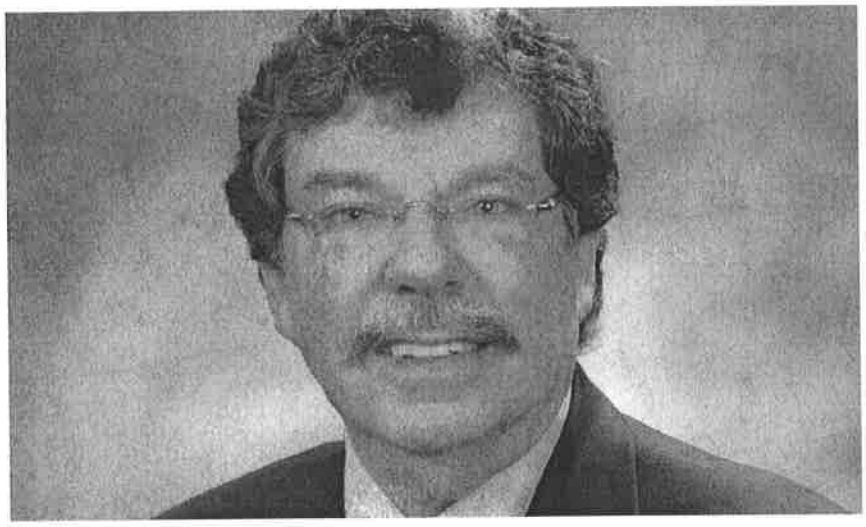
Lender's Choice in Naming Defendants Under Assault

By **Bruce J. Bergman** | November 28, 2017



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Cannot a foreclosing plaintiff choose who to name as a party defendant in a foreclosure action? In the absence of prejudice to the defaulting property owner, yes, although a recent holding of the Second Department tacitly suggests "no," but may not have addressed the actual controlling principles. In *NYCTL 2012-A Trust v. Phillip,* 145 A.D.3d 684, 43 N.Y.S.3d 96 (2d Dept. 2016), the court affirmed denial of an ex parte order of reference on the ground that the plaintiff refrained from serving tenants. This could be a dangerous precedent and can threaten the orderly progress of foreclosure cases in New York, actions already unduly burdened with delays and minefields.

What precisely did the case say, how might the ruling create problems, and what are the maxims urging that the holding may be off the mark?

Essence of the Case

This was a garden variety tax lien foreclosure upon a four-story building with five apartments per floor. Sundry junior lien holders were named as defendants and served, tenants were potentially included as "John Does" but not served, although the required notice to tenants was posted.[1] Upon ex parte application for an order of reference, the Second

Department affirmed the trial court's denial, holding that tenants are necessary parties (correct) and although non-joinder can be excused (correct), concluding nonetheless that judicial economy is best served by avoiding "piecemeal litigation... at the outset."

What distinct litigation was envisioned which would do violence to judicial economy is unclear, certainly not readily discernible. If the court just believed that judicial *discretion* should not be disturbed, the response urged here is that lack of citation in the ruling to applicable precedent militates against a role for discretion. Recitation of the suggested prevailing maxims and practicalities follows.

Tenants Already Protected

Rent Control or Stabilization. A noteworthy exception to the notion that a tenant is a necessary party defendant in a foreclosure action applies to the tenant benefiting from rent control or rent stabilization statutes. The rule is a creature of both statute [RPAPL § 1303(5)], and case law, the later providing that a judgment of foreclosure cannot abate a tenant's protection given by rent laws.[2] A foreclosure purchaser acquires title subject to the same disabilities which rent laws impose upon owners who acquire title by any other form of conveyance. Consequently, a foreclosure judgment does not deprive a tenant of the protection given by the restraints or eviction contained in emergency rent laws.[3]

Therefore, in a building where the tenants are rents protected—as was likely in this case, albeit not discussed—because both statute and case law bar possession to a foreclosure sale purchaser to the exclusion of a protected tenant, there appears no purpose to name and serve such a party. This further calls into question any concern about future litigation and its interference with judicial economy.

Other Tenants. Even if the residential tenants at a property in foreclosure are not rent protected, RPAPL §1303(5) still affords dispositive rights: the tenant can remain to the conclusion of any lease and if there is no lease, for 90 days after the new owner at a sale sends a further required notice.

This essentially renders meaningless (in most instances) any imperative to serve a residential tenant in a foreclosure; again it confirms no basis for concern about future litigation.

Necessary v. Indispensable

While a tenant is by definition a necessary party in a foreclosure action (although the dictates of RPAPL §1303 call this notion into question) that is not nearly as portentous or mandatory as it seems. That is so because there is a difference between a necessary party and an *indispensable* party.

One definition of a necessary party contemplates its limitation to those instances where the court determination will adversely affect the rights of nonparties;[4] citing the question as whether the nonparty may be inequitably affected by the judgment rendered in its absence.[5] Moreover, if a "complete determination" cannot be made without their presence, they can be brought in on motion.[6] For the protected tenants, the court determination would not adversely affect them, nor would the judgment

inequitably affect them in their absence, nor is a complete determination unavailable without them. Even more clearly to the ultimate point, and as a matter of law, while tenants are necessary parties to a foreclosure, they are not indispensable parties.[7]

Regarding the compelling result of the difference between necessary and indispensable, it is generally held that the absence of a necessary party in a mortgage foreclosure action simply leaves that party's rights unaffected by the judgment of foreclosure and sale.[8] That a party may be "necessary" does not make him indispensable to the validity of the foreclosure judgment.[9]

It has been held that where a tenant is not named as a party defendant, it does not render a foreclosure action defective,[10] nor would such a choice to refrain from naming a tenant impede the granting of summary judgment.[11]

Thus, as it is with any other party junior to the interest being foreclosed, failure to name a tenant merely leaves their rights unaffected[12]—hardly a deleterious consequence to the tenant. Of like outcome, if the foreclosed property is transferred subject to a lease, the tenant's obligations under that lease are not terminated by the foreclosure sale.[13] Accordingly, a purchaser at the foreclosure sale takes subject to the rights of a tenant not named in the action[14] which then served to ratify the lease.[15]

Choice, Prejudice

There is a very meaningful practical component that the decision under consideration unfortunately undermines; that is the foreclosing party's choice of defendants to name. In the end, it is the decision of the foreclosing plaintiff as to which defendants to name. Typically, the subject is not an issue, however, because the goal of the foreclosure is to have the property sold in the same legal condition as prevailed when the mortgage was originated.[16] Therefore, plaintiffs most often name all subordinate interests. Where there *is* a selection necessary, though, the only compulsion to name a necessary party (there is no debate about an indispensable party) is if its omission would be prejudicial to other parties.[17]

Regarding electing who to name, New York City, for example, in its tax lien foreclosure actions (pursued by a trustee) has traditionally employed a policy of not naming tenants and this was the practice long before the statutory protection for all residential tenants in foreclosure was created. As a matter of policy, the city prefers neither to cut-off tenants nor allow tenants to be evicted. If tenants are protected anyway, the choice seems moot, but the idea that constructive choice plays a role clearly emerges.

But there are other productive examples as well. If a property is more valuable with residential tenancies preserved—rather than the building vacated—a foreclosing plaintiff would refrain from naming and serving tenants, a right traditionally afforded.

In the commercial realm, the instance of a shopping center, a foreclosing lender would analyze, for example, a major anchor tenant. With a long-term lease, overages on sales payable towards rent and the ability to attract

traffic, such a tenant should remain, not have its lease extinguished, then to suffer eviction. The property is assuredly worth more with the anchor there rather than banished. Lenders would address such options for all tenants and have always assumed and understood that they could assure maximum bidding at the foreclosure sale in the process.

Yet another example is somewhat in the other direction. Suppose junior interest includes scores of judgment creditors and lienors with one very small subordinate mortgagee. The mortgage being foreclosed upon has been in existence for 10 years when the default ensued. The quantum of the subordinate mortgage is miniscule compared to the debt owed to the foreclosing party. After initiating the action, plaintiff determined that the subordinate mortgagee could not be located. A call to that mortgagee's attorney discloses that such potential party has not been seen by the attorney for years and is believed to be long out of business. The only way to obtain jurisdiction would be to publish the summons. That is expensive and time consuming and makes little sense in this case. The plaintiff opts to excise that mortgagee. If the junior mortgage was $5,000 and the mortgage in foreclosure was $900,000, that the junior survives the sale would not as a practical matter affect the bidding. Here, the plaintiff should not be ordered to maintain the inferior party.

Conclusion

Why, when no one opposed the ex parte order of reference application or protested the striking of the "John Does" in the *NYCTL* case, the court nonetheless feared future disruptive litigation is not at all apparent, certainly perplexing. Even were this judicial unease an actual, remote possibility, halting a case to insist that parties who could not be affected by the foreclosure must be served and maintained in the case augurs further confusion in this arena.

If tenancies are protected, as statute and case law confirm in this situation, there appears neither reason to include tenants in the case nor worry about eliciting later litigation. Even if in some cases tenants were subject to eviction after a foreclosure, there can be exigent reason not to name them —typically for the purpose of maximizing the value of the mortgaged premises at the foreclosure sale. If insisting upon certain defendants will diminish that value (burdening a purchaser with below-market long-term leases) then both mortgagee and mortgagor suffer. The lower the proceeds at the sale the less chance of a surplus and the greater chance of a deficiency.

In sum, unless non-service upon a defendant or defendants portends prejudice, a plaintiff's election naming defendants, or not, should remain.

ENDNOTES:

[1] RPAPL §1303.

[2] *Pisani v. Cominger*, 36 A.D.2d 593, 318 N.Y.S.2d 913 (1st Dept. 1971); *GCM Corp. v. Johnson*, N.Y.L.J., Nov. 5 1997, at 31, col. 3 (Civ. Ct., Housing Part, Kings Co., Birnbaum, J.) for a further review of the subject see 4

Bergman on New York Foreclosures §12.03[2], LexisNexis Matthew Bender (rev. 2017).

[3] *Drury v. Sidney Davies*, 116 N.Y.S.2d 118 (Sup. Ct. 1952). *See also Harlem Sav. Bank v. Cooper*, 199 Misc. 1110, 101 N.Y.S.2d 641 (1950); *Presprop Corp. v. Riveredge Holding Corp.*, 73 N.Y.S.2d 808 (Sup. Ct. 1947); *Da Costa v. Hamilton Republican Club of Fifteenth Assembly Dist.*, 187 Misc. 865, 65 N.Y.S.2d 500 (1946); *GCM Corp. v. Johnson*, N.Y.L.J., Nov. 5 1997, at 31, col. 3 (Civ. Ct., Housing Part, Kings Co., Birnbaum, J.)

[4] *Schulz v. De Santis*, 218 A.D.2d 256, 638 N.Y.S.2d 809, 1996 N.Y. App. Div. LEXIS 2051 (3d Dept. 1996), *citing Matter of Castaways Motel v. Schuyler*, 24 N.Y.2d 120, 125, 299 N.Y.S.2d 148, 247 N.E.2d 124.

[5] *Schulz v. De Santis*, 218 A.D.2d 256, 638 N.Y.S.2d 809 (3d Dept. 1996), *citing* CPLR 1001[a]; *Brookhaven v. Marian Chun Enters.*, 71 N.Y.2d 953, 528 N.Y.S.2d 822, 524 N.E.2d 143. See also, *L-3 Communications Corporation v. Safenet*, 43 A.D.3d 1, 841 N.Y.S.2d 82 (1st Dept. 2007), citing CPLR 1001(a); *Matter of Red Hook/Gowanus Chamber of Commerce v. New York City Bd. of Stds. & Appeals*, 5 N.Y.3d 452, 457, 805 N.Y.S.2d 525, 839 N.E.2d 878 (2005).

[6] *Gano v. Potter*, 105 Misc. 482, 173 N.Y.S. 528 (1918).

[7] See inter alia, *Wells Fargo Bank, N.A. v. Mazzara*, 124 A.D.3d 875, 2 N.Y.S.3d 553 (2d Dept. 2015); *Balt v. J.S. Funding Corp.*, 230 A.D.2d 699, 646 N.Y.S.2d 50 (2d Dept. 1996); *John Hancock Mutual Life Ins. Company v. 491-John Hancock Mutual Life Ins. Co.*, 220 A.D.2d 208, 632 N.Y.S.2d 10 (1st Dept. 1995); *Nationwide Associates v. Brunne*, 216 A.D.2d 547, 629 N.Y.S.2d 769 (2d Dept. 1995); *Marine Midland Bank v. Freedom Road Realty Associates*, 203 A.D.2d 538, 611 N.Y.S.2d 34 (2d Dept. 1994); *Scharaga v. Schwartzberg*, 149 A.D.2d 578, 540 N.Y.S.2d 451 (2d Dept. 1989).

[8] See inter alia, *Private Capital Group, LLC v. Hosseinpour*, 86 A.D.3d 544, 927 N.Y.S.2d 665 (2d Dept. 2011); *Glass v. Estate of Gold*, 48 A.D.3d 746, 853 N.Y.S.2d 159 (2d Dept. 2008); 6820 *Ridge Realty LLC v. Goldman*, 263 A.D.2d 22, 701 N.Y.S.2d 69 (2d Dept. 1999); *Nationwide Associates v. Brunne*, 216 A.D.2d 547, 629 N.Y.S.2d 769 (2d Dept. 1995); for further citation, see 2 *Bergman on New York Mortgage Foreclosures* §12.02[2], footnote 13, LexisNexis Matthew Bender (rev. 2017).

[9] See inter alia, *John Hancock Mutual Life Ins. Co. v. 491-John Hancock Mut. Life Ins. Co.*, 220 A.D.2d 208, 632 N.Y.S.2d 10 (1st Dept. 1995) (tenant); *In re Comcoach Corp.*, 698 F.2d 571 (2d Cir. 1983) (tenant); *Scharaga v. Schwartzberg*, 149 A.D.2d 578, 540 N.Y.S.2d 451 (App. Div. 2d Dept. 1989); *Polish Nat'l Alliance of Brooklyn v. White Eagle Hall Co.*, 98 A.D.2d 400, 470 N.Y.S.2d 642 (2d Dept. 1983).

[10] *Balt v. J.S. Funding Corp.*, 230 A.D.2d 699, 649 N.Y.S.2d 50 (2d Dept. 1996); *Flushing Sav. Bank FSB v. 509 Rogers LLC*, 32 Misc. 3d 420, 928 N.Y.S.2d 618 (Sup. Ct. 2011). See also, *276 W. 113 Funding, Inc. v. 113 St. Realty, LLC*, 2010 N.Y. Misc. LEXIS 1181 (Sup. Ct. Jan. 4, 2010)

[11] *John Hancock Mutual Life Ins. Company v. 491-499 Seventh Avenue Associates*, 220 A.D.2d 208, 632 N.Y.S.2d 10 (1st Dept. 1995).

[12] See *inter alia, Nationwide Associates v. Brunne*, 216 A.D.2d 547, 629 N.Y.S.2d 769 (2d Dept. 1995); *Marine Midland Bank v. Freedom Road Realty Associates*, 203 A.D.2d 538, 611 N.Y.S.2d 34 (2d Dept. 1994).

[13] *Davis v. Cole*, 193 Misc. 2d 380, 747 N.Y.S.2d 722 (Sup. Ct. 2002), citing *Metropolitan Life Ins. Co. v. Childs Co.*, 230 N.Y. 285, 230 N.Y. (N.Y.S.) 285, 230 N.Y. 285; 130 N.E. 295 (1921).

[14] *Markantonis v. Madlan Realty Corp.*, 262 N.Y. 354, 186 N.E. 862 (1933); *Metropolitan Life Ins. Co. v. Childs Co.*, 230 N.Y. 285, 230 N.Y. (N.Y.S.) 285, 230 N.Y. 285, 130 N.E. 295 (1921); *Scheidt v. Supreme Woodworking Co.*, 212 A.D. 179, 208 N.Y.S. 394 (2d Dept. 1925); *Harvey v. Mooney*, 168 A.D. 169, 153 N.Y.S. 268 (2d Dept. 1915); *Genuth v. First Division Ave. Realty Corp.*, 88 Misc. 2d 586, 387 N.Y.S.2d 793 (1976); *Dold Packing Corp. v. N.L. Kaplan, Inc.*, 37 N.Y.S.2d 390 (Erie County Ct. 1942), *aff'd*, 265 A.D. 1032, 39 N.Y.S.2d 776, 1943 N.Y. App. Div. LEXIS 6709 (4th Dept. 1943).

[15] *Home Life Ins. Co. v. O'Sullivan*, 151 A.D. 535, 136 N.Y.S. 105 (2d Dept. 1912).

[16] See discussion at 1 *Bergman On New York Mortgage Foreclosures* §2.02, LexisNexis Matthew Bender (rev. 2017).

[17] See discussion at 2 *Bergman On New York Mortgage Foreclosures* §12.05[2], LexisNexis Matthew Bender (rev. 2017).

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