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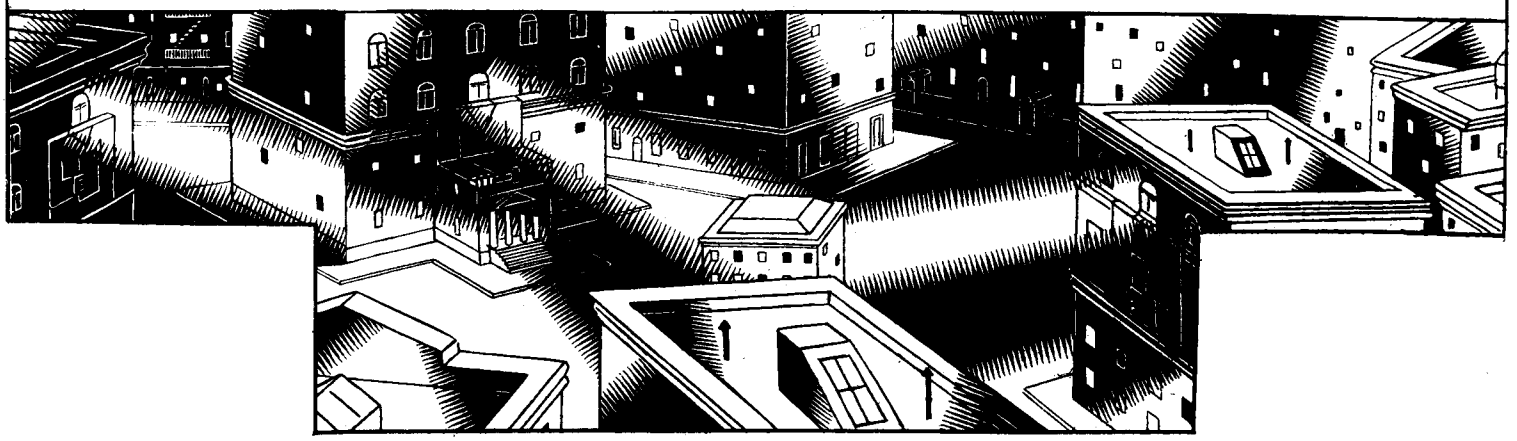
# REAL ESTATE UPDATE



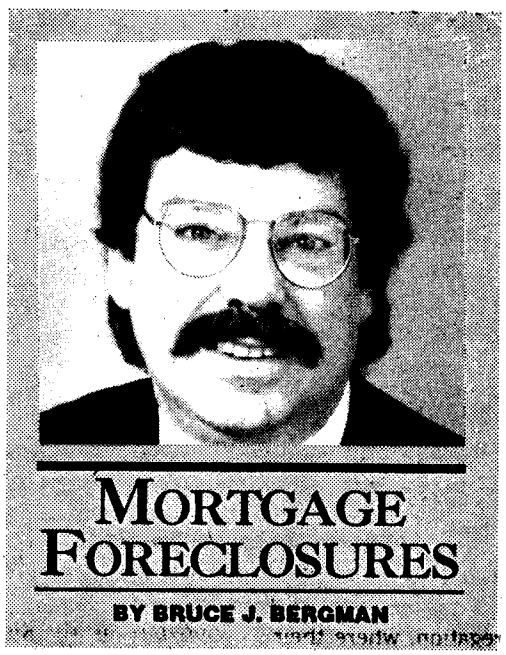
# No Scamming This Time

## *Protecting Receiver and Foreclosing Plaintiff From Deception*

IT IS SOMETHING like that immutable law of physics: for every action there is a reaction. An alternate allusion would offer "thrust and parry." However it may be phrased, the law is not unfamiliar with the counter move, but in the arena of the foreclosure receiver, those ripostes seem to be conspicuously slippery. Clever though the attempts to avoid the receiver's reach may be, case law provides rational protection for the receiver and, at the same time, the foreclosing plaintiff, who is an ultimate beneficiary of the receiver's success.

An initial impediment to a receiver's efforts is the obvious need to qualify by the filing of an oath and bond. Until the receiver meets that threshold obligation, there is no power to collect the rents and profits. For a number of reasons, a particular receiver could be slow to qualify. And a defaulting mortgagor would no doubt delight in the delay.

Here is a possible practical scenario. Recognizing the need for a receiver in a mortgage foreclosure case,[1] the mortgagee asks counsel to obtain the appropriate order. The document is submitted and signed on Aug. 1. Court and/or county clerk delays retard entry of the order until Aug. 29. The order is quickly sent to the receiver with the invitation to embark upon his duties. It arrives in the receiver's office on Sept. 3. He is on trial, however, and upon the eventual conclusion of the trial the receiver is slow to obtain and file the bond. Qualification of the receiver does not occur until Oct. 4. What is the status of the rents for the months of August, September and October? Case law confirms that the receiver remains entitled to rents from Aug. 1 (the date the appointment order was signed), even though entry of the order and qualification of the receiver followed later and even though the owner may have collected those rents.[2] The owner will be required to surrender those sums to the receiver.[3]

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### When the Mortgagor Pays

Assuming the mortgagor is in possession, which is hardly uncommon, one of the mightiest resistors to a receiver's search for rents is the mortgagor. Indeed, the general rule is that a receiver is neither required nor entitled to have occupational rent fixed and paid by the owner occupying the premises.[4]

The compelling and practical exception to the general rule is that a mortgagor will be required to attorn to a receiver if the mortgage so provides.[5] Whether the receiver will be able to evict a mortgagor who declines to pay a fair rental value will likewise be a function of the mortgage contract. Language that a receiver is authorized to fix and collect rent

may be insufficient to support eviction;[6] but more specific language will be effective.[7]

Who the mortgagor is, and who his affiliates may be lends nuance to the principles. In one case, where there was no language in the mortgage obligating the mortgagor to pay rent to a receiver, Minkoff the mortgagor occupied the front of the building as his dwelling place. But in the rear, Minkoff occupied in the form of a partnership and conducted business. Because a partnership, not the mortgagor, was deemed to be in possession of the business portion of the premises, a rental value was presumed and the receiver had to be paid.[8]

In another variation, language in the mortgage provided that in the event of default, the mortgagor, its "associates" and "affiliates" were required to pay a reasonable rent.[9] Peregrine was the mortgagor's managing agent and occupied a portion of the premises rent free. The ruling was that Peregrine fulfilled either definition because, resulting from an overlapping of both corporate officers and shareholders, there was common control of Peregrine, the mortgagor and the corporation which owned all the stock in the mortgagor.

Further, the court stated that Peregrine's occupancy was an incident of its function as the building's managing agent and thereby the principal and agent relationship brought it within the ambit of "affiliate" of the mortgagor.[10] Finally, the court articulated the overarching concept which pervades so many of the cases in this field; a mortgagor is prohibited from contracting away his right to receive rent or from leasing space for a nominal sum in violation of the lien of a mortgage containing an assignment of rents.[11]

As to the quantum of rent to be paid by a mortgagor, some authority goes so far as to rule that absent a lease, the amount of rent a receiver deems reasonable is solely within his discretion and not susceptible to court inquiry.[12] If the mortgagor is aggrieved by the receiver's rent request, the remedy simply would be to depart the premises.[13]

Many, and perhaps most, attempts to stymie the receiver are condemned by the courts on the theory that the mortgagor's ploy (and these vary, as case law reveals) is a breach of the mortgage or an impairment of the mortgagee's rights under that mortgage. Examples are many and serve to underscore the point.

In the instance of a leasehold mortgage, default elicited a foreclosure action and the appointment of a receiver. Leases at the premises were the collateral for the mortgage, but the mortgagor accepted an early surrender of a long-term lease for the sum of $1.2 million in satisfaction of all claims against the tenant. Only a portion of that money remained when the receiver was appointed (some $70,000 held in escrow by the mortgagor's successor's attorney) and it was that amount which was sought by the receiver. Because the lease was security for the mortgage, liquidation of the collateral, even though prior to the foreclosure action, generated funds which themselves became collateral and were reachable by the receiver.[14]

Another cause for consternation is the owner who enters into ad hoc rental credit agreements with tenants based on repairs due or sundry other arrangements.[15] Is a receiver empowered to demand use and occupancy from tenants even if no rent is due from them to the landlord until some date in the distant future? Although the general rule is that a receiver is bound by any lease agreement between the tenant and the mortgagor,[16] the court nevertheless retains the authority to set aside a fraudulent or collusive lease[17] based upon inadequate rental or advance payment of rent in anticipation of foreclosure.[18]

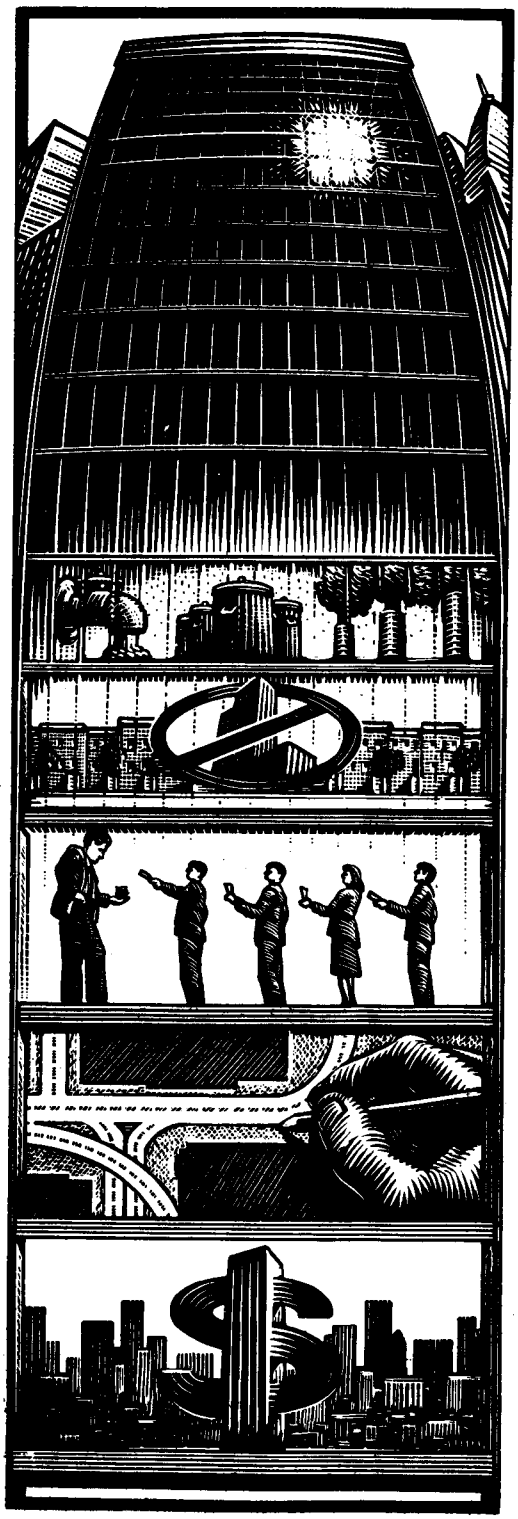

ILLUSTRATION BY JOHN MacDONALD

At the same time, and even without fraud or collusion, a mortgagor's agreement as to the mortgaged premises binds neither the mortgagee nor the receiver where that agreement contravenes an express or necessarily implied provision of a prior recorded mortgage.[19] Based upon the cited maxims, the ruling as to the rental credit agreements was that any deal permitting a tenant to take a credit for amounts payable by the landlord must be viewed as an improper assignment of rents. Consequently, the tenants are liable to the receiver for rents due pursuant to their leases, without any setoffs.[20]

Lease termination is another not uncommon mortgage breach condemned by the courts. The mortgage in one case required the mortgagors to obtain the mortgagee's consent to terminate any lease. The mortgagors did terminate a 20 year major restaurant chain lease at the premises, but did not secure the requisite consent. Perhaps not surprisingly, the mortgagors collected a lump sum termination payment.

Although the restaurant itself had the right to cancel its lease at any time, there were specific provisions as to the manner of termination (which were not followed either.) Further, the termination breached the lease because the premises were not re-let.[21] Because the mortgage was breached — via lack of consent to terminate — all rent termination proceeds were due to the receiver.[22]

A similar case involved a mortgage provision prohibiting any prepayment of rent without the mortgagee's express written consent. Nevertheless, the mortgagor extended a major commercial lease for five years, at the same time requiring prepayment of one year's rent in advance — $160,000 covering the period June 1, 1993 through May 31, 1994.

The money was paid on Oct. 15, 1992, followed by a mortgage default and then by initiation of a foreclosure action on Jan. 28, 1993. Inevitably, the tenant declined to pay the receiver rent for the prepayment period (June 1993 through May 1994.) Again on the theory that the lease extension contravened the mortgage, it could not bind the mortgagee or the receiver and the tenant was obligated to attorn to the receiver.[23]

## Other Permutations

There are yet other permutations of mortgage breaches. There was a mortgage with the usual assignment of rents and clauses that the mortgage lien should not be impaired.

But the mortgagor's successor at an apartment hotel came upon hard times and until

he could pay a particular debt, he granted to his creditor the right to use one of the apartments rent free or to sublet it. The apartment was sublet for a substantial rental and the battle was then between the creditor and the receiver for the rental proceeds.[24]

In substance, ruled the court, the rental proceeds, instead of being paid in cash were used to offset interest otherwise due upon the mortgagor's debt. That right, though, ceased when the receiver was appointed. The arrangement breached the mortgage and the receiver was not bound by it.[25]

Something similar occurred when a mortgagor's partner and his wife occupied an apartment in the mortgaged premises without paying rent. When the receiver sought to assess a rental, the tenants defended based upon their free lease.[26]

Upon the underlying principle that it is beyond the mortgagor's power to defeat the mortgage pledge of rents by leasing out portions of the secured premises either rent free or for a nominal sum,[27] a summary proceeding was authorized.

## Conclusion

In the end, the terms of the mortgage will be the mortgagee's salvation in empowering a receiver. If the mortgagor will be in possession, rent from him and any form his sundry companies, partners or corporations may assume, will be available if the mortgage so provides. But unless the mortgage says that possession is available for a rental default, the receiver be shackled solely with a money judgment action.

As to various scams of the crafty, most are sure to work a diminution of the security or violate the assignment of rents provision. To the extent that such is so,[28] the devices will not withstand the receiver's attack.

(1) For a further discussion of the usefulness of a receiver in a foreclosure action, see 1 *Bergman on New York Mortgage Foreclosures*, §§10.01 and 10.02, Matthew Bender & Co., Inc. (Rev. 1996); "The 5 Percent Question — Receiver's Commission: Confusion Reigns Over 'How Much'", *New York Law Journal*, May 24, 1995, at 5, col. 2; "Mortgage Foreclosure — A Modern Primer For Corporate Counsel," 3 *The Metropolitan Corporate Counsel* 3 (April, 1995).

(2) *Ronbarst Realty Corp v. Boardwalk Owners Corp.*, 177 A.D.2d 436, 576 NYS2d 279 (1st Dept. 1991), citing *New York Life Insurance Company v. Fulton Development Corporation*, 265 N.Y. 348, 352, 193 N.E. 169; *Wyckoff v. Scofield*, 98 N.Y. 475, 478; *Kane Associates* v. *Blumenson*, 30 A.D.2d 127, 128, 290 NYS2d 420, aff'd 23 NY2d 942, 298 NYS2d 724, 246 N.E.2d 527; *Rider v. Bagley*, 84 N.Y. 461, 465.

(3) Id.

(4) *Holmes* v. *Gravenhorst*, 263 N.Y. 148, 188 N.E. 285 (1933); *Carlin Trading Corp. v. Bennett*, 24 A.D.2d 91, 264 NYS2d 43 (1st Dept. 1965); *Bein v. Mueson Realty Corp.*, 17 Misc.2d 661, 184 NYS2d 246 (1959); *Underwriters Trust Co. v. Molitor*, 21 NYS2d 895 (1938); *modified*, 259 A.D. 1092, 21 NYS2d 897 (2d Dept. 1940); *First Nationwide Bank v. Fouche, NYLJ*, June 28, 1995, at 27, col. 2 (Sup. Ct. N.Y.Co., Lehner, J.).

(5) *Aetna Life Ins. Co. v. ABS Properties, Inc.*, 186 A.D.2d 448, 588 NYS2d 557 (1st Dept. 1992); *Carlin Trading Corp. v. Bennett*, supra. at note 4; *Nationwide Bank v. Fouche*, supra. at note 4.

(6) *Carlin Trading Corp. v. Bennett*, supra at note 4; *Holmes v. Gravenhorst*, supra. at note 4; but see *Alexander v. Kelly*, 169 Misc. 521, 7 NYS2d 617 (1938) to the contrary.

(7) *Union Dime Sav. Bank v. 522 Deauville Assoc.*, 91 Misc.2d 713, 398 NYS2d 483 (1977); *Bein v. Mueson Realty Corp.*, supra. at note 4.

(8) *Chase Nat'l Bank of City of N.Y. v. Minkoff*, 54 N.Y.S.2d 169 (Sup. Ct. 1944).

(9) *Aetna Life Ins. Co. v. ABS Properties*, supra. at note 5.

(10) Id.

(11) *Aetna Life Ins. Co. v. ABS Properties*, 186 A.D.2d 448, 588 N.Y.S.2d 557 (1st Dept. 1992), citing *Bank of Manhattan Trust Co. v. 571 Park Ave. Corp.*, 263 N.Y. 57, 188 N.E. 156; *New York City Community Preservation Corp. v. Michelin Assocs.*, 115 A.D.2d 715, 496 N.Y.S.2d 530, lv. denied 68 NY2d 604, 506 NYS2d 1027, 497 N.E.2d 707).

(12) *Schaeffler v. Ducorsky Bros. Photo Face, Inc., NYLJ*, Oct. 3, 1991, at 26, col. 5 (Sup. Ct., Nass. Co., Wager, J.).

(13) Id.

(14) *Manhattan Life Ins. Co. v. K.B.A. Planeta N. Am., Inc., NYLJ*, Dec. 28, 1993, at 29, col. 4 (Sup. Ct., Nass. Co., O'Brien, J.).

(15) For the variety of facts, see *Kanbar v. Ka Wah Bank, NYLJ*, April 22, 1994, at 22, col. 3 (Sup. Ct., N.Y.Co., Saxe, J.).

(16) See, inter alia, *Markantonis v. Madlan Realty Corp.*, 262 N.Y. 354, 186 N.E. 862 (1933); *Prudence Co. v. 160 West 73rd St. Corp.*; 260 N.Y. 205, 183 N.E. 365 (1932); *Jacobs v. Andolina*, 123 A.D.2d 435, 507 NYS2d 450 (2d Dept. 1986); *New York City Community Preservation Corp. v. Michelin Assoc.*, 115 A.D.2d 715, 496 NYS2d 530 (2d Dept. 1985)

(17) See, inter alia, *Prudence Co. v. 160 West 73rd St. Corp.*, supra. at note 16; *New York City Community Preservation Corp. v. Michelin Associates*, supra. at note 16.

(18) Advance rental payments in anticipation of foreclosure is very much a part of this entire subject. In the interests of space, however, it will not be reviewed here. Instead, attention is invited to 1 *Bergman on New York Mortgage Foreclosures*, §10.15[2], Matthew Bender & Co., Inc. (Rev. 1996), for a lengthy analysis of the issues.

(19) *Kan Bar v. Ka Wah Bank, NYLJ*, April 22, 1994, at 22, col. 3 (Sup. Ct., NY. Co., Saxe, J.), citing *New York City Community Preservation Corp. v. Michelin Assoc.*, 115 A.D. 2d 715 (2d Dept. 1985); *Bank of Manhattan Trust Co. v. 571 Park Ave. Corp.*., 263 N.Y. 57, 62 (1933); *Colter Realty, Inc. v. Primer Realty Corp.*, 262 App. Div. 77 (1st Dept. 1941).

(20) *Kan Bar v. Ka Wah Bank*, N.Y.L.J., April 22, 1994, at 22 col. 3 (Sup. Ct., N.Y.Co., Saxe, J.).

(21) *Crossland Fed. Sav. Bank v. Pekofsky*, _A.D.2d_, 641 NYS2d 406 (2d Dept. 1996).

(22) Id.

(23) *Dime Sav. Bank of N.Y. v. Montague Street Realty Associates*, _A.D.2d_, 645 NYS2d 533 (2d Dept. 1966).

(24) *Bank of Manhattan Trust Co. v. 571 Park Ave. Corporation*, 263 N.Y. 57, 188 N.E. 156 (1933).

(25) Id.

(26) *Union Dime Sav. Bank v. 522 Deauville Assoc.*, 91 Misc. 2d 713, 398 N.Y.S.2d 483 (1977).

(27) *First Nationwide Bank v. Fouche*, N.Y.L.J., June 28, 1995, at 27, col. 2 (Sup. Ct. N.Y.Co., Lehner, J.), citing *Bank of Manhattan Trust Co. v. 571 Park Avenue Corp.*, 263 N.Y. 57 (1933); *New York City Community Preservation Corp. v. Walker*, 115 A.D.2d 715 (2d Dept. 1988), leave to appeal denied, 68 N.Y.2d 604.