AVOIDING WAIVER OF FORECLOSURE — THE LENDER'S HIDDEN ENEMY

by: Bruce J. Bergman

Introduction:

Mindful that foreclosure usually represents a conspicuously unpleasant last resort for many mortgage lenders, even the most benevolent recognize that in some instances, this remedy must be pursued. When that time arrives, a lender is best served by proceeding in as resolute a manner as possible in order to gain command over the foreclosure process and to proceed from a position of strength. Once having adopted that stance, a lender is able to do all that is necessary to protect its investment while at the same time retaining the power to be as gracious as it desires.

Initially, the leverage required to achieve the stated goals is obtained through acceleration — the exercise of the lender's option to declare due the entire balance of principal and interest. Except when a FNMA form of mortgage is used, in which event a lender is bound to accept arrears until a judgment of foreclosure and sale is rendered, a lender is otherwise free to reject arrears tendered after acceleration and instead proceed with the foreclosure. It **may** accept the arrears if it chooses to do so, but only upon its own terms. In any event, such acceptance should have a chastening effect upon future defaults.[1]

Mr. Bergman is a partner in the Garden City, New York law firm of Roach & Bergman and is counsel to a number of major lenders. He is an Adjunct Associate Professor of Real Estate with the Real Estate Institute of New York University, a member of the American College of Real Estate Lawyers and a frequent lecturer to bar associations and other professional groups. Portions of this article are adapted from his forthcoming book, **Bergman on New York Mortgage Foreclosures,** to be published in early 1990 by Matthew Bender & Co., Inc.

If acceleration is so important to a lender — and clearly it is — there should be both an awareness and avoidance of destroying that acceleration by waiver. In essence, some conduct by a lender, either prior or subsequent to acceleration which is inconsistent with demand for the full sum due on the mortgage can lead to a waiver of acceleration. (In turn, the lender could be held "estopped" to proceed with a foreclosure because it is deemed to have waived that right.)

If a lender sends an acceleration letter, and the act is then vitiated by a waiver, the result is at the very least unfortunate and productive of wasted effort, unnecessary expense and loss of control. The problem is greatly exacerbated, however, if this waiver defense surfaces after the foreclosure has proceeded for some time. Then, the lender/plaintiff has lost the case and is banished to pursuing the obstreperous borrower upon the next occasion of default.

Consequently, waiver is a realm fraught with possible peril for lenders. It is always convenient for a borrower to "claim" that the lender, or someone on its behalf, "told him" something or by conduct led him to believe that an obligation did not have to be honored. Although as a matter of law sympathy is not an element to be considered, experienced foreclosure practitioners can confirm that courts sometimes lean in favor of finding some way to avoid foreclosure, at least when a borrower's plight appears to merit compassion. That being so, lenders must be especially careful to avoid any action or documentation which could be construed as a waiver, presuming of course that lenders wish to maintain control over those accounts where reinstatement may be contemplated.

COMMON WAIVER SITUATIONS

Perhaps the best way to view the acts of a lender which can lead to waiver of the ability to foreclose is to separate the more apparent actions from those that tend to be obscure.

Aware that the minutiae of case law throughout the country can vary somewhat, nevertheless, there are some basic concepts. Once a lender has accelerated (whether by letter or starting a foreclosure action), acceptance of a check for any sum other than the **full** balance due on the mortgage is susceptible to being declared a waiver. Thus, if a borrower owes five months worth of payments and late charges, taking a check for one month, or two, or all the arrears, is a waiver of acceleration.

A lender's desire to hold such a check or checks and apply the sums to the mortgage is understandable and seductive, but is mistaken. When such remittances arrive, unless lender wants to assume the risk, they should be rejected and returned, preferably with correspondence so declaring. The letter serves to confirm the return lest a borrower argues that the checks never came back.

Some sharp borrowers will repeatedly send checks for portions or all of the arrears. Again, to avoid waiver, lenders must remain unswerving in returning all remittances each time they are submitted, always accompanied by the suggested letter for confirmation in the file.

While "accepting" a check assumes negotiating the instrument, there is danger even in merely holding the check for some period of time a court could construe as inconsistent with acceleration. What period of time falls into that category is difficult to discern. A few days would undoubtedly not present a problem. A few months probably would. Therefore, a submission of any sum less than full balance should be returned immediately, or at least, as soon as possible.

A permutation of this scenario applies to banks and other large institutional lenders who make second mortgage loans. Instead of mailing deficient sums to the mortgage department, some borrowers will make a payment of arrears to a branch. Mechanically, it is often impossible for large institutions to "flag" accounts so that tellers can reject such submissions. The result is that the payment is negotiated and a considerable period of time may pass until the money wends its way to a mortgage department, and even later to lender's counsel to initiate the rejection process. The best a lender can do is return the check as soon as circumstances allow. In the face of a challenge that the check was "retained" for an inordinate period, the lender should be able to successfully argue that it did all that it could to reasonably reject the payment.

A final recognizable area of danger with broad application is the possible penalty a lender can endure for a prior history of graciousness. A borrower subjected to foreclosure would likely suffer such action only after a record of tardiness. Since few lenders would ever foreclose the very first time a payment was one day late, it is apparent that some borrowers could argue that a particular lender had previously indulged late payments. If that prior forbearance can be found to have genuinely lulled the borrower into believing that late payments would always be tolerated, waiver of the right to accelerate and foreclose could be found. When encountering such a conundrum, the solution is for lender to send a letter specifically advising that late payments will not be accepted in the future and that the lender will insist upon strict adherence to the letter of the mortgage documents. Once a correspondence of that nature is sent, the lender will rid itself of this waiver problem if subsequent payments are indeed late.

HIDDEN WAIVER CASES

Less obvious than, for example, accepting arrears after acceleration, is the lender running afoul of a waiver (or estoppel) defense through entering into some "understanding" with a borrower.

To appreciate the point, observe that when a default reaches a certain level, be it two, three or four months in arrears (or whatever other breach might exist) a lender could refrain from anything other than allowing a lump sum reinstatement, or payment in full (if acceleration has already taken place) or cure of the breach if the default is of a non-monetary nature. Such a posture, however, fails to take into account genuinely sympathetic circumstances, public relations considerations, as well as relationships between lenders (lender's officers) and borrowers, any or all of which often present countervailing considerations.

So, as a practical matter, there are times when accommodations can, and indeed, should be made to borrowers. Those are business, not legal decisions, which must depend upon the special and disparate circumstances encountered. In short, "arrangements" are effectively unavoidable.

That such arrangements can be a source of considerable mischief for lenders is underscored by two cases of recent vintage in New York State, even though New York is one of the stricter jurisdictions when weighing the efficacy of acceleration for monetary mortgage defaults. The fact patterns of these two matters are enlightening and serve to provide a warning.

In the first of these, a mortgage loan was chronically in default. In a typical effort to save the borrower, the loan was restructured in an extension agreement with a more liberal repayment schedule. With the borrower still having difficulty honoring the obligation, the lender sent a letter agreeing to consider a still further extension, conditioned upon the borrower fulfilling certain conditions. When the borrower did not comply, a foreclosure was begun. When the borrower contested the foreclosure, the lender moved for summary judgment and was **defeated.**

The borrower argued that a lender's officer **told** him he did not have to do what the letter mandated. Because the mortgage modification agreement contained the usual language that the agreement could not be changed orally, the lender did not even deign to refute the claim of oral waiver, choosing instead to rely upon the documents. In the absence of refutation by the lender, the court found an oral waiver.

This case suggests immediately the very compelling necessity to refrain from oral repartee with a borrower. But if there **are** such discussions, the lender should be able to reduce them to some writings in a file which can then disprove the expected wild claims of a desperate borrower. That is sound advice which urges a way out of what would otherwise be a dilemma of common occurrence.

But a still later case portends further peril. For want of payment of three quarterly installments aggregating $8,500, a corporate mortgage went into default. The lender accelerated. The borrower and its individual guarantors sought negotiations with the lender, resulting in some agreement. The problem was that the lender's version of the agreement was diametrically opposed to the borrower's version.

The lender said that the understanding contemplated submission of $10,000 in escrow, pending sale of the property on a date certain, at which time the mortgage was to be satisfied. The borrower interpreted the settlement to mean that the payment was towards arrears in full, with the mortgage thereupon reinstated.

Upon a motion for summary judgment, this lender also lost its case. Significantly, the court observed that lender's correspondence emanating from the settlement negotiations "tended" to support its position. But in face of borrower's especially vigorous opposition, a question of fact sufficient to deny summary judgment was found.

If these arrangements or accommodations are a potential source of difficulty, how can deleterious consequences be avoided? The frightening but sage response is that they can never be avoided with complete certitude. The safeguard though — and one apparently not as obvious as it first appears — is to approach any forebearance with exceptional care.

If a lender is giving time to pay or cure a breach, it should not be left to purely verbal discussions. Exactly what the lender is or is not allowing should be reduced to **some** persuasively clear writing, be it a stipulation or a letter. Something done only orally leaves room for dispute, ambiguity and excess compassion from the judiciary.

Since it is not always practical to seek an attorney's aid at every state of a mortgage relationship, sometimes the lender must memorialize whatever the terms are to be. In that instance, the advice is to precisely set forth exactly what the borrower must do, when, and in what form. Then, address the precise consequences of failure to comply. If the writings are **clear,** there is much less chance for a later finding of waiver or estoppel.

In sum, the doctrine of waiver represents a potent and often overlooked enemy of the lender seeking to enforce overdue obligations. But consciousness of the pitfalls — and the solutions — can avoid most of the problems.

[1]For a more thorough exploration of the nuances and advantages of acceleration, see "Protecting the Loan — Aggression or Compassion," **NSMA Equity** 15 (September 1986); " Acceleration — The Key to Foreclosure," **NSMA Equity 5** (March 1987); "Tightening Your Mortgage Documents." **NSMA Equity** 5 (March 1987); "A lender's Guide to Success in Mortgage Foreclosure — A New Look," **NSMA Equity 2** (September 1988).