By Bruce J. Bergman

Legal Fees to Borrowers! World Sees Servicers as Bad Guys

A law passed in New York, effective Dec. 19, 2010, awards legal fees to borrowers who are successful in defending a foreclosure action. This creates potential problems, as will be explored.

The Empire State is important enough by itself so that this observation is meaningful on its own. More portentous, though, is the likelihood that this will find favor in other states. Further, it underscores the seemingly pervasive, unfortunate view of lawmakers that lenders and servicers are oppressive behemoths taking advantage of hapless, victimized borrowers.

Indeed, part of the impetus for the New York statute (Real Property Law section 282) was the claim that many borrowers were being sued without basis and that they were possessed of valid defenses to foreclosure actions. While there are any number of foreclosure actions dismissed for technical reasons—or just wrongly terminated—servicers will vigorously reject the notion that innocent borrowers are being foreclosed upon for no reason.

Some specifics about the law are relevant to reveal the ultimate peril they pose. Entitled "Mortgagor's Right to Recover Attorneys' Fees in Actions or Proceedings Arising Out of Foreclosures of Residential Property," whatever precisely the statute means, its application is solely to residential real property. (While exempting commercial cases, it still applies to the overwhelming majority of foreclosures.)

Residential real property is then defined in subsection 2 of the statute as property "improved by a one-to-four-family residence, a condominium that is occupied by the mortgagor or a cooperative unit that is occupied by the mortgagor."

So, while this clearly covers an owner-occupied condo or co-op, the one-to-four-family residence can apparently be an investment property; the condition of owner-occupied is appended only to the condo and co-op. And why investors—as opposed to homeowners—may need this protection is elusive.

The essence of the new statute is that where a mortgage contains a legal fee provision for the lender (which of course is typical), then there must be implied in the mortgage a covenant that the lender pay to the borrower the reasonable attorneys' fees and/or expenses incurred by the borrower resulting from the failure of the lender to perform any covenant or agreement on its part under the mortgage, or in the successful defense of any action commenced by the lender against the borrower arising out of the "contract." (Any waiver of this new obligation in a mortgage is deemed void as against public policy, so there is no escape by that route.)

While the idea that a borrower might be entitled to collect legal fees in a mortgage-foreclosure action is generally unpalatable to lenders (such an obligation had not previously existed in New York), where it might involve a lender breaching a mortgage, then reimbursing the borrower for legal fees does not seem so offensive. The problem, though, is that from time to time, courts may indict a lender or servicer for a supposed breach when the lender argues quite genuinely that such a breach never occurred.

But the real danger here is granting the award for a successful defense of any foreclosure action. What precisely *is* a successful defense?

If a lender loses a foreclosure because it made a mistake, such as the borrower truly was not in default; the lender lost the record of funds having been paid; or someone just stumbled and erroneously began a foreclosure, such would be reasonably included in the definition. But what happens if a foreclosure is defeated because a process server fumbled and the case was dismissed? Sometimes, not incidentally, borrowers will claim that the person served at their home in their behalf was unknown to them, and a court might accept it even if one could deem the assertion to be a prevarication.

Then there is the dilemma of a lender being accused of not having sent a notice where it did so, but the records to prove it are imprecise. After all, it is commonplace for borrowers to aver that the ubiquitous 30-day cure letter (mandated by the Fannie Mae/Freddie Mac uniform instrument) was never received.

Then there is a possible (claimed) miscue of not appending some warning to a summons as required by other legal provisions. Are any or all of these successful defenses to a foreclosure action worthy of entitling the borrower to be repaid its legal fees?

It is one thing for a lender or servicer to be substantively wrong and pay the price, but it is another for a technical misstep to elicit payment of a borrower's legal fees. Thus, too compendious a statute becomes a possibly maladroit effort.

In all fairness, it should be observed that the new law in New York is based upon a similar statute applying to landlord-tenant cases. History there presents some reason to predict that a borrower's victory in any particular foreclosure will need to be substantive rather than procedural. Adopting a cliché, only time will tell how the new statute will actually be interpreted.

But that does not advise about results in other states without benefit of a like progenitor law. Moreover, the strict zeal with which courts interpret borrower-friendly laws gives pause about just how this new one on legal fees will be assessed. There just may be room for alarm.

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