

A New Look at RPAPL Section 1351 Relief — A Treat for Lenders*

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Introduction

To what should be the delight of mortgage lenders, a new case suggests a broadening application of the relief afforded by RPAPL §1351 in avoiding surplus money proceedings. *Liberty View Limited v. 90 West Associates*, N.Y.L.J., May 1, 1991, p. 22, col. 5 (Sup. Ct., New York Co. (Sklar, J.)). The decision holds that the presence of a third mortgage may not be an impediment to seeking §1351 relief on behalf of a second mortgagee!

For those well-schooled in this area, the portent of the cited thought should be apparent, although it will perhaps be less perceptible to others. To appreciate the significance, a look at surplus money proceedings, the initial use of §1351 and the new view should be enlightening.

The Surplus Money Proceeding

Though no doubt less frequently encountered in these distressed times, surpluses **do** emerge from some foreclosure sales. Thus, for example, if a house worth \$375,000 is encumbered by a first mortgage of \$200,000, there is a reasonably good chance that a foreclosure sale bidder would pay more than \$200,000 to own the dwelling.¹ Precisely how high the bidding would go is impossible to assess in a hypothetical situation — or in an actual case for that matter. Nonetheless, it could be opined that a bid of \$350,000 would be unlikely, while a bid of \$250,000 would not be beyond the realm of possibility. Whatever the number, anything over \$200,000 (with the example assuming such to be the sum owed to the foreclosing lender) is surplus — available to encumbrancers whose liens were extinguished by the foreclosure sale.²

Presupposing the existence of a surplus, claimants must analyze a combination of RPAPL §§ 1354, 1355, 1361 and 1362, which is sometimes a daunting exercise. When one plows through the maze of statutory authority,³ discerns the nature of surplus monies⁴ and then addresses the practice in a surplus money proceeding,⁵ it is discovered that the proceeding cannot be instituted less than three months nor more than four months after a referee's report of sale is filed.⁶ Even then, a motion is required to confirm the report of sale and appoint a referee. In turn, the referee serves notices, conducts a hearing and issues a report which must be confirmed by yet another motion. Only then are proceeds distributed, assuming no untoward delay in contemplating the relative priorities of the claimants. In short, if monies are disbursed from surplus within six months of the foreclosure sale, the recipient can be considered quite fortunate indeed.

The Relief of RPAPL §§ 1351 and 1354

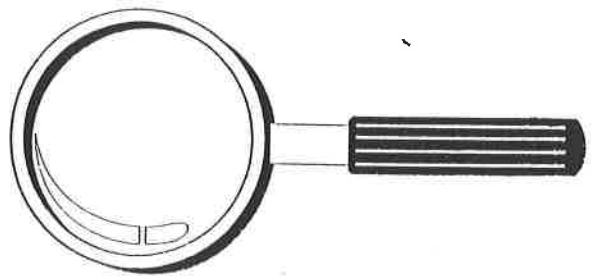
The burdens of a surplus money proceeding were

reduced in 1982 with the simultaneous passage of RPAPL §§ 1351(3) and 1354(3). The provisions empowered a referee to pay the sums due a subordinate mortgagee directly out of the sale proceeds without resort to a surplus money proceeding, if the judgment of foreclosure and sale so provided. The ability of the judgment to so provide, however, was conditioned upon the requirement that no more than one other mortgage existed on the premises.⁷

Procedurally, the subordinate mortgagee is required to cross-move against the senior's motion for judgment of foreclosure and sale and if no other party objects, the relief should be granted. As a practical matter, the procedural aspects are not nearly as expansive as circumstances would warrant, and practitioners have fashioned a number of approaches to avail themselves of the relief — all of which is another issue.

Although the procedure is often more cumbersome than the statutes would indicate, it is certainly a far more commodious approach to garnering surplus than the surplus money proceeding. The application of the relief, though, has always appeared somewhat limited, that is, confined solely to the situation of but two mortgages encumbering the premises.

The noted limitation, however, always seemed a bit askew. If a subordinate mortgage lender was to receive the most welcome benefit of avoiding a surplus money proceeding, why constrain the bounty merely because there happens to be yet another junior mortgage? At least one subordinate mortgagee could otherwise benefit. Although bereft of apparent basis, such is the mandate of the verbiage which had to be tacitly accepted — until now.



The New Approach

Liberty View faced this issue and carved out an exception, which may or may not be pervasive. The thrust of the decision was that existence of a third mortgage will not prohibit §1351 relief to a second mortgagee under

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certain circumstances, although it is not clear how confining those circumstances are to be.

In *Liberty View*, the question posited was whether a senior foreclosure judgment could provide for sale proceeds to be paid to the separately foreclosing second mortgagee, notwithstanding existence of a third mortgage on the premises. The answer was "yes," but based upon the following facts and analysis.

Liberty View was foreclosing a senior mortgage. R.H.Z. was simultaneously foreclosing its wraparound second mortgage. The same referee was appointed in both actions and application for judgment of foreclosure and sale was simultaneously made by both foreclosing lenders. The senior judgment provided for payment directly to R.H.Z. of any surplus without necessity to pursue a surplus money proceeding. The request for relief was founded upon RPAPL §1354(3).

The parties were aware, however, of RPAPL §1351(3), which authorized the remedy only if the court was satisfied that no more than one other mortgage existed on the premises. With neither court nor counsel finding case law authority to resolve the dilemma, examination of the bill jacket ensued in an effort to glean the legislative intent.

Both a letter from the Assembly co-sponsor of the legislation and the original memorandum in support of the bill essentially discussed the streamlined procedure intended to provide recompense to a subordinate mortgagee while avoiding a surplus money proceeding. No comments were addressed to the limitation that there be no other mortgage on the premises besides the senior and the junior. The court then placed emphasis upon the authorization of RPAPL §1354(3) permitting the officer conducting the sale to remit proceeds to the subordinate mortgagee after deduction of certain expenses.

Combining the cited sources, the court offered three grounds to grant the requested relief. First, it found the history clear that legislative intent was to pay a second mortgagee without the delay and expense that a surplus money proceeding would engender.

Second, and somewhat cryptically, the court stated that:

"...these cases (the confluence of the first and second foreclosures reaching judgment at the same time) provide a unique circumstance different from merely making a motion in the *Liberty View* foreclosure. Here R. H. Z., which is second in priority only to *Liberty View*, has instituted its own foreclosure proceeding and, in the ordinary course, is now settling, upon notice, its judgment which provides for payment to it. As a plaintiff, R. H. Z. comes within the literal terms of (section) 1351(3) RPAPL. Since R. H. Z. is a plaintiff, the holder of the third mortgage, under these circumstances, presumably could have moved in the R. H. Z. foreclosure for payment to it." (parenthetical material added)

The court's third point was that no objection had been

presented by anyone. Finding, in conclusion, that the separate foreclosure having ripened into judgment was a special circumstance, the §1351 relief was granted.

What Does It All Mean?

On behalf of the lending community, this writer would prefer to urge that this case dispositively banishes from consideration the problem of a third mortgage intercepting an award of §1351 relief. That certainly seems like a good idea which, both technically and practically, would do neither harm nor mischief to anyone's position. But is it correct, and will it resist further judicial scrutiny?

Because presumably §1351 relief would never be granted if it violated any priority in claiming against surplus monies, it is somewhat difficult to imagine when anyone would object. If that is so, it may be a long time before anyone ever deigns to assault the principle enunciated in *Liberty View*. But that still doesn't confront the validity of the underlying proposition.

The real problem is convincingly discarding the language of RPAPL §1351(3) requiring the court to be satisfied that no more than one other mortgage attaches to the premises. Although the legislative history focuses on the worthy goal of speedily compensating a subordinate mortgagee, its neglect to discuss the "no other mortgage" proviso doesn't necessarily render it meaningless. Either the language has a purpose or it doesn't.

The court, in part, avoided confronting that point by emphasizing the proffered unique nature of the circumstances encountered. Finding senior and junior mortgagees at the point of judgment simultaneously may be happenstance, but it is hardly so singular an occurrence.

In the end, it is evident that the judge desired to do what was assuredly sensible and amenable. It ought to be the status of the law. Whether it is, though, may just coincide with the length of time this decision remains unassailed.

Endnotes

1. The point is essentially the same in principle if the example was a shopping center worth \$37,500,000 encumbered by a \$20,000,000 mortgage.
2. For a more detailed discussion of claimants to surplus monies, see 2 *Bergman On New York Mortgage Foreclosures* §35.03 (Matthew Bender 1990).
3. See 2 *Bergman On New York Mortgage Foreclosures* §35.01 [1] (Matthew Bender & Company, Inc. 1990).
4. *Id.*, §35.01 [2].
5. *Id.*, §35.02.
6. RPAPL §1355(2).
7. §1351(3) — If it appears to the satisfaction of the court that there exists no more than one other mortgage on the premises which is then due and which is subordinate only to the plaintiff's mortgage but is entitled to priority over all other liens and encumbrances except those described in subdivision 2 of section 1354, upon motion of the holder of such mortgage made without valid objection of any other party, the final judgment may direct payment of the subordinate mortgage debt from the proceeds in accordance with subdivision 3 of section 1354.

§1354(3) — The officer conducting the sale after fully complying with the provisions one and two of this section and if the judgment of sale has so directed shall pay to the holder of any subordinate mortgage or his attorney from the then remaining proceeds the

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amount then due on such subordinate mortgage, or so much as the then remaining proceeds will pay and take the receipt of the holder, or his attorney for the amount so paid, and file the same with his report of sale.

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