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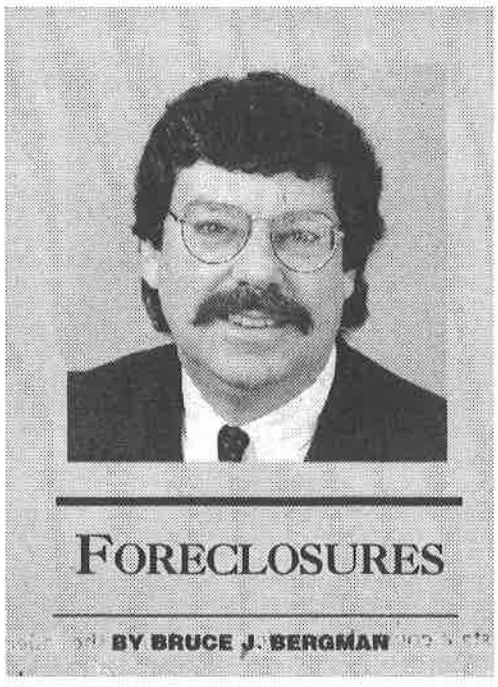
REAL ESTATE UPDATE

Non-Judicial Actions

Statutory Ambiguities Could Cause Delays in Default Cases



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IT HAS long been obvious, both to mortgage foreclosure specialists and practitioners who only occasionally enter the arena, that the foreclosure case in New York tends to be unduly protracted. For those who represent a national clientele, the recognition is even more dramatic because mortgage lenders and servicers with loan portfolios in other states are able to make unflattering comparisons. Although there are a few other states with similar, or worse, problems (neighboring New Jersey for example), New York is widely perceived around the country as a dreaded venue in which to hold defaulted mortgage paper.

A laudable attempt to alleviate this problem was the signing by the Governor of the Commercial Mortgage Reform Bill (S. 588/A. 8690) on July 7, 1998 which repealed the existing and fatally flawed RPAPL Article 14 (foreclosure by advertisement) and substituted a new Article 14 — Foreclosure of Mortgage by Power of Sale. The new methodology became effective on the date of signing, although it remains in force only until July 1, 2001 when it is deemed repealed.

The statute was conceived by a New York State Bar Association task force with changes then forthcoming in the legislature. Mindful that rendering this arcana coherent is a daunting task, the drafters did a commendable job. The end product is a solid and erudite assault upon the unfortunate delays imposed by the existing judicial foreclosure process. To the extent it is available, a power of sale foreclosure should consume about three months, as opposed to the ten to twelve months for a judicial foreclosure — considerably longer in New York City. Of course, any statute designed to reshape the landscape is likely to embody the result of compromise. This one is no exception and that, in turn, imposed major limitations on its use, an important point to recognize. Then too, almost anyone benefitting from time and distance could probably find infirmities and anomalies in the text. In reviewing those here, the idea is not to nit pick, but to suggest inquiry so that this law designed to streamline procedures will not be victimized by wily mortgagors employing possible ambiguities to their advantage.

Judicial Aspects

Although power of sale foreclosure (it will probably be commonly thought of as non-judicial foreclosure) is generally designed to bypass the courts — where much of the delay in judicial foreclosure originates — there are a number of necessary *judicial* aspects in the process. For example, should a party desire to opt out of the proceeding, court involvement is necessary.[1] If a subordinate interest

in the mortgaged property is held by the United States of America, or any of its agencies or instrumentalities, the government is not bound by the proceeding unless an order of the supreme court in the county where the property is situate is obtained.[2] Court intervention is also required to pursue surplus monies,[3] a deficiency [4] or the appointment of a receiver.[5]

With one exception, and one inconsistency, prerequisites to employing non-judicial foreclosure are standard and essentially *pro forma*. There must, of course, have been a default under the mortgage, together with written notice of declaration that the outstanding indebtedness is due conveyed to the mortgagor in the mode required by the mortgage.[6]

Consistent with RPAPL Article 13 judicial foreclosure, no action can have been brought either to foreclose the mortgage or recover the debt, and if there has been an action on the debt, it must have either been discontinued or dismissed without prejudice or, if an execution upon a judgment was obtained, it has to have been returned wholly or partly unsatisfied.[7]

Before the expiration of the statute of limitations applicable to commence a mortgage foreclosure action, the first notice of sale [8] must have been published.[9]

Critically, the mortgage to be foreclosed pursuant to RPAPL Article 14 must contain a power of sale clause, defined as a provision that upon a mortgage default or a default upon a note (or bond or other obligation thereby secured) the mortgagee has the right to sell the mortgaged property.[10] While some mortgages as a matter of boilerplate *might* contain such language, many will not. As a consequence, power of sale foreclosure may not as a practical matter find application until newer mortgages which include the magic phrases ultimately go into default. In any event, this requirement is an alert to mortgage *drafters* that a clause of perhaps only academic interest is now necessary for any mortgage which could possibly be the subject of a RPAPL Article 14 foreclosure.

Finally, the mortgage to be foreclosed must have been recorded in accordance with RPAPL Article 9 in the county where the property is situate — at least pursuant to RPAPL §1401(3). In understandably mirroring judicial foreclosure precepts,[11] which require the mortgage to be recorded as a condition to issuance of the judgment of foreclosure and sale, Article 14 first mandates that the property "may be foreclosed in the manner prescribed by this Article . . ." [12] if the mortgage has been duly recorded. But the statute later provides, at RPAPL §1412(2), that before the foreclosure sale deed is conveyed, if the mortgage is not in recordable form, that mortgage must be filed with the court, although if it is in recordable form it must first be recorded.

If *filing* the mortgage is an option — and RPAPL §1412(2) says it is — then the RPAPL §1401(3) obligation to *record* the mortgage is inconsistent. As a practical matter, the unrecordable mortgage will only seldom be encountered. When it is, though, it exposes an ambiguity in the efficacy of Article 14. In any event, the anomaly is present and is worthy of revisiting by the legislature.

Availability

Exceptions to the availability of non-judicial foreclosure essentially confine it to residential buildings of more than five units outside of New York City (although the foreclosure would have to leave leases intact), and commercial premises anywhere in the state. The procedure is *not* available for a mortgage on real property improved solely by:

- A residential building of less than six dwelling units;[13] and
- A residential condominium unit in a residential building owned in condominium form of ownership;[14] and
- A residential building owned by a qualified cooperative apartment corporation;[15] and
- A building containing sixty-five percent or more residential tenancies located in a city with a population of one million or more,[16] which means New York City.

Non-judicial foreclosure is likewise unavailable for a mortgage on property containing residential apartment units where the foreclosure would seek or would result in foreclosure, termination, modification or impairment of a tenants' interest in any lease for a residential unit in the mortgaged property or of the tenant's possessory rights.[17]

Even for the somewhat narrow category of instances where non-judicial foreclosure remains available, there is an ability on the mortgagor's part to either opt out or challenge imposition of the procedures. These opt-outs apply separately to mortgages in existence before the effective date of the statute (July 7, 1998),[18] and those in existence subsequent to the effective date of the statute.[19]

The main problem with judicial foreclosure, which prompted exploration of revivifying non-judicial foreclosure in New York, was the length of time necessary to complete a mortgage foreclosure action. Although much of the time consumed in a judicial foreclosure involves achieving the various plateaus, congested court calendars (particularly downstate) are a major component of burdensome durations. The provisos of the power of sale procedure greatly reduce the time, primarily by eliminating the need to invoke court involvement for most steps.

The various means, however, by which mortgagors — and others — can assault the accelerated procedures (see text of RPAPL §1421) portend diminution of utility in employing the power of sale solution. Although it could be opined that injunctive relief available to other than the mortgagor (afforded by RPAPL §1421) might not be so often used, and is probably less susceptible to abuse because of the high standards set forth, the opt-outs for mortgagors seem more fertile.

For mortgages executed before July 7, 1998, judicial foreclosure can virtually be imposed upon a mortgagee by a mortgagor. For mortgagors who seem to thrive upon delay, and who will suffer only perhaps a greater quantum of legal fees in the ultimate judgment of foreclosure and sale, choosing to avoid the rapid retribution of power of sale foreclosure appears as an automatic re-

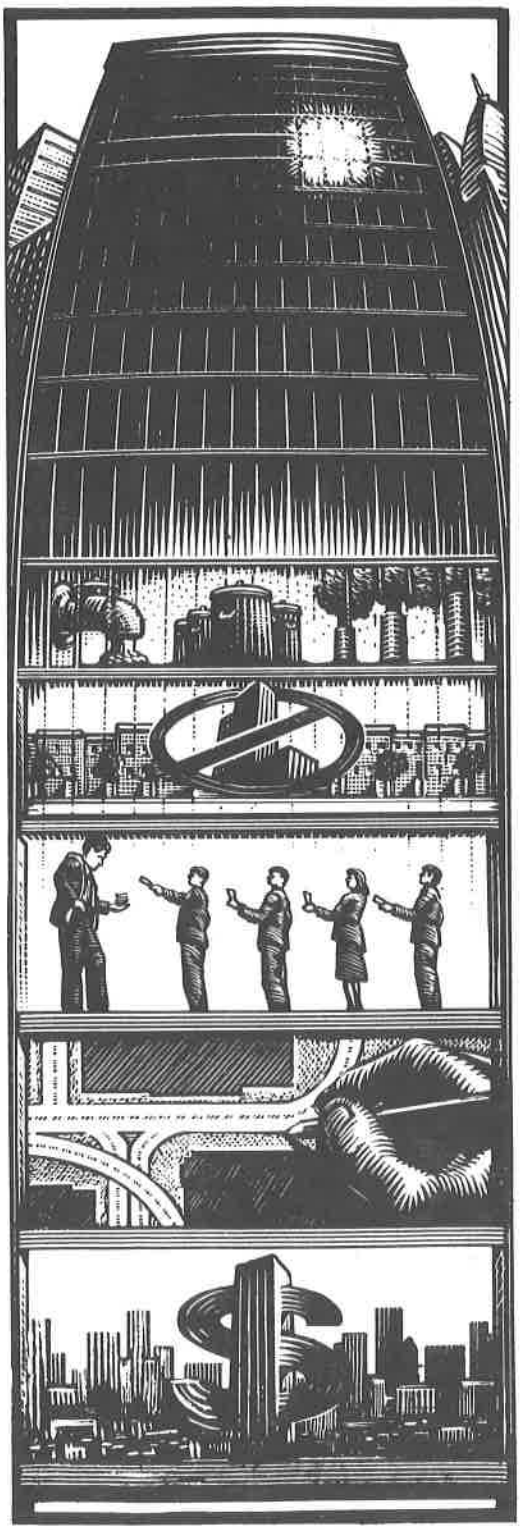

ILLUSTRATION BY JOHN MacDONALD

sponse. Hence, the mortgagee holding a vintage pre-July 1998 mortgage would quickly eschew the non-judicial route because the new method is likely to just add futile time to a progression already unacceptably protracted.

Opting out of the post-July 1998 mortgage may not be automatic,[20] but the Legislature was conspicuously generous in excavating an escape route — or at least, a time killer. Putting aside the lack of a power of sale clause as an out — because mortgagees should know clearly at the outset whether it is in the mortgage or not — the next four grounds in the statute [21] to argue against the abbreviated course open the door to contention and mischief.

Although ultimately proving the point is far more difficult, claiming the mortgage is invalid because of fraud in the inducement is hardly an unheard-of assertion. Then there is the claim that the mortgage is not due because the mortgagee gave an extension, or was irresolute in some correspondence on the subject, or erroneously rejected a remittance or misapplied a check. Then there is waiver, unconscionable conduct, bad faith, and the lower grade laches or unclean hands, among hosts of others.

And might not a mortgagor successfully argue pursuant to the "undue hardship" standard: "I can refinance this mortgage in five months. In a judicial foreclosure case, which wouldn't conclude for perhaps twelve months, I would obtain all the funds to save the property and satisfy the mortgage. But in this rapid power of sale proceeding, the foreclosure will be over before I can get the money. I will suffer undue hardship!" Maybe. Moreover, undue hardship is an ill-defined phrase. It is difficult to predict what a court might do, particularly when loss of property and a business is in the offing.

If a mortgagor's assault on the non-judicial proceeding is successful, the hapless mortgagee endures all the time generated in starting the power of sale case and then attempting to fend off the attack. Defeat then confines the remedy solely to judicial foreclosure, and whatever time would have been saved by the non-judicial approach thereby proved illusory. Even if the mortgagor's offensive is routed, the apparent economy of the power of sale procedure is considerably reduced.

Conspicuously — and perhaps unfortunately — unlike judicial foreclosure, the non-judicial Article 14 contains specific language creating a cause of action against a mortgagee for failure to comply with the procedures and conditions of Article 14.[22] Although it is a reasonable assumption (but only an assumption) that a mortgagor, or any other person, claiming a mortgagee's neglect to adhere to the myriad dictates of Article 14 will be required to prove some damage to make the effort worthwhile, the path is nevertheless open for a new defensive tactic. Whether real or imagined, this counterstroke could serve as a threat or a weapon; all the more reason for the statute to be so clear that mortgagees will stumble only on the rarest of occasions.

But the statute does have a few areas of possible imprecision which could render mortgagees more vulnerable to this counterattack. For example, RPAPL §1407-1 is very specific in delineating how a *mortgagee* postpones the foreclosure sale. RPAPL §1407-2 allows postponement if the person designated to conduct the sale does not appear and states that publication and service of the postponement notice shall be as provided in subdivision 1. But the *duration* of postponement, noted with particularity in subdivision 1, is not mentioned in subdivision 2. The drafters no doubt intended the duration to be the same, but it doesn't say so and the neglect to address it when other issues *are* specified could lead to ambiguity or worse.

A similar concern could be expressed about RPAPL §1407-4 which provides that the mortgagee can postpone the sale more than once. No mention is made, however, about multiple postponements based upon failure to appear by the person designated to conduct the sale.

Can the sale be reset more than once on this latter basis, or does all become a nullity? If it is always the mortgagee who postpones the sale for whatever reason, then there is no distinction between postponements by a mortgagee and postponements engendered by the officers' neglect to appear. This lack of clarity could be eliminated were the provision to state that the sale can be postponed by the mortgagee, multiple times, for any reason, and if it needs to be said at all, including failure of the officer to appear.

Bid deposit and memorandum of sale are addressed by RPAPL §1408-4 which affirmatively states that "[t]he memorandum of sale shall not be amended or modified." The motivation here is understandable; it is written to mean that perhaps a week later the parties cannot agree to materially alter the terms to the detriment of other bidders.

But case law would have always prohibited that anyway and judicial foreclosure has not suffered lack of precision for want of such a proviso in Article 13. The possible problem here in Article 14 is that the verbiage might even prohibit a change to correct a slip of the pen at the time of the auction sale.

Suppose, for example, the officer conducting the sale innocently reverses some numbers or confuses the bid price — or incorrectly notes the bidder's name. It is then crossed out and corrected. Is this not barred by the anti-modification section — at least by its very words? The answer will surely be: that is not what was intended. Nevertheless, it *is* what the statute says and it opens the door for protest by the disgruntled — precisely what needs to be avoided in the contentious foreclosure arena.

As to foreclosure sale bidding, if the mortgagee bids up to the full amount of the indebtedness (a term clearly defined by the statute) then according to RPAPL §1409, no bid deposit will be required. This suggests — but does not affirmatively so provide in this section — that if the mortgagee bids above the total indebtedness, a bid deposit will be mandated. Assuming that is so, whether the deposit then needs to be 10 percent of the entire bid, or only 10 percent of the excess over the total indebtedness is unstated. Absent definitive recitation, there is again room for doubt.

Regarding the report of sale (RPAPL §1414) and filing the report of sale (RPAPL §1415), both sections measure the time (15 days to make the report and a total of 30 days to file it) from completing the sale and executing the proper conveyance to the purchaser. Whether "executing to" is the same as delivering is at least somewhat ambiguous because the deed *could* be executed but not delivered. Additionally, what is the relationship between "completing the sale" and then "executing the proper conveyance to the purchaser"? [23] There could not be a proper conveyance unless a sale had been completed and because the sale must come before execution (and delivery) of the deed, any mention of the sale appears to be not only surplusage, but insertion of a confusing element as well.

At a lower level of concern,[24] the surplus monies provision (RPAPL §1418) discusses the stages of pursuit in terms of a notice of claim, an application and a motion. Although the "application" and the "motion" are intended to be synonymous, neither is a defined term in the statute. A first reading of the section certainly gives

pause. Lack of further clarity will probably result in no more mischief than readers scratching their heads, but a sharpening of language here would be helpful.

Returning to the report of sale, RPAPL §1414-1 lucidly provides what the report is to state and four denominated subsections list those exactly. After a subsequent subsection recites attachments to the report, another subsection resumes a mention of what the report shall specify and notes a further attachment. Why the information in this latter subsection (RPAPL §1414-3) is not distributed in the preceding subsections is perplexing and certainly leads to awkwardness in interpretation.

Conclusion

Welcome though power of sale foreclosure is, its application appears to be limited. And because its use will depend at the very least upon the presence of a power of sale provision in mortgages, it may be a while until those documents season. Even when that occurs, it is difficult to predict how dedicated the borrowing community will be to derail the accelerated process designed to divest title. Perhaps the only sure bet is that Article 14 will provide the long awaited shortcut to *consensual* foreclosure. Even if that is all it does, it will have provided much needed succor to mortgage lenders.

(1) RPAPL §1421-2.
(2) RPAPL §1411-4.
(3) RPAPL §1418-1.
(4) RPAPL §1419-2.
(5) RPAPL §1420-1.
(6) RPAPL §1401(1).
(7) RPAPL §1401(2).
(8) See RPAPL §§1404, 1405, 1406 and 1407.
(9) RPAPL §1404(4).
(10) RPAPL §1401.
(11) RPAPL Article 13.
(12) RPAPL §1401(3).
(13) RPAPL §1401-1(a).
(14) RPAPL §1401-1(b).
(15) RPAPL §1401-1(c).
(16) RPAPL §1401-1(d).
(17) RPAPL §1401-2.
(18) RPAPL §1421-1.
(19) RPAPL §1421-2.
(20) RPAPL §1421-2.
(21) RPAPL §1421-2 (1) through (4). Among a few other items, the borrower must present facts to support one or more of these allegations: - That the mortgage obligation is invalid or not otherwise due; and/or — That the mortgagor is not in default under the mortgage or otherwise has a meritorious defense to the foreclosure; and/or — That the mortgagee has not complied with the terms and conditions of the non-judicial foreclosure statute; and/or — That under the facts and circumstances presented, undue hardship to the mortgagor would result from allowing the foreclosure to proceed non-judicially.
(22) RPAPL §1421-7.
(23) These are the precise words in RPAPL §1414. RPAPL §1415 merely substitutes "completion of" for "completing" in referring to the sale.
(24) Perhaps lower still, and hence treated in a footnote, RPAPL §1420-5 quantifies receivers' commissions as five percent of the greater of sums received or disbursed, as the court allows. Absent a receiver advancing his own monies, which is both unusual and certainly not recommended, it is hard to imagine how sums disbursed would ever be greater than those received. And if a mortgage holder advances monies to the receiver, these would logically be calculated as sums received. All this renders this commission formulation curious indeed. Under redemption (RPAPL §1410), a holder of a subordinate security interest is appropriately in the category of those who can redeem. Why then the necessity to say in §1410-2 "The rights under this subdivision may be enforced by the holder of any subordinate security interest in or lien upon the mortgaged property even though it is a subordinate security interest or lien"?