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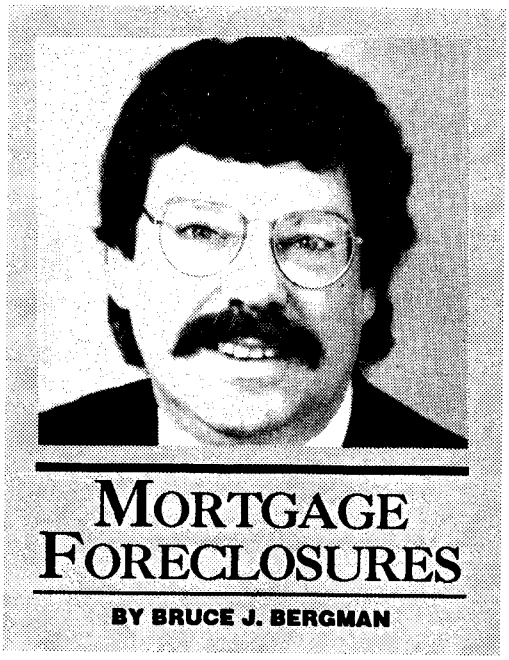
Killed by Kindness

The Perils of the Long, Drawn Out Settlement Discussion



MORTGAGE FORECLOSURES

BY BRUCE J. BERGMAN

DOES DROSS now replace cream at the top? Could it be that even a cautious lender might waive its rights in daring to talk settlement with a borrower for 10 months? It certainly should not be, but the answer in New York now is maybe. [See the unfortunate ruling in *Massachusetts Mutual Life Ins. Co. v. Gramercy Twins Associates, NYLJ,* May 12, 1993, at 29, col. 1 (Sup. Ct. N.Y.Co., Arber, J.)]

The cited case appears to be a conspicuously protean interpretation. But lenders must cope with such pronouncements as do any other litigants. That is what happened with the battle between the first mortgage and the condominium common charge lien. The initial decision was misguided, creating a mess for years until the issue wended its way to the Court of Appeals[1]. And that could be what will happen here — if lenders are lucky and if there are even appeals to follow.

Before assessing this case in detail, it could be helpful to address some basic principles concerning both traditional notions of waiver and the mechanics of settlement discussions.

Lenders and servicers reasonably proceed on the assumption that the mortgage documents will contain language providing that the obligations cannot be changed — except in a writing signed by the parties. That being so, untoward modifications or defenses claimed to be founded upon such changes, are likely to be of little moment.

Because obviously mortgagees would not so readily yield their rights to foreclose, the precepts of waiver were most often feared where a mortgagor asserted oral waiver. To be sure, oral waiver by the mortgagee of, for example, the right to accelerate the debt is a valid defense to foreclosure.[2]

An immediate distinction should be drawn, however, between an oral modification of the mortgage and an oral right to enforce obligations pursuant to the mortgage. Modification requires consideration unless a writing evidencing the modification exists.[3]

Because a modification is an agreement supported by consideration, it binds by its terms and can only be canceled by another agreement.[4] But a waiver requires neither consideration nor agreement;[5] only the abandonment of a right which would otherwise have been enforceable.[6] Although once created the waiver can be nullified, that occurs only upon notice coupled with a reasonable time to perform.[7]

Perilous though the oral waiver assault might initially appear to be, case law generally has offered much comfort to mortgagees.[8] For example, the party asserting oral waiver cannot succeed presenting mere conclusions rather than detailed factual allegations.[9] Similarly wanting are unsubstantiated allegations[10] as well as conclusory and contradictory assertions.[11]

If the claim is of an oral promise to forgo or delay foreclosure, it must rise to a threshold of believability.[12] And the burden on the party asserting oral waiver is not met by conclusory allegations which defy reality and are at variance with documentary evidence.[13] The protective standards go further, but the minutia of them need not be explored in further depth here.[14] It is enough to observe that the threat of an oral waiver defense is not nearly as perilous as it might appear to be.

Even so legally emboldened, the holder of a mortgage seeks nevertheless to avoid the possibility of a waiver by being guarded and meticulous in approaching settlement negotiations.

The lender typically agrees to nothing unless and until a writing it prepares is signed first by the borrower, or at least contemporaneously by lender and borrower together. Insofar as there may be discussions or correspondence, the sage mortgage holder prefaces any and all of that with a written statement asserting that any discussions or correspondence are absolutely without prejudice to enforcement of the mortgage.

The writing also will say that nothing is waived or modified without the lender's signature. (The experienced practitioner in this arena has seen such language with regularity.)

'Mass Mutual'

Assuming the mortgage holder is appropriately scrupulous in protecting its rights, there should be no danger in pursuing settlements with borrowers. That the *Massachusetts Mutual*[15] case may suggest to the contrary is either a function of a truly flawed holding, or a recitation of facts which are incomplete. But possibly it exposes a real gaffe by the lender.

As presented by the court, the facts of the case were that beginning in October 1991, the borrower approached the plaintiff's officer to advise of financial difficulties being experienced. In January 1992, the borrower met with a bank representative requesting a modification of the mortgage terms. In March the borrower transmitted to the bank a proposed standstill agreement and discussions between the parties continued through April 1992.

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In May of that year the bank agreed to contribute to a tax payment agreement the borrower had signed with the city and in a letter in June 1992, the bank's attorneys submitted a pre-workout agreement to the borrowers, later withdrawing the acceleration which had issued in January of that year.

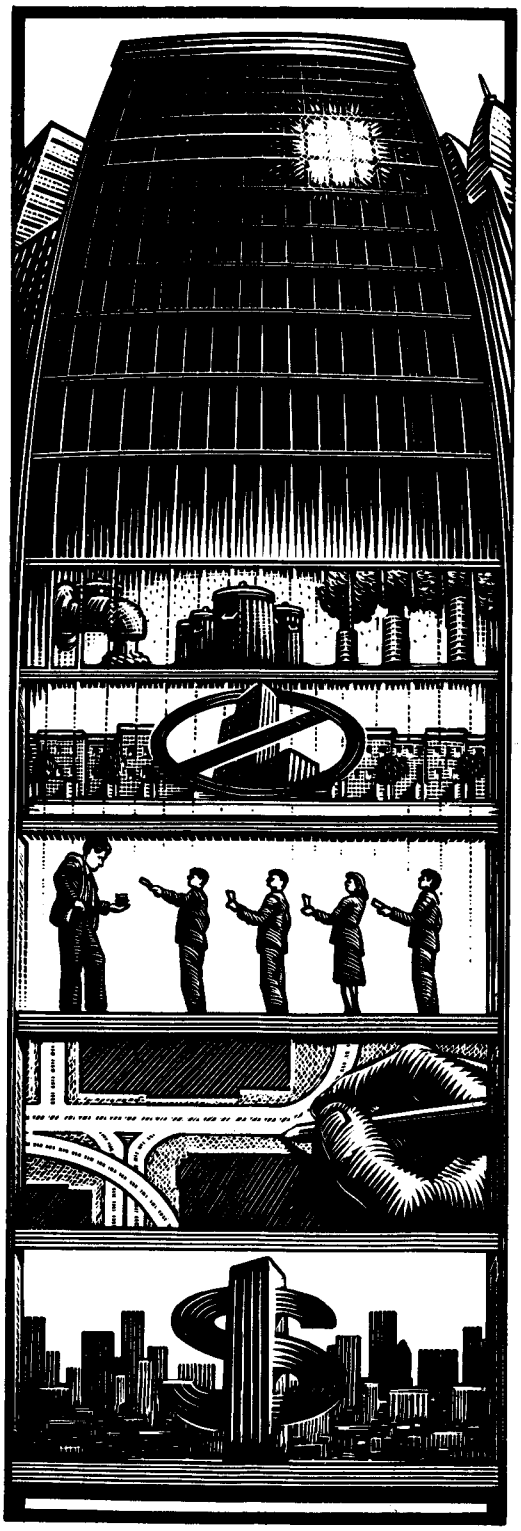

ILLUSTRATION BY JOHN MacDONALD

The next fact recited by the decision is that on July 22, 1992, the plaintiff instituted the foreclosure action while negotiations were continuing.

If the defendant was in default, that the plaintiff continued discussions should have been of no moment, particularly if it reserved its rights. This would be especially important in light of the defendant's typical argument that negotiations were not conducted by the bank in good faith.

Aggrieved borrowers will frequently claim some lack of good faith on the part of the lender, which is a very difficult assessment to make one way or the other. But it shouldn't be relevant in any event.

Confirming that the parties began negotiations in October 1991 which continued through July 1992, the court gave credence to the defendant's assertion that many actions were taken in reliance upon the lender's good faith through efforts to arrive at a mutually satisfactory modification. (What actions were taken were not recited in the decision.)

These allegations, combined with the duration of negotiation created, in the court's view, issues of fact as to whether there was a waiver or an estoppel. Consequently, summary judgment was denied.

As a practical matter, it seems unlikely that a full trial of this case would support the possibility of a waiver by the lender. Mindful, though, of how long a trial (or alternatively, an appeal) would nowadays take in New York, the lender will suffer jeopardy merely through the passage of time and the concomitant accrual of interest. In other words, the lender can ill-afford the loss of the motion for summary judgment, even if ultimately it prevails.

Crucial Facts Unstated

What is critically unstated by the factual delineation in the case is whether the lender had dutifully papered the file with the recommended disclaimers and non-waiver statements. Nor do the facts tell us whether there was a letter sent prior to instituting the foreclosure shutting down the discussions or advising that if a conclusion was not reached in a certain period of time the legal action would follow. What then is to be made of all of this?

If the appropriate protective measures were taken by the lender, then this case is a sad commentary upon the future. However, it survives as a decision at the Supreme Court level and should not necessarily be viewed as binding, perdurable precedent. Then too, it may be an aberration.

If, on the other hand, the lender did not protect itself with the necessary non-waiver statements, then the decision may not be quite as wrong or pernicious as it appears. Indeed, it would buttress the admonition habitually urged by counsel that a lender must take preemptive measures when entering into settlement negotiations.

In the end, the case is certainly a stern warning for lenders to consider with care both the tenor and length of their settlement procedures. In tough times, lenders may very well need to be generous, but they may have to temper their largesse with a level of resolution commensurate with the harm which can be encountered by runaway fact patterns.

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(1) See, "1st Mortgage vs. Condo Lien," *NYLJ*, June 16, 1993, at 5, col. 2.

(2) *Nassau Trust Co. v. Montrose Concrete Prod. Corp.*, 56 N.Y.2d 175, 451 N.Y.S.2d 663, 436 N.E.2d 1265 (1982); *Marine Midland Bank v. Bullard Orchards Inc.*, 140 A.D.2d 870, 528 N.Y.S.2d 445 (3rd Dept. 1988); *Winker v. Robinson*, 36 Misc. 2d 804, 233 N.Y.S.2d 981 (1962); *Seamen's Bank of Sav. v. Wallenstein Realty Corp.*, 6 N.Y.S.2d 706 (Sup. Ct. 1938); See Also, 1 Bergman on New York Mortgage Foreclosures, §5.02[2]

(3) G.O.L. §5-1103; *Nassau Trust Co., v. Montrose Concrete Prod. Corp.*, supra at note 1

(4) *Nassau Trust Co. v. Montrose Concrete Prod. Corp.*, supra at note 1.

(5) Id.

(6) Id.

(7) Id.

(8) See, 1 Bergman On New York Mortgage Foreclosures, §5.02[3]

(9) *Flintkote Co. v. Bert Bar Holding Corp.*, 114 A.D.2d 400, 494 N.Y.S.2d 43 (2d Dept. 1985)

(10) *Chemical Bank v. Econ*, 87 A.D.2d 706, 448, N.Y.S.2d 898 (3d Dept. 1982)

(11) *Federal Land Bank Of Springfield v. Azapian*, 98 A.D.2d 760, 469 N.Y.S.2d 474 (2d Dept. 1983); *State Bank of Albany v. Fioravanti*, 51 N.Y.2d 638, 435 N.Y.S.2d 947, 417 N.E.2d 60 (1980)

(12) *New York State Urban Dev. Corp. v. Marcus Garvey Brownstone Houses Inc.*, 98 A.D.2d 767, 469 N.Y.S.2d 789 (2d Dept. 1983); *Morsemere Fed. Sav. Bank v. Westside Rehab. Assocs., NYLJ*, Feb. 28, 1990, at 22, col. 1 (Sup. Ct. N.Y. Co., Lehner, J.)

(13) *New York State Urban Dev. Corp. v. Marcus Garvey Brownstone Houses Inc.*, supra. at note 11, citing *Kramer v. Harris*, 9 A.D.2d 282, 193 N.Y.S.2d 548

(14) Additional concepts and nuances of the formulation can be found in, inter alia, *Security Pac. Mortgage and Real Estate Servs. v. Canadian Land Co., of Am.*, 690 F. Supp. 1214 (S.D.N.Y. 1988); *Morsemere Fed. Sav. Bank v. Westside Rehab Assocs.*. supra. at note 11; *Charco Corp. v. North American Dev. Corp.*, 171 A.D.2d 506, 567 N.Y.S.2d 232 (1st Dept. 1991)

(15) *NYLJ*, May 12, 1993, at 29, col. 1 (Sup. Ct., N.Y.Co., Arber, J.)