. Minus ambiguity, parol evidence was powerless to contradict the plain term of the mortgage documents. So, diffident draftsmanship sunk the lender and cost $70,000 plus interest.[3]

Not surprisingly, a lender can stumble in innumerable other ways in mortgage drafting. A different case underscores the danger, this time relative to a receiver, his obligation to pay real estate taxes and the lender's tax escrow.[4]

In a mortgage foreclosure case, the foreclosing lender obtained the appointment of a receiver who then sought to pay real estate taxes upon the property in his charge — all as was appropriate. The lender, meanwhile, had been holding a substantial escrow for taxes. When the receiver's account was insufficient to pay taxes based upon the income he had collected, he moved to compel the lender to turn over the escrow sums to him for the purpose of paying the taxes.

The lender resisted, contending that the receiver had no authority to compel turnover of the tax escrow account because those monies were collected and deposited prior to the receiver's qualification. Additionally, the lender argued that the mortgage documents did not require the lender to apply the tax escrow towards the outstanding property taxes once an action to foreclose the mortgage had been commenced. The question then became, what did the mortgage documents provide in this regard?

The tax escrow clause in question, with emphasis as supplied by the court, read as follows:

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"Mortgagor shall deposit with Mortgagee on the first day of each month, a sum equivalent to one-twelfth of the annual taxes assessed and annual installments of assessments levied against said premises, plus any tax accrual deficiency as periodically estimated by Mortgagee, on an accrual basis *to be applied by Mortgagee toward the payment of such taxes and assessments . . . In the event of foreclosure of this Mortgage such deposits may, in the dis-cretion of Mortgagee, be applied toward the indebtedness to the extent they have not otherwise been used . . .*"

Finally, then, the question devolved to what the language of the mortgage "in the event of foreclosure" meant. While most lenders would deem that verbiage to mean if a foreclosure action were begun, the court ruled otherwise, citing both case law to support the proposition and other wording in the mortgage documents interpreted to suggest that foreclosure meant the completion of a foreclosure sale.

As a practical matter, it is extremely unlikely that the con-struction imposed by the court in this case was the conscious intention of the mortgage drafter. But lack of clarity proved to be the lender's undoing on this point. The result may not have been fatal to the foreclosure, but it was certainly a con-clusion the lender neither wanted nor expected and an expensive denouement as well.

Yes, care in the preparation of mortgage documents is always the watchword of a lender's faith.

Endnotes

1. Even among lawyers, the terms mortgagee and mortgagor tend to become cumbersome. Although recognizing that sometimes the holder of a mortgage is not the lender, for perceived clarity, these columns will prefer most often to refer to the person or entity in that position as the "lender."
2. Home & City Sav. Bank v. Bilinsky, __ A.D.2d __, 580 N.Y.S.2d 561 (3rd Dept. 1992).
3. There was an additional issue in the case which should not be neglected. The Third Department found that the status of the $25,000 debt remained at issue, and, on that point, the appeals tribunal disagreed with the trial court which had ruled that the subsequent renewals of the $25,000 note and eventual consolidation with other loans operated to discharge the original note and therefore extinguish the mortgage entirely. Upon appeal, the decision was that it is well established that execution of a subsequent note does not discharge the original debt unless there is an express agreement between the parties to that effect.
4. Trustco Bank v. 11 North Pearl Associates, ___ A.D.2d ___, 580 N.Y.S.2d 847 (1992).

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Editors' Note: The editors welcome a long time contributor as a regular columnist in this newsletter.