SERVICING MANAGEMENT

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Lis Pendens - A Servicer's Shield?

A notice of pendency represents an official statement to all interested parties that a foreclosure action has been instituted.

BY BRUCE J. BERGMAN

So, during a foreclosure action, the defaulting borrower transfers the mortgaged property to a dummy corporation that later attacks the foreclosure, saying, "Not only did I not know about this foreclosure, but you never served me. So my title is unaffected by your action."

Is the servicer stymied by this bit of apparently clever legerdemain?

Although it is true that the new corporate owner was never served (which normally would be a major problem), a document called a *lis pendens* - a notice of pendency - saves the day. Hence this tale of a valuable servicer's legal ally.

Critical role

While the rules and procedures can vary from state to state, the role of the paper commonly referred to as a *lis pendens* is absolutely critical to the foreclosure case. This is especially relevant in judicial foreclosure states.

By definition, the *lis pendens* just sounds obscure - a document that gives constructive notice to the world that an action affecting the right, title, use or enjoyment of real property has begun.

Stated in more understandable terms, upon filing of the *lis pendens* with the county clerk or register, everyone in the world is charged with the knowledge that a mortgage foreclosure action has been instituted against a particular property - even if those people aren't actually aware that is so. The filing means people are deemed to know that the property is in foreclosure.

But it is the practical effect of the *lis pendens* that is ultimately so important. In short, after its filing, the *lis pendens* binds anyone obtaining an interest in the property to the result of the foreclosure action as if they were a party - even though they were never in fact made a party to the action.

Appreciating just how dramatically important the last statement really is relates to our scenario and invites a look at some foreclosure basics.

When a mortgage loan originates, the prospective lender makes two basic decisions - one business, one legal. The business decision establishes whether the relationship between the loan sum to the value of the property makes sense.

So, for example, if a borrower is buying a $250,000 house, and seeks a loan of $200,000, the lender asks - and answers - the question, upon default and foreclosure, will someone pay $200,000 to purchase a house worth $250,000? Yes, says the lender.

The next dispositive inquiry is a legal one. Assuming this loan is to be a first mortgage (some lenders take second or even more junior mortgages), a title examination tells the lender whether any interests currently burden the property, such as mortgages or judgments.

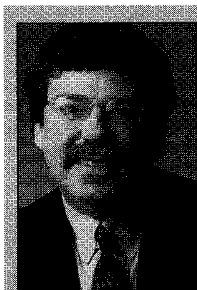
If so, the lender will require that those liens be removed from the property (paid, extinguished, satisfied) so the new mortgage will in actuality be a first mortgage.

In that way, the lender understands that should there ever be a default and a foreclosure, so long as the foreclosure action names and serves anyone with a later interest in the property (e.g., a junior mortgage, judgment, mechanic's lien, lease, etc.), those later interests will be wiped out.

Therefore, whoever buys at the foreclosure sale takes the property just as the lender originally envisioned it - free and clear of all later interests. (This does not include real estate taxes which survive, but lenders and servicers take that into account.) In turn, this supports that business decision the lender made at the outset.

To accomplish this goal and allow the foundation expectations to be met, when there is a default, the first step in a foreclosure is to obtain a title search to reveal those very persons or entities that may have later, subordinate interests in the property. They are then named in the foreclosure action and (in a judicial foreclosure state) served with process.

A foreclosing plaintiff would typically file a *lis pendens* at the beginning of the foreclosure action as part of this procedure. (This would certainly be standard practice in New York, for example. But observe that nuance and practice can be different in other states.)



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Although the foreclosure search is designed to disclose those junior parties to be named and served in the foreclosure action, it is readily apparent that the search could be accurate only up to the day it is read into the public records. The condition of title can - and often does - change thereafter.

How is a foreclosing plaintiff to know when new interests attach to the property after the search? On the noted theory that junior interest holders need to be named and served, being unaware of their existence seems to defeat the well-ordered plan. Embellishing our original scenario, here is the dilemma in concrete terms:

Suppose, after being served with process, a clever defendant-borrower "sells" the mortgaged premises to a friendly cousin. Because, obviously, the cousin is unknown to the plaintiff, that new owner is not served. Upon the understandable assumption that an unserved owner will retain an interest not extinguished by the foreclosure, a plaintiff might be compelled to periodically update the search to ferret out holders of these later interests.

But with what frequency should the search continuations be obtained? Daily makes no sense. Weekly is also too often - and too expensive. Monthly isn't very practical or economical either.

Search update

However often it may be, it would seem the servicer will be constrained to update the search eventually and at least at some strategic moments. How often would remain problematical. Even if some update timely unearths the cousin, what is to prohibit a new conveyance to yet another compliant relative - or any other cooperative friend or a corporation created for the very purpose of owning the property?

Even without such schemes, a borrower could still suffer judgments or other liens which attach to the property weeks or months after the foreclosure search was read and sent to servicer's counsel. And each time a new potential defendant is discovered, a motion to amend the caption of the action would be required.

In some jurisdictions, such motions are themselves time consuming. Worse, a new defendant could be found a day before the foreclosure sale. If that person has to first be added to the case, then served - and afforded an opportunity to answer the complaint - it makes the point that no foreclosure would ever end.

You can predict the rest of the story. Borrowers would instantly discover this procedural glitch and could effectively cripple the mortgage foreclosure process by making every case interminable. But it doesn't happen that way - because of the *lis pendens*.

As mentioned, anyone acquiring an interest in real property subsequent to the filing of the *lis pendens* is bound by the action as if they had been served. In other words, the *lis pendens* takes care of all later interests and disposes of the insurmountable problems that would otherwise be present. Servicers cannot be thwarted by those helpful cousins. SM