REPRINTED FROM

SERVICING MANAGEMENT

THE MAGAZINE FOR LOAN SERVICING ADMINISTRATORS ■ VOL. 8, NO. 9 MAY 1997

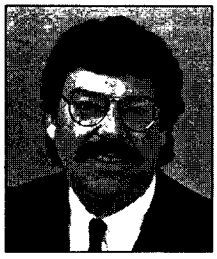
FORECLOSURE

You Can Sue On The Note...

...In Certain States, But Consider Carefully What You Might Be Forfeiting

BY BRUCE J. BERGMAN, © 1997

The subject is "election of remedies" and the technical aspects of the subject, both around the country and in New York, are obscure and complex.



Bruce J. Bergman

But as a practical matter, they are of potential significance to a mortgage holder or servicer. A brief review of background and the relationship to a new case will highlight the importance.

In many states, this is called the "one action rule." In New York, it is better known as the "election of remedies." Remember that when a borrower signs (more accurately, executes) a mortgage note (or bond), he promises to pay a monetary obligation. Security for that promise is execution of a mortgage - the pledge of property in support of the promise to pay.

In judicial foreclosure states, quick reference to the two basic documents - the note and the mortgage - reveal dual paths available to a mortgage holder:

- suit on the note, the promise to pay (referred to as an action at law); or
- foreclosure of the mortgage (referred to as an action in equity.)

The problem in New York, and many other one action rule states, is that statute prohibits a mortgagee from pursuing both remedies at the same time. Would a mortgagee really want to start two separate suits? Probably not, but sometimes, circumstances create the dilemma (which is just what happened in the new case, but more on that in a moment).

A good idea, perhaps

Suppose, for example, that the mortgaged property is worth less than the debt due. At the same time, though, the mortgagors, or guarantors, if there are any, have readily reachable assets; that is, they could pay a money judgment. Suit on the note would be a good idea.

Then there is the situation where environmental problems at the property mitigate against foreclosing upon it. Or, a lender knows that a foreclosure could be quite lengthy, but a suit on the note is likely to proceed quickly, and the borrowers have some assets. Again, suit on the monetary obligation looks appealing.

If (in New York) a mortgagee opts to sue on the note, but for whatever reason decides later that it wasn't such a good idea after all, if a judgment has been obtained, institution of a mortgage foreclosure is barred until the judgment is returned fully or partially unsatisfied - a possibly time-consuming effort.

With those basic principles in mind, observe a lender's dilemma under these facts, found in Valley Sav. Bank v Rose, A.D. 2d, 646 N.Y.S.2d 349 (2d Dept. 1996):

Bank loans $300,000 to corporation in New York secured by a guaranty and mortgage from the corporation's principals, the Roses. The Roses later sued the bank in New Jersey. The bank counterclaims for all sums due it, including the $300,000 mortgage. Judgment is awarded the bank for some $714,000.

Thereafter, the Roses file a Chapter 7 bankruptcy petition in New York. The Roses' unsecured debts are ultimately discharged, prior to which the bank has the automated stay lifted to commence a foreclosure upon its mortgage.

What's the problem?

The problem should be apparent. The bank has a judgment, but has never endeavored to execute upon it. Because the judgment has not been returned fully or partially unsatisfied, there is an election of remedies problem and it looks like foreclosure is excluded. That was the ruling of the lower court, notwithstanding the untenable dilemma it imposed upon the mortgagee.

Bruce J. Bergman, author of the two-volume treatise, Bergman on New York Mortgage Foreclosures, Matthew Bender & Co. Inc. (Rev. 1996), is a partner with Certilman Balin Adler & Hyman in East Meadow, N.Y., outside counsel to a number of major lenders and servicers, and an adjunct associate professor of real estate with New York University's Real Estate Institute, where he teaches the mortgage foreclosure course. He is a member of the National Foreclosure Professionals and the American College of Real Estate Lawyers, and is on the faculty of the Mortgage Bankers Association of America's School of Mortgage Banking.

On appeal however, the bank was saved. Among other things, the appeals tribunal noted that the bank did not elect to sue in New Jersey and get a judgment. It was sued and was therefore obliged to raise its own claims. Next, any attempt by the bank to execute upon its judgment would have been futile because of the initial automatic stay occasioned by the Roses' bankruptcy filing. Finally, and most critically, after the foreclosure was begun, the Roses received a discharge in bankruptcy. Therefore, the money judgment was void (11 USC §524[1]) and no execution upon it was possible (11 USC §524[2]).

So, if the bank were precluded pursuant to otherwise applicable New York statute from foreclosing, it would be entirely stymied. In the end, the remedy at law - on the note - is effectively gone. Thus, there cannot and should not be a bar against the bank's foreclosure.

"Election of remedies" dictates can move in convoluted ways. But here, justice was clearly served. SM