

Forewarned: Legal Fee Clause

For Pre-1991 Mortgages, Recovering Costs Can Be Tricky — So Read Those Documents

BY BRUCE J. BERGMAN

© 1995, Bruce J. Bergman

This one can't be repeated too often: A lender's or servicer's available legal fees are being lost in mortgage foreclosure cases. Why? Read on. But, wait: Help has arrived!

The Fannie Mae/Freddie Mac form arguably did not provide legal fees to a lender if the case proceeded to a conclusion. When the form was revised in October 1991, the problem was solved - at least when a mortgage of that vintage or newer will be the subject of a foreclosure.

Although this should have consistent application in all judicial foreclosure states, such as New York, a foreclosing lender can and should be allowed to recoup its legal fees in the



Bruce J. Bergman

foreclosure action. This is radically different than most other litigation, because the American rule is that the parties to a suit bear their own legal expenses.

That general rule is changed, however, if either statute or contract authorizes legal fee reimbursement. Although no statute in New York requires legal fees to be paid by one party to the other in a mortgage foreclosure case, contract - that is, the mortgage itself - can so provide.

In plainer language, if a mortgage holder wants the opportunity to be reimbursed for the sums it pays counsel to prosecute the mortgage foreclosure action, the mortgage should say so.

Crafting a clause

How difficult is this to accomplish? The ready and obvious answer is, not difficult at all!

A sentence as simple as this will do nicely: "In the event this mortgage shall be foreclosed, the mortgage holder shall be awarded reimbursement for reasonable legal fees." There are myriad other ways to express the same thought. Other versions may be lengthier and more elaborate, but the ease of completing the task is quite apparent.

Here are a few other concepts, just to round out this important subject, before coming to the heart of the dilemma:

■ While a legal fee clause in a mortgage is effective, if the language is only in the mortgage note (or bond), it may be insufficient to support payment of legal fees.

■ If attorneys' fees are to be recouped, the amount is decreed by the court and made a part of the judgment of foreclosure and sale. (That is so in New York. In your state, it could

appear in a different legal paper.)

■ How much a lender or servicer has paid or has agreed to pay its counsel is not the measure of the reimbursement. The award is based solely upon "reasonableness".

■ Sometimes courts are disconcertingly frugal when assessing legal fees and even though there is not authority for it (when a legal fee clause is in the mortgage), judges occasionally decline to make the award.

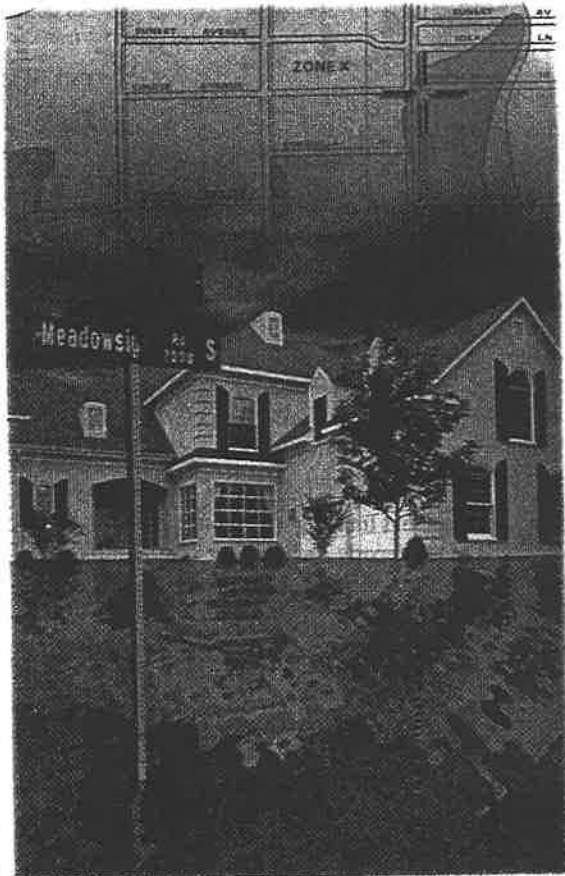
What's the problem?

If it is so effortless to insert a legal fee clause into a mortgage (and it really is), where then is the problem?

The response is, the draftmanship of the standard Fannie Mae/Freddie Mac form of mortgage as it existed for so many years.

Because a significant percentage of

continued on page 40



When Two Rivers Meet, the Current Gets Stronger

NATIONAL FLOOD INFORMATION SERVICES, INC.,
an industry leader for flood compliance,
and

CHICAGO TITLE AND TRUST COMPANY,
the nation's largest title insurance organization,
have combined to form the nation's strongest comprehensive flood
determination company.

Since 1988, NFIS has offered the mortgage banking industry a clear channel to nationwide flood determinations and census tract information.

Now the confluence of these two companies will ensure continued powerful delivery of guaranteed compliance, and offer a single source for a complete line of mortgage service products delivered by premier automated systems.

For more information on developing your compliance strategy, please call:
800-432-6347



Developing Comprehensive Compliance Strategies

National Flood Information Services, Inc.
1521 N. Cooper Street, Suite 400
Arlington, Texas 76011
Skymark Tower

A Wholly-Owned Subsidiary of Chicago Title and Trust Company

Life of Loan Portfolio Monitoring FloodStat Automated Ordering HMDA/Census Tract Information

Transfer Tax Rule: It's New, Saves \$\$\$

A change in New York law which reduces the real estate transfer tax paid by foreclosing lenders is welcome news. According to the new rule, the transfer tax paid by a lender who takes back a foreclosed property can now be based upon market value rather than the judgment amount.

For many years, New York has had a transfer tax on real estate of \$4 per \$1,000 of consideration. The seller, not the buyer, is obligated to pay the tax, however a contract can shift the obligation for the tax to the purchaser.

But what about a foreclosure situation? There, a foreclosing plaintiff (typically, the lender or servicer) has been forced to suffer the time, annoyance

and expense of a foreclosure action that is sometimes dragged out because of repeated bankruptcy filings and other legal mayhem. When finally the foreclosure pushed to a conclusion, no one bid at the foreclosure sale. And why should they? The accrual of interest and all other costs can create a mortgage balance of double that of a property's market value.

Until a few months ago, the obligation in New York to pay the transfer tax was, of course, upon the lender and servicer - the lone bidder in such situations. The bid price on the above example might have been a few hundred dollars, but the law imposed a tax upon what the judgment said was due on the mortgage - at the rate of .004% per

\$1,000. The lender paid the transfer tax rate (say, \$1,600 on a \$400,000 judgment) for the privilege of completing a foreclosure and taking back a house worth less than the debt - a property it never wanted in the first place.

The State of New York, heeding the entreaties of the lending community, amended the law and, in turn, provision was made for a supplemental tax form to accompany the deed (form TP-584-1). Now, for a conveyance pursuant to foreclosure - and so long as the loan is in recourse - the tax can be computed upon the fair market value of the premises rather than the full debt (\$800 on a \$200,000 property rather than \$1,600 on a \$400,000 judgment for example).

Depending on the number of New York foreclosures in one's portfolio, the law change could have a dramatic effect on foreclosure losses.

As a practical matter, any lender or servicer should expect to have an appraisal to support market value. Otherwise, there would be little choice but to base the tax on the judgment amount. Does this mean a servicer must order an appraisal for every foreclosure sale? No, but it is something to consider where a shortfall is both clear and significant.

The new form also accommodates changes in ownership for creation of owned real estate subsidiaries, as well as addressing co-op shares.

Bruce J. Bergman

continued from page 38

mortgage paper is sold on the secondary market, there is a frequently irresistible compulsion to use this form. Among the pre-1991 form's many shortcomings (from a lender's point of view) is the coverage of legal fees.

If a defaulting borrower wishes to reinstate, the mortgage clearly obliges the payment of legal fees, with this lucid language from paragraph 18 (Borrower's Right To Have Lender's Enforcement Of This Security Instrument Discontinued), subsection (c), imposing this condition:

"I pay all of lender's reasonable expenses in enforcing this security instrument including, for example, reasonable attorneys' fees...."

There is no doubt about the cited language. But where reinstatement or satisfaction is not the issue, where instead the foreclosure proceeds to judgment and when legal fees would be assessed if available, precision disappears and

the best that is left may be ambiguity.

Pre-1991 provisions

In the pre-1991 Fannie Mae/Freddie Mac mortgage form, there are only two provisions which seem to apply to the legal fee equation.

One is non-uniform covenant 19 (Lender's Rights If Borrower Fails To Keep Promises And Agreements), the second paragraph which reads as follows:

"If lender requires immediate payment in full, lender may bring a lawsuit to take away all of my remaining rights in the property and have the property sold. At this sale lender or another person may acquire the property. This is known as 'foreclosure and sale.' In any lawsuit for foreclosure and sale, lender will have the right to collect all costs allowed by law."

This looks like the portion of the mortgage which would apply to counsel fees in foreclosure. The shortcoming is that payment is provided solely for "all costs allowed by law."

Law in New York does not contemplate legal fees in a mortgage foreclosure action. Thus, it's up to the mortgage contract. But the mortgage contract refers back to law so, it can be seen, that unending circularity short circuits the lender. This clause will not support legal fees. (Unless

Bruce J. Bergman, a partner with Certilman Balin Adler & Hyman in East Meadow, N.Y., is outside counsel to a number of major lenders and servicers and author of the two-volume treatise, Bergman on New York Mortgage Foreclosures, Mathew Bender & Co. Inc. (Rev. 1995). He is a member of the National Association of Foreclosure Professionals, the American College of Real Estate Lawyers, an adjunct associate professor of real estate with New York University's Real Estate Institute, where he teaches the mortgage foreclosure course, and on the faculty of the MBA's School of Mortgage Banking.



**Peak Performance
For Your
Delinquent and
"Odd Lot"
Loans**

- ◆ Servicing small and large portfolios (1-100)
- ◆ Specializing in B & below paper
- ◆ Risk free "spread basis" fee structure
- ◆ Foreclosure claim processing & management
- ◆ REO Nationwide Network

Old Dominion offers asset management at its best - upgrading the quality of the portfolio, lowering delinquencies to acceptable percentages with specialized services. Old Dominion prides itself in curing the problem professionally since 1977.

OLD DOMINION
FINANCIAL SERVICE, INC.

804-285-6166
FAX 804-285-2442
David Silver
8010 Ridge Road, Ste. F • Richmond, VA 23229

TO GET ON TRACK WITH YOUR SUB-SERVICING REQUIREMENTS...

When it comes to servicing and sub-servicing loans, we have a coast to coast reputation for excellence, diversity, flexibility, and responsiveness supported by state-of-the-art automated systems.

A subsidiary of the nation's 3rd largest homebuilder, we are ranked among the largest servicers in the country.

If you need someone to trust, just call Ryland Mortgage Company.

...JUST TURN TO THE COMPANY WITH THE TRACK RECORD.

- **DIVERSITY**—Our portfolio consists of a wide variety of products, including more than 200 different ARM products. We also offer electronic and customized reporting, mortgage solicitation, portfolio valuations, and REO management.

- **FLEXIBILITY**—Select a full range of loan administration services, or just some of our functions.

- **RESPONSIVENESS**—State-of-the-art call management system enables immediate and efficient response to customer inquiries.
- **CUSTOM PROGRAMS**—We tailor sub-servicing programs to meet your specific needs.

**RYLAND
MORTGAGE**

To find out more about our truly customized service and flexible fees, call Jerry French at (410) 715-7677 today or write to us.

RYLAND MORTGAGE • 11000 Broken Land Parkway • Columbia, MD 21044

provision for foreclosure legal fees in your state is found in statute, you have the same dilemma.)

The second provision

The only other provision holding any promise is paragraph 7, inopportunistically entitled: "Lender's Right To Protect Its Right In The Property: Mortgage Insurance." The first portion of that paragraph reads:

"If: (A) I do not keep my promises and agreements made in the Security Instrument, or (B) someone, including me, begins a legal proceeding that may significantly affect Lender's rights in the property (such as a legal proceeding in bankruptcy, in probate, for condemnation or to enforce laws or regulations), Lender may do and pay for whatever is necessary to protect the value of the property and Lender's rights in the property. Lender's actions may include appearing in court, paying reasonable attorneys' fees and entering on the property to make repairs. Lenders must give me notice before Lender may take any of these actions. Although Lender may take action under this paragraph 7, Lender does not have to do so."

That language doesn't sound like it was designed to provide legal fees to a foreclosing lender (a conclusion some judges are reaching with increasing frequency), except if broken down into its elements in this way:

"If: ... I do not keep my promises and agreements made in the security instrument ... Lender may do and pay for whatever is necessary to protect Lender's rights in the property. Lender's actions may include appearing in court, paying reasonable attorneys' fees ..."

Now it appears as if the mortgage drafter intended this verbiage to cover legal fees if a borrower defaults and a foreclosure ensues. Stated in the words of the paragraph, if the borrower fails to keep a promise and the lender protects its rights.

So, what's the point?

Here's the ultimate predicament and the lament of this review.

The portion of the mortgage which is supposed to address legal fees in foreclosure (paragraph 19) clearly fails. And that is the place where it should be dealt with.

The only other place a lender or servicer might be saved can readily be interpreted to apply to protecting the mortgage and the property from third party assaults - not to fund attorneys' fees in a foreclosure case. And if the drafter of the mortgage wanted a foreclosing lender to receive a counsel fee award, it would have been an effortless task. Either the mortgage's author egregiously blundered, or never meant to so benefit the lender.

In the end, the true interpretation is whatever a judge says it is in a particular case.

Sadly for lenders and servicers, cases where the ruling is against granting legal fees are on the rise. Thus, if the mortgage being foreclosed is the Fannie Mae/Freddie Mac form in use before October 1991, collection of legal fees - if the action goes to a conclusion - remains problematical.

The fall of 1991 brought a welcome change. Paragraph 21 - the cure letter provision - contains this enlightened verbiage in its second paragraph:

"If lender requires immediate payment in full, lender may bring a lawsuit to take away all of my remaining rights in the property and have the property sold ... In any lawsuit for foreclosure and sale, Lender will have the right ... to add all reasonable attorneys' fees to the amount I owe Lender, which fees shall become part of the sums secured."

Problem solved - for newer mortgages, anyway. For vintage documents, the dilemma persists. **SM**

SCANNING THE HORIZON?



Document imaging is no longer a luxury that the mortgage industry can afford to do without.

In today's market, managing large amounts of paper is a major contributor to the rising cost of mortgage lending and servicing. In fact, industry studies estimate that over 90% of the information used in business is still stored off-line, on paper -- making access to information difficult, time consuming and expensive. In short, paper is threatening the profitability, productivity and future of the entire mortgage industry.

Fortunately there is MECA from American Security Group.

The MECA Image Business Center offers a wide array of out source document management services, designed exclusively to serve the needs of the mortgage industry. Through the use of advanced technologies, state-of-the-art facilities, and a professional staff, MECA makes document imaging easy and affordable.

MECA services are performed both on and off site, and have been used by leading mortgage lenders and servicers to facilitate bulk transactions, back-file conversions, loan servicing, due diligence, ARM audits, and more. Best of all, with MECA, clients are not required to have an in-house system to take advantage of this important technology.

Call the MECA Image Business Center today, and discover what many already know is a more profitable and productive way of doing business.

Don't just scan the horizon ... be a part of it.

MECA
IMAGE BUSINESS CENTER
(800) - 253 - MECA

State of the Art Management of your Default Loans

Bankruptcy • Foreclosure
REO • Claims Management
Workouts

(Interfacing available for most Servicing Systems)

DRI Management Systems

4121 Westerly Place, Suite 201, Newport Beach, CA 92660

(714) 553-1440 FAX (714) 553-0757