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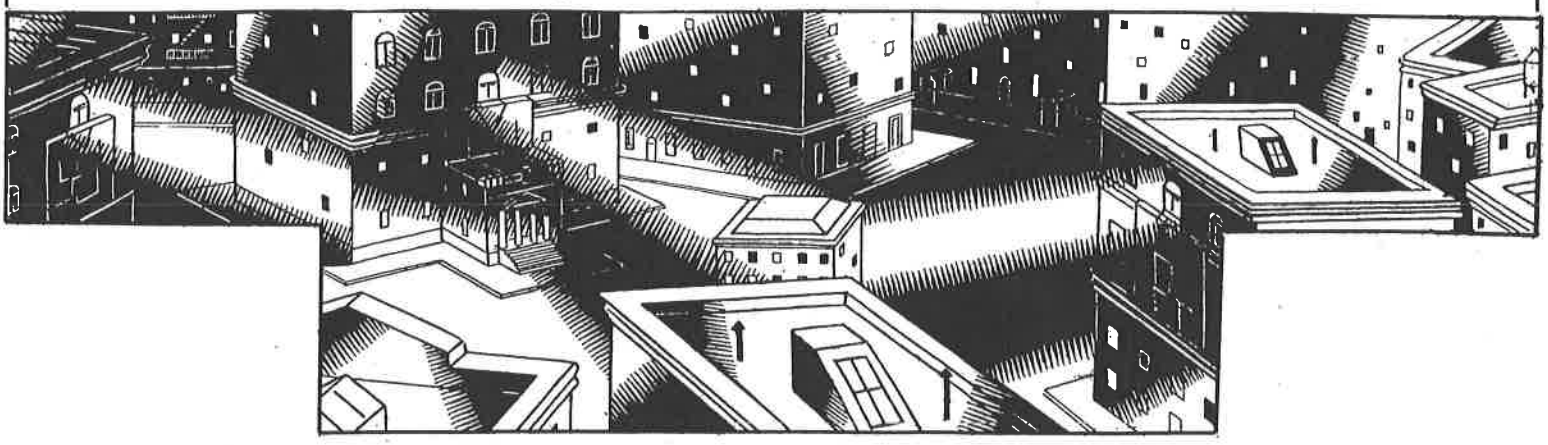
REAL ESTATE UPDATE



'Mariani' Scenario

A Perfect Anomaly: Deficiency vs. Judgment by Confession

THE TITLE of the piece sounds crushingly technical. But as arcane as it appears to be, in these creatively troubled times of new approaches to workouts and the garnering of protection for lenders, the subject possesses considerable practical application.

Found among the crannies of foreclosure law and practice are the rules for pursuing the deficiency judgment and, if anything more obtuse, the precepts of election of remedies. Formidable though each area is, one could surmise that their paths had long ago clearly intersected, resolving whatever inconsistency or clash there might have been between them. That seems perhaps not to be so, however, and jarring testament to that, sure to be alarming to some lenders, is the decision in *Mariani v. J.K.I.F Management Inc.*, ___ Misc.2d ___, 602 NYS2d 84 (1993).

Well thought out and coherently presented, the case proposes the arguably unsettling notion that a foreclosing lender who first licitly obtains a confession of judgment loses the ability to enforce that otherwise valid judgment if a subsequent deficiency is not seasonably pursued.

As if by alchemy, that which once existed vanishes. Arguably, the Legislature has never taken that position, at least not with any precision. One apparently forgotten case may have addressed the issue, but it is not certain.

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'Mariani'

Here is the *Mariani* scenario. Corporation borrowed $185,000, with the debt guaranteed by an individual, secured by a mortgage upon guarantor's property. Additionally, the guarantor supplied an affidavit which would permit entry of a confession of judgment at any time.

Default on the loan ensued and the lender (plaintiff) filed a confession of judgment for almost $258,000, the balance benefitting from a high rate of interest. An attempt to execute on the judgment proved fruitless and it was returned unsatisfied — a prerequisite to foreclosure of the mortgage given as security for the obligation. A year later, the foreclosure was instituted, resulting in a foreclosure sale at which the plaintiff was the sole bidder, for the nominal sum of $100. (The court noted that the bid was assigned to a third party for an amount not specified, but characterized as "substantial.")

No deficiency judgment was pursued. Founded upon the neglect to seek a deficiency, the guarantor argued that receiving the

property thus constituted full satisfaction of the debt. Accordingly, the guarantor posited that the confession of judgment must be set aside. The court granted the guarantor's motion and discharged the money judgment.

Competing Mandates

Understanding this theme requires an overview of the competing mandates — those attendant to election of remedies and those attaching to deficiency judgments.

First as to election of remedies,[1] it is both clear and well settled that the holder of an obligation and mortgage has two remedies. Either he may proceed at law and sue for judgment on the monetary obligation, or proceed at equity and foreclose the mortgage.[2] And the mortgage holder cannot be divested of this choice by any unilateral act on the mortgagor's part.[3]

Statute addresses the subject in RPAPL §1301. Although the nuances are expansive, for present purposes, RPAPL §1301(1) provides that where a mortgage holder has elected initially to sue on the note, and where a money judgment has been obtained, foreclosure is barred unless an execution upon the judgment has been issued and has been returned fully or partially unsatisfied.

This statutory framework applies also to a confession of judgment,[4] as in the case under consideration. Then too, action on the debt is inclusive of an action on the guaranty,[5] which is likewise apposite to the subject decision.

That there is some independence and vitality to suit on the monetary obligation is suggested by a series of cases. For example, if the judgment has been returned either fully or partially unsatisfied, foreclosure is authorized[6] and leave of the court is not required.[7] No extinguishment of a mortgagee's right to foreclose develops because judgment on the debt was pursued.[8] Nor is it a defense to foreclosure that a judgment was obtained, so long as it was indeed returned unsatisfied.[9]

Turning to the arena of deficiency judgments,[10] RPAPL §1371 controls. Both statute and case law provide that regardless of the quantum of sale proceeds, if a deficiency judgment motion is not timely made in accord with statutory requirements, the sum yielded by the foreclosure sale must be considered as full satisfaction of the debt.

Then, the right to recover the deficiency in any action or proceeding is deemed extinguished.[11] And where the debt is deemed satisfied, no action may thereafter be maintained against guarantors.[12]

Armed with that background, the *Mariani* court reached its conclusion, first by citing RPAPL §1371 and observing that if the moving party had been the borrower, instead of the guarantor, there would be no doubt that recovery on the confession of judgment would be barred. (Why such a distinction is so obvious is unstated in the decision.)

The court cited three cases for the accepted proposition that where the plaintiff did not seek a deficiency "it must be conclusively presumed that the proceeds of the foreclosure sale were in full satisfaction of the mortgage debt, thereby depriving (plaintiffs) of further recourse to any other security which (movant) may have contemporaneously given on the same obligation[.]"[13]

Citing *Sanders v. Palmer*,[14] the court went on to hold that a guarantor is a person liable for the debt pursuant to RPAPL §1371 and "like the debtor, is entitled to the protection of RPAPL §1371(3) when no deficiency judgment is obtained[.]"

The denouement was the holding that to allow enforcement of the earlier money judgment would permit circumvention by plaintiff of the statutory protection afforded mortgagors. That safeguard is computing credit to the obligor or guarantor for the market value of the property.

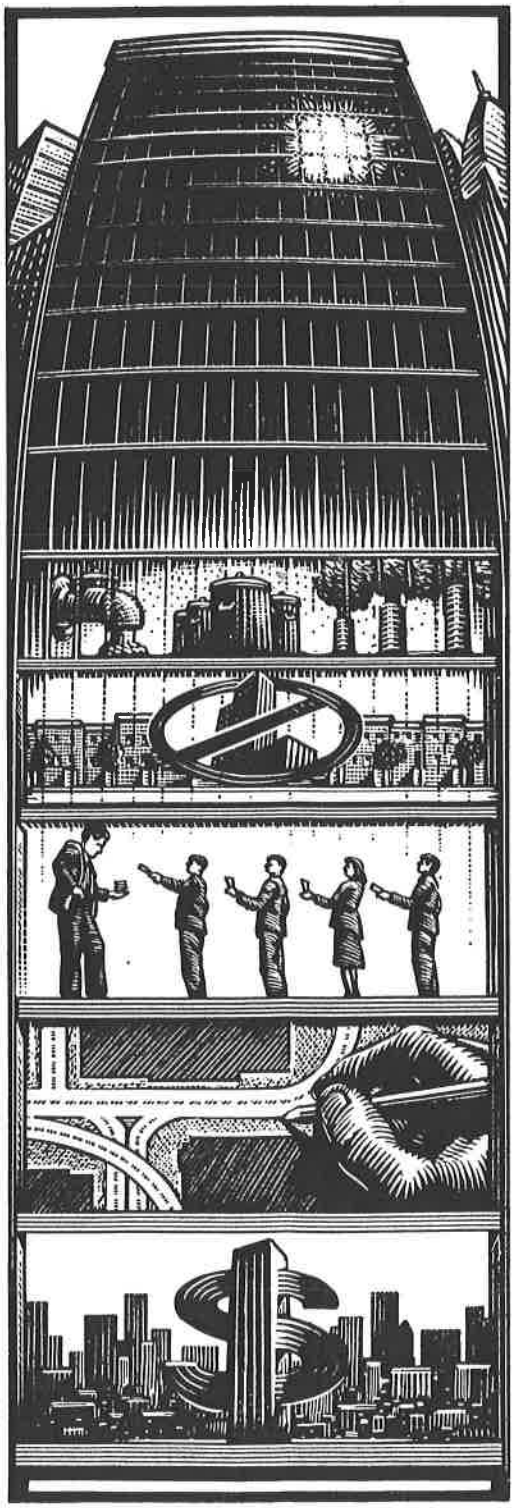

ILLUSTRATION BY JOHN MacDONALD

What the court did *not* cite was an apparently dispositive ruling back in 1940, by the Court of Appeals.

In that case, *Rossbach v. Rosenblum*,[15] the pervasive extent of the doctrine that pursuit of the underlying debt expires with failure to obtain a deficiency is rather dramatically affirmed.

The plaintiff instituted foreclosure with a complaint alleging three causes of action, the first for foreclosure, the second seeking a money judgment for real property taxes and the third for an installment of interest. Summary judgment issued on the second and third causes of action, with a money judgment entered for approximately $2,347.

The ultimate foreclosure judgment duplicatively included the sums due for the taxes and interest. At the foreclosure sale, plaintiff was the successful bidder, but for a price some $3,000 less than the total debt. No deficiency was sought. Instead, plaintiff attempted to execute upon its money judgment.

The court ruled that the money judgment could not be enforced because, having taken the property in foreclosure without seeking a deficiency judgment, plaintiff was barred from further relief for any part of the mortgage debt.

For those of a mind to assault *Mariani*, presumably buttressed by the affirmance in *Rossbach*, there is case law holding that the right to a deficiency judgment in a foreclosure action is a creation of, and solely dependant upon statute.[16] This suggests the argument that if the statute does not clearly prohibit enforcement of the previous judgment by confession, no preclusion should issue.

Moreover, analysis of all the cases relied upon in the *Mariani* decision reveals only the usual fact patterns — certainly not the specific confluence of an already obtained judgment and the possible need to procure a deficiency.

For example, *Statewide Savings and Loan Association v. Canoe Hill Inc.*[17] rejects a claim to personal property when no deficiency is sought. In *Corley v. Miller*,[18] pursuit of a claim to insurance proceeds was barred where the deficiency was not obtained.

Finally, in *Polish National Alliance of Brooklyn, USA v. White Eagle Hall Company Inc.*,[19] the general principle about the property being the equivalent of the debt in the absence of a deficiency was mentioned, but only as an incident of an argument concerning adequacy or inadequacy of bid price as a claimed basis to overturn a foreclosure sale.

In the cases cited in *Mariani*, the deficiency was not pursued; consequently, further efforts to collect the debt would be deemed over, certainly an accepted aphorism.

But does such a standard scenario support a leap to the perhaps unique circumstance

assessing the viability of a first obtained confession of judgment followed by a foreclosure which proceeds to a conclusion?

The *Mariani* court did not exactly phrase the issue in such verbiage, but its affirmative result is the response. Whether the holding is correct, though, could be viewed as one of those marvelously perplexing issues which renders the academic effervescent.

But maybe the most persuasive rejoinder to *Mariani*, if there is one, is found in the general principle that a foreclosure action brought to conclusion without issuance of deficiency liability is not an absolute bar to recover of the balance of the debt.[20] Leave to sue separately on the obligation is discretionary with the court, and is to be founded upon equitable principles.[21] In order for that leave to issue, special circumstances must be shown[22] which manifestly require such relief.[23]

For example, where a defendant liable for a deficiency cannot be personally served in New York and does not appear in the foreclosure, suit on the balance of the note can be authorized.[24]

Special circumstances would also exist where mortgagee and mortgagor's assignee specifically agree that no deficiency would be sought and that the assignee's liability for the debt would be pursued only after the foreclosure was concluded.[25] So the subject doctrine is not quite as inviolate as most case citations would suggest.

Mechanics

In the end, what is enigmatic and technical is reduced to the merely mechanical.

Where a lender is able to bargain for a confession of judgment as part of the mortgage transaction, or as an incident of a later workout or restructuring, it would like the luxury of electing to enforce the money judgment. It has that.

If *Mariani* and the earlier Court of Appeals case (*Rossbach v. Rosenblum*),[26] are the standard, there is some constraint on that luxury, in the form of limitation in the duration of enforcement, which should only rarely be a burden.

When the initial judgment is returned unsatisfied, the only handicap imposed upon a foreclosing plaintiff by *Mariani* arises if the once impoverished debtor precipitously amasses assets just as the foreclosure is ending.

When the foreclosure concludes, instead of being empowered to simply enforce an extant judgment, the mortgage holder must seek the deficiency.

The procedure is marginally inconvenient, but probably the greater, more equitable good. Getting the property and all the money is not what the statute endorses. After all, a stated purpose of RPAPL §1371 is to strictly control judicial sales in foreclosure to avoid both double payments and sales at sacrificial prices.[27]

Another compelling goal is to achieve a balancing of the equities to establish a standard which protects unfortunate mortgagors while allowing foreclosing plaintiffs to secure deficiency judgments when it is equitable under the circumstances.[28] *Mariani* did those maxims no harm.

The only other solution the court could have fashioned was decreeing a credit to the guarantor for the value of the property when the money judgment was executed upon. But that would have elicited an assessment of that credit by the court and would, therefore, have been only minimally different from the deficiency judgment motion with its resultant valuation trial.

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Yes, *Mariani* looks like it diminishes the essential arsenal of distressed lenders in tough (albeit easing) times. Upon close examination, however, that is probably not so. If lenders truly need relief on this point, aid of the Legislature should be invoked.

(1) See 1 *Bergman on New York Mortgage Foreclosures* §7.05 et. seq.

(2) *Marine Midland Bank v. Virginia Woods Ltd.*, 151 Misc. 2d 915, 574 NYS2d 485 (1991); *Chase Lincoln First Bank v. Kesselring-Dixon Inc.*, 554 NYS2d 379 (1990); *Application of Callan*, 129 Misc. 2d 7, 491 NYS2d 918 (1985); *Stein v. Nellen Dev. Corp.*, 123 Misc. 2d 268, 473 NYS2d 331 (1984); *Stein v. Blatte*, 118 Misc. 2d 633, 461 NYS2d 189 (1983); *Wyoming County Bank & Trust Co. v. Kiley*, 75 AD2d 477, 430 NYS2d 900 (4th Dept. 1980); *Boyd v. Jarvis*, 74 AD2d 937, 426 NYS2d 142 (3d Dept. 1980); *Goddard v. Johnson*, 96 Misc. 2d 230, 408 NYS2d 923 (1978); *Stern v. Itkin Bros.*, 87 Misc.2d 538, 385 NYS2d 753 (1975); *D'Agostino v. Wheel Inn Inc.*, 65 Misc. 2d 227, 317 NYS2d 472 (1970); *Bernstein v. Friedlander*, 58 Misc. 2d 492, 296 NYS2d 409 (1968), citing *Drover's Deposit Nat'l Bank of Chicago v. Newgass*, 161 A.D. 769, 147 N.Y.S. 4; *Copp v. Sands Point Marina*, 17 NY2d 291, 270 NYS2d 599, 217 N.E.2d 654 (1966); *Seamen's Bank for Sav. v. Smadbeck*, 293 N.Y. 91, 56 N.E.2d 46 (1944).

(3) *First Nat'l Bank & Trust Co. of Walton v. Eisenrod*, 263 A.D. 227, 32 NYS2d 641 (3d Dept. 1942); *Seamen's Bank for Sav. v. Smadbeck, supra.* at note 2; *Marshall v. Davies*, 78 N.Y. 414 (1879); *Calvo v. Davies*, 73 N.Y. 211 (1878).

(4) CPLR §3218(b); *Silverman v. Leucadia Inc.*, 156 AD2d 442, 548 NYS2d 720 (2d Dept. 1989).

(5) *Manufacturers Hanover Trust Co. v. 400 Garden City Assocs.*, 150 Misc. 2d 247, 568 NYS2d 505 (1991); *TBS Enters. Inc.*, v. *Grobe*, 114 AD2d 445, 494 NYS2d 716 (2d Dept. 1985).

(6) RPAPL §1301(1); *Jamaica Sav. Bank v. Henry*, 112 AD2d 920, 492 NYS2d 437 (2d Dept. 1985); *Goddard v. Johnson, supra.* at note 2; *Stern v. Itkin Bros., supra.* at note 2; *Trapani v. Vista Realty Corp.*, 37 Misc. 2d 132, 233 NYS2d 756 (1962); *President & Directors of Manhattan Co. v. Callister Bros.*, 256 A.D. 1097, 11 NYS2d 593, reargument denied, 257 A.D. 1004, 13 NYS2d 644 (2d Dept. 1939), aff'd, 282 N.Y. 629, 25 N.E.2d 978 (1940).

(7) *Jamaica Sav. Bank v. Henry, supra.* at note 6.

(8) *Goddard v. Johnson, supra.* at note 2.

(9) *Bank Leumi Trust Co. of N.Y. v. Sibthorp*, 135 A.D. 476, 522 NYS2d 568 (1st Dept. 1987).

(10) For more on the subject, both specifically and generally, see *Bergman*, "How the Good Guys Lost — The Continuing Trap of the Deficiency Judgment Dictates," N.Y.L.J., Dec. 15, 1993 at 5, col. 2; 2 *Bergman on New York Mortgage Foreclosures*, Chap. 34.

(11) *Sanders v. Palmer*, 68 NY2d 180, 507 NYS2d 844, 499 N.E.2d 1242 (1986); *Whitestone Sav. & Loan Ass'n v. Alstate Ins. Co.*, 28 NY2d 332, 321 NYS2d 862, 270 N.E.2d 694 (1971); *Bedford Realty Corp. v. Brooklyn Trust Co.*, 290 N.Y. 520, 49 N.E.2d 992 (1943); *Corley v. Miller*, 133 AD2d 732, 520 NYS2d 21 (2d Dept. 1987); *TBS Enters. Inc. v. Grobe, supra.* at note 5; *Polish Nat'l Alliance of Brooklyn v. White Eagle Hall Co.*, 98 AD2d 400, 470 NYS2d 642 (2d Dept. 1983); *Sportmen's Park Inc. v. New York Property Ins. Underwriting Ass'n*, 97 AD2d 893, 470 NYS2d 456 (3d Dept. 1983), aff'd, 63 NY2d 998, 483 NYS2d 1012, 473 N.E.2d 262 (1984); *Kleet Lumber Co. v. J & J Foley Const. Corp.*, 91 AD2d 1014, 458 NYS2d 889 (2d Dept. 1983); *Guardian Fed. Sav. & Loan Ass'n v. Horse-Hawk Holding Corp.*, 72 AD2d 737, 421 NYS2d 244 (2d Dept. 1979); *Band Realty Co. v. North Brewster Inc.*, 59 AD2d 770, 398 NYS2d 724 (2d Dept. 1977); *Statewide Sav. & Loan Ass'n v. Canoe Hill Inc.*, 54 AD2d 1018, 388 NYS2d 188 (3d Dept. 1976), aff'd, 44 NY2d 843, 406 NYS2d 755, 378 N.E.2d 118 (1978); *Serial Fed. Sav. & Loan Ass'n of N.Y.C. v. Crescimanno*, 35 AD2d 561, 313 NYS2d 326 (2d Dept. 1970); *Bodner v. Brickner*, 29 AD2d 441, 288 NYS2d 342 (1st Dept. 1968); *Rossbach v. Rosenblum*, 260 A.D. 206, 20 NYS2d 725 (1st Dept.), aff'd, 284 N.Y. 745, 31 N.E.2d 509 (1940); *Frenger v. Katz*, 241 A.D. 766, 270 N.Y.S. 539 (2d Dept.), aff'd. 2.D. 837, 275 N.Y.S. 668 (2d Dept.), appeal dismissed, 265 N.Y. 515, 193 N.E. 299 (1934); *Feiber Realty Corp. v. Abel*, 240 A.D. 985, 268 N.Y.S. 940 (2d Dept. 1933); *Merchants Nat'l Bank & Trust Co. of Syracuse v. Wagner*, 93 Misc. 2d 224, 402 NYS2d 936 (1978); *Gouldner v. Rachlin*, N.Y.L.J., Mar. 30, 1977, at 10, col. 1 (Sup. Ct. N.Y. Co., Evans, J.); *Moke Realty Corp. v. Whitestone Sav. & Loan Ass'n* 82 Misc. 2d 396, 370 NYS2d 377 (1975), aff'd, 51 AD2d 1005, 382 NYS2d 289 (2d Dept. 1976), aff'd, 41 NY2d 954, 394 NYS2d 881, 363 N.E.2d 581 (1977); *Zawadzki v. New York Property Ins. Underwriting Ass'n*, N.Y.L.J., Sept. 17, 1974, at 18, col. 7 (App. Term, 2d Dept., Schwartzwald, J.); *State Bank of Albany v. Amak Enters. Inc.*, 77 Misc. 2d 340, 353 N.Y.S. 2d 857 (1974); *Pomperaug Realty Corp. v. Schulte Real Estate Co.*, 182 Misc. 1080, 50 NYS2d 238 (1944); *D.M. Sherman Corp. v. Jefferson County*

Sav. Bank, N.Y.L.J., Jan. 5, 1971, at 2, col. 4 (Sup. Ct. N.Y. Co. Fralman, J.); *Klein v. Gray*, 127 NYS2d 459 (Sup. Ct. 1954); *Glen Cove Trust Co. v. Trypuc*, 110 NYS2d 368 (Sup. Ct. 1952), aff'd, 281 A.D. 1034, 121 NYS2d 278 (2d Dept. 1953).

(12) *Sanders v. Palmer, supra.* at note 11; *Bedcro Realty Corp. v. Brooklyn Trust Co., supra.* at note 11; *TBS Enters. Inc. v. Grobe, supra.* at note 5; *Kleet Lumber Co.* v. *J & J Foley Constr. Corp., supra.* at note 11; *Band Realty Co. v. North Brewster Inc., supra.* at note 11; *Kings County Sav. Bank v. Fulton Sav. Bank*, 268 A.D. 452, 52 NYS2d 47 (2d Dept. 1944); *Merchants Nat'l Bank & Trust Co. of Syracuse v. Wagner, supra.* at note 11; *Gouldner v. Rachlin, supra.* at note 11; *State Bank of Albany v. Amak Enters. Inc., supra.* at note 11.

(13) Citing *Statewide Savings and Loan Association v. Canoe Hill* Inc., 54 AD2d 1018, 388 NYS2d 188 (3d Dept. 1976), aff'd, 44 NY2d 843, 406 NYS2d 755, 378 N.E.2d 118 (1978); *Corley v. Miller, supra.* at note 11; *Polish National Alliance of Brooklyn, U.S.A. v. White Eagle Hall Company Inc., supra.* at note 11.

(14) *Supra.* at note 11.

(15) *Supra.* at note 11.

(16) *New York Life Ins. Co. v. H & J Guttag Corp.*, 265 N.Y. 292, 192 N.E. 481 (1934); *Rutherford Realty Co. v. Cook*, 198 N.Y. 29, 90 N.E. 1112 (1910); *Scofield v. Doscher*, 72 N.Y. 491 (1878); *Equitable Life Ins. Soc'y.* v. *Stevens*, 63 N.Y. 31 (1875); *Marine Midland Bank v. Harrigan Enters. Inc.*, 118 AD2d 1035, 500 NYS2d 408 (3rd Dept. 1986); *Griffo v. Swartz*, 61 Misc. 2d 504, 306 NYS2d 64 (1969); *City Real Estate Co. v. Realty Constr. Corp.*, 167 Misc. 379, 3 NYS2d 312 (1938).

(17) *Supra.* at note 11.

(18) *Supra.* at note 11.

(19) *Supra.* at note 11.

(20) *Rose v. Gershman*, 93 Misc. 2d 524, 402 NYS2d 921 (1978); Application of Warner, 267 A.D. 775, 45 NYS2d 550 (2d Dept. 1943); *Irving Trust Co. v. Seltzer*, 265 A.D. 696, 40 NYS2d 451 (2d Dept. 1943); *National City Bank of N.Y. v. Gelfert*, 284 N.Y. 13, 29 N.E.2d 449 (1940); *Matter of Rothschild*, 160 A.D. 530, 145 N.Y.S. 955 (2d Dept. 1914).

(21) *Bianchi v. Bianchi Orchids Inc.*, N.Y.L.J., Sept. 9, 1991, at 26, col. 6 (Sup. Ct., Suffolk County, Cohalan, J.); *Rose v. Gershman, supra.* at note 20; *Irving Trust Co. v. Seltzer, supra.* at note 20; *Matter of Rothschild, supra.* at note 20.

(22) *Manufacturers Hanover Trust Co.* v. *400 Garden City Assocs., supra.* at note 5; *Bianchi v. Bianchi Orchids Inc., supra.* at note 21; *Boyd v. Jarvis, supra.* at note 2; *Application of Warner*, 267 A.D. 775, 45 NYS2d 550 (2d Dept. 1943); *National City Bank of N.Y. v. Gelfert, supra.* at note 20.

(23) *National City Bank of N.Y. v. Gelfert, supra.* at note 20.

(24) *Citibank v. Covenant Ins. Co.*, 567 NYS2d 983 (1991); *Irving Trust Co. v. Seltzer, supra.* at note 20.

(25) *Matter of Rothschild, supra.* at note 20.

(26) *Supra.* at note 11.

(27) *Alison v. Roslyn Plaza, Ltd.*, 95 Misc. 2d 501, 408 NYS2d 674 (1978); *Lincoln First Bank of Rochester v. Healy*, 86 Misc. 2d 373, 382 NYS2d 453 (1976); aff'd 55 AD2d 1021, 391 NYS2d 849 (4th Dept. 1977); *Primary Realty Corp.* v. *Librett*, 178 Misc. 40, 32 NYS2d 7 (1941).

(28) *Dows Estate Inc. v. Smith*, 290 N.Y. 484, 49 N.E. 977 (1943); *Heiman v. Bishop*, 272 N.Y. 83, 4 N.E. 944 (1936).