# SHOULD A LENDER WORRY ABOUT SETTLEMENT?

**By Bruce J. Bergman***

In a perfect world we suggest the answer as no; in our imperfect real world the answer is yes - a point slammed home by a case recently reported in these very pages.[1]

Mindful that in most foreclosures borrowers have no legitimate defense to the action (as when they simply defaulted in paying installments) it seems incongruous and ungracious to punish or imperil lenders who give borrowers a chance to save what the law would not otherwise allow to be preserved. There are of course some rare instances where a lender may not be so pure or blameless, or more commonly where creating a performing loan benefits the lender. In these latter situations the lender's motive may not be unalloyed generosity, nonetheless, the attempt to settle (or extend a settlement opportunity) to a borrower ought not to be an exercise laden with danger.

Commercial (as opposed to residential) mortgage lenders and servicers account for possible untoward results by prefacing settlement negotiations with a protection letter - the borrower confirming in writing that lender has reserved and preserved all its rights, that the lender has waived nothing and that no settlement or compromise arises until there is a mutually signed agreement to that effect.

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Size and volume of loans, however, tend to make such precautions less economical, and consequently less prevalent, in the residential mortgage arena. This leaves more room for courts to find some fault with events in the settlement process which can lead to judgments being vacated or foreclosure sales overturned.

First, it should perhaps be observed that when a lender errs at the foreclosure sale, courts seem loath to afford relief and there are more than a few examples of this.

In one case, a sale to be conducted on courthouse steps was moved into a dark lobby before normal court hours. A junior mortgagee missed the senior sale, had its interest extinguished, but was defeated in an effort to overturn the sale even when demonstrating that it had the funds to payoff the mortgage.[2]

In another, the foreclosing plaintiff erroneously stopped its bidding at $43,000, which permitted a relative of the mortgagor to purchase for $55,000. When the relative left for twenty minutes to obtain the bid deposit sum, plaintiff's representative realized that the correct instructions were to bid from $160,000 to $200,000 - a huge difference. Although conceding the lender's mistake to be unfortunate, the court nonetheless ruled the sale valid.[3] The lender was out of luck.

Like rejection of a lender's attempt to vacate a sale occurred when lender's bid mistakenly neglected to include $18,000 which had been advanced for taxes and insurance. Combining this unilateral mistake with a price differential of only three percent, the sale was upheld[4] (and the lender lost again).

An overriding point is that unilateral mistake, without much more, will not be a basis to vacate a sale and concededly, even borrowers have been rejected under such circumstances.[5]

But what if a court were to find that the mistake was really mutual - lender and borrower both erred. Then there could possibly be a basis to vacate the sale. This is what happened in the new case mentioned which, if it has value as precedent, could present peril to foreclosing plaintiffs - supporting the old aphorism that no good deed goes unpunished.

Here is a not uncommon scenario. On the eve of the foreclosure sale, lender and borrower agree that the loan can be modified. Lender thereupon sends the package of loan modification documents. Those papers are never signed and returned so the sale is conducted. A third party buys at the sale at a sum which will make the lender whole. Upon the borrower's post sale motion, however, the foreclosure sale is vacated. That is our new case.[6]

So how did a lender trying to accommodate a borrower get beaten up so badly? The answer (to be reviewed) suggests two things: one, some lenders may need to consider a change in procedures (or at least more meticulous care); two, being gracious and amenable can sometimes backfire. All this assumes that the new case is not purely and aberrationally fact related.

Lenders should understand that courts have many grounds upon which they can vacate sales, such as based upon equity and fairness, or mistake, among others. In the case at issue, the court concluded that relief could be granted if the borrower was led to believe that the sale would be cancelled or postponed pending consummation of the loan modification or if the borrower never received the loan modification package.

The court's view of the facts then hurt the lender. It found that the borrower *was* allowed to believe that the sale would not be conducted because of the oral agreement to modify the loan. Although the borrower was specifically notified of the foreclosure sale, the court found no warning to the borrower that if the documents were not signed and returned in time the sale would go forward. (Requesting a response within 48 hours and emphasizing urgency was deemed insufficiently explicit.) It was reasonable therefore (the court decided) for the borrower to assume that all would be well while things were pending.

As to delivery of the loan modification package, the borrower claimed she never received it. The servicer, though, sent it by UPS nine days before the sale and the carrier was able to attest to delivery the next day. But there was an unexplained discrepancy in the carrier's records whereby the package was noted to have arrived at the nearby distribution center at precisely the time it was delivered to the borrower (9:31 a.m.).

Because the borrower had a pattern of consistent conduct in contacting the servicer endeavoring to elicit settlement, and because the borrower asserted she could have readily staved off the foreclosure sale via a bankruptcy filing had she thought anything was amiss, doubt was raised (the court believed) regarding delivery of the loan modification package.

In the end, the court found a pattern of mutual mishap which created a question about the fairness of the sale, observing that the servicer didn't contact the borrower after it sent the documents (but why would it have been bound to do so?), failed to notify her that they were sent (but if sent they would arrive and borrower would know it) and neglected to ascertain receipt (how often do overnight delivery services fail?). From the borrower's side, she didn't contact the servicer searching for the loan documents or checking on the foreclosure sale status. Borrower mistakenly assumed that the sale was postponed while the plaintiff was found to make no assumptions at all - which seems appropriate. When borrowers ignore correspondence, which so often happens, there is nothing servicers can do. (We all remember the hackneyed "you can lead a horse to water...")

Finally, the court held that the servicer's failure to particularly tell the borrower that if the documents were not returned by a certain date the foreclosure sale would go forward allowed the borrower to continue "her misapprehension and neglect" - the recited confluence of events said to result in a forfeiture which was inadvertent and unfair.

This is all rather bizarre from a mortgage lender or servicer's point of view. After all, how much does a servicer have to do to create a settlement? Here, the servicer agreed to the modification and sent the papers. It had a valid judgment of foreclosure and sale and had a sale date scheduled. The borrower needed to act. Inaction or inattention is what often puts borrowers in this unenviable position in the first place so it is hardly surprising when a defaulting borrower returns to his or her inexplicable slumbers.

It is not that what the court did was irrational. But the decision does not seem to consider the real world of servicing - and the role of neglectful borrowers. And it is overly sympathetic to the borrower here under circumstances that arguably don't call for such largesse.

So we return to the possible message. Eve of sale settlements are fraught with more peril than others. They may not always be so productive. If the mortgage lender or servicer nevertheless feels compelled to entertain a settlement, they need to be very clear and specific. They should set time limits and recite the terms. Mortgagees may even want a signed acknowledgment of those time dictates, in advance of the settlement, if time permits. Will such precautions save the day? Maybe.

1. *Fleet v. Galati*, N.Y.L.J., Mar. 23, at 19, col.3 (Sup. Ct., Nass. Co., Winslow, J.).

2. *Long Island Sav. Bank of Centereach v. Jean Valiquette*, 183 A.D.2d 877, 584 N.Y.S.2d 127 (2d Dept. 1992), *Citing Weil v. Laube*, 134 Misc. 454, 235 N.Y.S. 14.

3. *Crossland Mort. Corp. V. Frankel*, 192 A.D.2d 571, 596 N.Y.S.2d 130 (2d Dept. 1993).

4. *Jutkowitz v. H&L Attel Realty Corp*., N.Y.L.J., Aug 12, 1994, at 26, col.3 (Sup. Ct., Nass. Co., Lockman, J.). The lender-plaintiff argued to no avail an aggregation of other errors: sale conducted two days beyond the statutory period and failure to adhere to posting requirements.

5. *Dime Sav. Bank of New York v. Zapala*, 255 A.D.2d 547, 680 N.Y.S.2d 665 (2d Dept. 1998).

6. *Fleet v. Galati, supra* at note 1.