MORTGAGE FORECLOSURES A NEED FOR OUTSIDE COUNSEL?

By Bruce J. Bergman, Esq*

This is a reprint of an article originally appearing in the October, 1981 edition of MORTGAGE BANKING and is reprinted here with their kind permission.

The debate concerning the relative merits of employing house counsel or outside attorneys for various legal problems experienced by mortgage lenders is likely to continue for as long as legal difficulties exist. This is not surprising because the answer probably varies with the nature of the particular case or problem. However, a persuasive argument can be made for engaging outside counsel to foreclose mortgages.

Because the issue can become arcane, some background is in order. As we well know, lenders do not like to foreclose mortgages. The process is

---

Abernathy was a malpractice action against certain defendants who treated plaintiff's intestate during his terminal hospitalization following a fall from a Long Island Railroad train. The moving defendants sought to amend their answers to plead that the railroad and plaintiff had reached a $12,500.00 settlement in satisfaction of plaintiff's claim for damages. The plaintiff opposed the motion on the ground that the imposition of the defense would be prejudicial to her. The court granted the motion and noted that the effect and purpose of CPLR 4533-b was

> ". . . to modify the rule in Livant v. Livant, 18 A.D. 2d 383, 239 N.Y.S. 2d 608, app. dism., 13 N.Y. 2d 894, 243 N.Y.S. 2d 676, 193 N.E. 2d 503, under which payment by one of several tortfeasors was permitted to be proved in the presence of the jury. The reason for changing the *Livant* rule was concern that where a prior payment has been revealed the jury might return a nominal verdict in the belief that the tortfeasor who settled before is the only wrong doer merely because he settled . . ."
>
> *Abernathy v. Azzoni, supra*, at 266.

Thus, *Abernathy* reveals that the purpose of CPLR 4533-b is to prevent the fact of the settlement from being revealed to the jury, which would be the case if Section 15-108 of the General Obligations Law were to solely govern this procedure. Hence, the non-settling defendants may put in evidence the settling tortfeasor's potential liability to the plaintiff during trial. They may not put in evidence the fact of the settlement and once the trial has ended and the jury instructed to apportion a percentage of the fault, should it so find, to the settling defendant, and a total verdict rendered apportioning no fault or some portion of fault to the settling defendant, the court may then reduce the verdict by the amount of the settlement, outside of the presence of the jury, should it turn out to be greater than the percentage of fault accorded by the jury to the settling defendant.

thoroughly distasteful for both sides and no one really emerges a "winner," except that the lender can hope, or expect, to protect his investment. But whatever the ramifications, lenders have an obligation to protect their mortgage portfolios in a skillful and prudent fashion.

While the procedures involved with a foreclosure action will vary from state to state, it is safe to say that they are highly technical, precise, ritualistic, and time consuming. The nuances of a foreclosure may often trap an unwary practitioner who does not specialize in that area of the law.

The process itself may typically be viewed in steps along these lines:

- After a default in mortgage payments, which is the usual, although not the exclusive mode of default, the lender begins his own internal collection efforts.
- When a default continues for approximately three months, an alert mortgage servicing department will usually conclude that the lawyer is now needed.
- Under the terms of most mortgages, as generally construed by case law, the mortgage lender may, upon certain defaults, "accelerate" the mortgage - that is, declare the entire principal balance due. This is usually done in writing, although the lender could demonstrate his call of the mortgage by making his declaration in the pleadings (court papers). *Once the principal balance has been accelerated, the mortgage lender need not accept a tender of arrears.*
- The file is turned over to counsel for an analysis and determination of necessary parties to the suit, such as judgment creditors, subordinate mortgage holders, and so forth.
- After the summons and complaint are served, counsel awaits the running of a statutory period for an "answer". If none is forthcoming, there is a default - an uncontested action - and it moves to the next phase. If there is an answer, the possibility of complex litigation is a real one. This does not take into account the not uncommon element of a bankruptcy.
- After a default, or the disposition of an answer, a computation of the amounts due under the mortgage is made, usually by a court appointed referee, although this aspect can vary from state to state.
- Then follows the obtaining of the judgment of foreclosure and sale.
- After the judgment, a notice of sale is published for a period of weeks as may be required by law.
- Finally, an actual sale takes place.
- If the lender is the purchaser at the foreclosure sale, he now has a parcel to sell or lease. If the party who defaulted on the mortgage in the first place hasn't yet departed, a proceeding to oust him must be begun.
- Where it turns out that the property was worth less than the mortgage, the

** Mr. Bergman is a deputy Nassau County Attorney and a member of the Association.*

pursuit of a deficiency judgment must be considered.

- When someone other than the lender becomes the purchaser at the sale, a closing must then be completed.

Who should take care of all of this for mortgage lender?

A surface of analysis might lead to the conclusion that is better to use "your own" lawyers rather than some "expensive" firm from outside. But such an argument doesn't necessarily hold up.

In exploring the question, there are these major areas of comparison: recovery of costs, quality of legal work, and price.

RECOVERY OF COSTS

Most mortgage foreclosure actions are settled prior to sale. Indeed, one generally accepted settlement figure is 85 percent of all foreclosures transmitted to counsel. The defaulting party may obtain reinstatement by paying arrears or may sell the property to satisfy the entire sum.

But the moment a file is given to an attorney, whether in house or outside, a legal expense has been incurred, and if the case were to be litigated, the legal cost could be thousands of dollars. On the other hand, if the file had just been opened, the expense would be minimum. Either way, if the attorney in charge of the case was *not* in the employ of the lender, all legal fees would usually be paid by the defaulting party as a condition of reinstatement.

If the lender uses house counsel, it is often difficult to justify a legal fee. More important, when a foreclosure is litigated and a fee is to be set by the court, in most states *house counsel is not entitled to a legal fee.* No such prohibition applies to the private attorney. Hence, as far as recovery of legal expense is concerned, outside counsel is the clear choice.

QUALITY OF WORK

Because there is more competition and incentive in the entrepreneurial arena of private practice, many observers would conclude that outside attorneys, motivated by the marketplace, are probably more aggressive than those who settle into the less competitive world of house counsel.

This is no way to suggest that highly competent attorneys are not employed by lenders, but there is the compelling consideration of obvious incentive on the outside. Private counsel's retention of the lender's business depends solely on performance. If the job isn't done efficiently, the account is lost. The outside attorney is constantly being tested. He, or his firm, *must* give satisfaction at all times, lest the mortgage department seek other legal help. That consideration weighs heavily in assuring first class service.

As a corollary, outside counsel will often be called upon to render ancillary legal services for which they hesitate to submit a bill - another bonus for the mortgage lender. Still further, the private attorney is always aware that the lender has other legal work it can direct to outside firms, which is an additional incentive for rendering the best possible service.

THE COST ELEMENT

House counsel is expensive - in the end probably *more* expensive than the services of an independent firm. If a beginner is to be hired, a salary of anything less than $20,000 nowadays would be low, with possible exceptions in more rural areas. However, a beginner is hardly the ideal lawyer to joust with the intricacies of mortgage foreclosure law. An experienced practitioner is a much better choice, a selection with an annual price tag of $25,000 or $35,000 and up. Even then it might be difficult to lure the attorney who knows the courts well enough to expeditiously prosecute these foreclosures which can become litigated to a fare-thee-well.

The cost of in-house legal help does not, of course, stop with salary. There are the necessary fringe benefits including any combination of medical insurance, unemployment, workmen's compensation, social security, stock options, pension and/or profit sharing, among others.

Then too, there is the support staff associated with the house foreclosure man such as secretaries, telephone operator, clerical, etc. What about the telephone, postage, photocopying, and the supply bills? With any foreclosure volume at all these can be substantial.

Having put into place this expensive machinery to handle the foreclosures, what happens when there is a lull in defaults? It would be wonderful *not* to have foreclosures, but the staff retained to process them will be without the work they were hired for.

So, on the question of cost, outside counsel again appears to have an edge.

RELATED DISBURSEMENTS

A final question associated with the area of costs is the issue of disbursements in foreclosures. These out-of-pocket expenses in foreclosure actions tend to be high in many states, from perhaps $400 to well over $1,000 in some cases, for such costs as service of process, court filing fees, referee's compensation, cost of advertising the sale, etc. How does all this enter the equation in deciding upon staff attorneys as opposed to private counsel?

This raises some interesting observations about a lender's internal accounting procedures. By way of explanation, the initial disbursements early in the foreclosure action will not be large - they build later on. So, if house counsel is employed, there are only minor disbursements in the preliminary stages. Outside counsel, however, require and expect some advance towards disbursements, such as $300, so they are not forced to lay out huge sums for a significant case load.

But this $300 is a deductible legal expense, an operating expense for problem loans. Moreover, given an eighty-five percent settlement figure for foreclosures (cases that don't go to sale), this $300 will *come back* when outside counsel settles the case and collects legal fees and disbursements from the defaulting mortgagor.

Applying this concept to a large foreclosure portfolio, let us assume there

are sixty accounts in default, each with $300 advanced to counsel for disbursements. $18,000 is now "out" not earning interest. But, this sum is almost always recoverable. (House counsel's salary is not.)

Then too, some accounts won't even use the $300 and it quickly comes back at reinstatement. As the foreclosure progresses and disbursements increase drastically, it is the private attorneys who must advance the disbursements, often an additional $600 that would otherwise have been the lender's burden if proceeding in-house. Thus, the lender *saves* interest on all the costs over the amount of the advance disbursement.

To be sure, in the first year a system engaging outside counsel might be used, there could be a significant legal expense in the form of advance disbursements, depending of course upon the magnitude of the caseload. Again, though, this is legitimately written off for tax purposes.

Using the $18,000 figure in our continuing example, some portion of that will not be recaptured in the first year of the system and the appropriate deduction will be taken. The books will show a loss for legal expense in that year. *But*, in year number two, many accounts from the first year will be recovered. With $300 per case being recaptured, the legal expense budget could be nothing or even be on the plus side. Thus, if in the second year twenty new cases go out, but forty come back, the lender is in a most favorable position indeed.

CONCLUSION

For those still leaning towards house counsel, let's assume the worst result in a foreclosure - that a case goes all the way to a foreclosure sale and no one "bids in". The lender is stuck with a parcel of property.

Even if the house is a disaster, outside counsel can pursue a deficiency judgment. If the house *can* be sold, the lender's price should include easily identifiable legal fees, something not readily done with house counsel. And, to show no loss to your department, you may pay off principal, department operating expenses, legal fees, and then attribute excess to earnings. There is much room to protect the bank.

Any decision concerning house counsel as opposed to outside attorneys is an area *not* to be taken lightly. The economic decision can be of major proportion and is worthy of an analysis in depth.