REPRINTED FROM

SERVICING MANAGEMENT

THE MAGAZINE FOR LOAN SERVICING ADMINISTRATORS ■ VOL. 6, NO. 6 FEBRUARY 1995

FORECLOSURE

So, What's Your Position, Junior?

Examine Your Lien Status To See Whether You'll Come Out On Top

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As tough as salvaging rights in a mortgage foreclosure case can be from time to time, there are added nuances when the lender is in a second or more junior position.

Second mortgage or home equity lenders may be more regularly exposed to the pitfalls, but it can be helpful to servicers to focus on some of the intricacies - particularly because it is quite seldom that anyone doesn't eventually encounter one of its mortgages in a junior position.

Try this scenario.

A summons and complaint in a mortgage foreclosure action of an (apparently) senior mortgage is served. The papers are, wisely, sent to counsel. Now, the likelihood is that the junior mortgage is also in default. So the initial choice (assuming it hadn't been addressed earlier) is to assess whether it is worth the effort to foreclose the junior position or, instead, "tag on" to the senior foreclose.

That is perhaps more of a business decision than a legal one, dependent in part upon how generous the equity cushion may be. Whether opting to foreclose or not, how to respond to the senior foreclosure is an immediate issue.

Examine your options

Here there are some choices to be made. Exactly what can be done - the form it takes and what the documents are called - will certainly vary from state to state. But many of the basic concepts and strategies will be consistent.

(This discussion will use the procedures and nomenclature in New York as an example.)

Without becoming overly technical, there are essentially three practical paths to pursue:

- a notice of appearance and waiver,
- a notice of appearance, or
- an answer.

Let's see what each does in order to weigh which might be best in any given situation.

The **notice of appearance and waiver** is a document whereby counsel gives notice to the foreclosing plaintiff that you are represented in any way, reserving receipt of notice only to the actual foreclosure sale and of surplus money proceedings.

The advantage to this mode of appearance is that it allows the senior foreclosure to proceed with maximum speed. (In New York, like some other states, that is always a relative question.) The idea is that the junior lender wants the accrual of debt ahead of its position to be as little as possible. Refraining from slowing down the senior foreclosure reduces the accumulation of interest and legal fees, thus tending to minimize the monetary growth of that prior obligation.

If there is some hope that time would allow the borrower to extricate himself from the dilemma, either by satisfying the senior and the junior, reinstating both, or entering into some acceptable workout, then the notice of appearance and waiver may not achieve the desired goal.

A lengthy process

The resultant surplus money proceeding, though, could be lengthy and, in New York for example, is unfortunately cumbersome, tending to consume at least six months. A solution is to employ a faster method which may be available.

In New York, the approach is called in common parlance, "1351 relief." In a nutshell, this is the ability to direct the referee to pay surplus to the junior lender directly and instantly out of the foreclosure sale proceeds without necessity to traverse through a time consuming surplus money proceeding.

But the procedure to obtain 1351 relief is a cross motion to the application for judgment of foreclosure and sale. Since a notice of appearance and waiver skips necessity to give judgment notice to the appearing par-

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ty, that is an item for which notice should be *reserved* - in the notice of appearance and waiver.

With the noted amendment, the notice of appearance and waiver may indeed be utilitarian for the junior lender's goal. Assuming, though, that a somewhat higher level of detainment in the senior action seems appropriate or helpful, then a notice of appearance can be considered. That document mandates that *each* stage of the senior foreclosure action proceed on notice to the junior. This tends to add a number of months to the progress of the foreclosure action and, if such is desired, the general notice of appearance achieves that end.

Serving an answer

If for some reason more time is thought to be needed, and really only if the junior mortgagee believes it has a valid defense to the foreclosure, **an answer** can be served.

The answer contests the foreclosure either on the issue of priority, lack of service or any number of other defenses which could exist, albeit not so frequently.

Although circumstances and fact patterns vary, most junior lenders choose the **notice of appearance** route so that they can watch over the course of the senior foreclosure, including making sure that the referee's computation of the senior debt is accurate. (That is another opportunity lost when a notice of appearance and waiver is chosen, unless notice of the referee's computation is retained.)

So, what happens most often - and properly - is that the holder of the junior mortgage sends the summons and complaint in the senior foreclosure to its attorney with a request to serve the notice of appearance. Since a notice of appearance (in New York at least) can be served at any time in a foreclosure action, thus entitling the appearing party to notice of all subsequent proceedings, there may not be such a rush to transmit the legal papers to counsel.

Nevertheless, it is strongly recommended that the documents be conveyed as quickly as possible.

Making assumptions

As a practical matter, the attorney does not know what depth of review was given to the senior foreclosure papers in the offices of a junior mortgagee. A reasonable assumption on the part of the lawyer is that the lender knows very well what level of priority it is in, and in sending the papers and asking that a notice of appearance be prepared, it was done with foresight. Most often that is true, but not always.

It is certainly possible that a foreclosure complaint served by a lender assumes that it is in a senior position. But it might not be so, either because a search was misread, or because there really are legal issues to be disposed of, which the supposedly senior lender has chosen to resolve in its own favor.

For example, say Mortgage X is executed on Feb. 1, with your mortgage executed on Feb. 15. But your mortgage is recorded first, on Feb. 20, with the earlier executed mortgage later recorded on Feb. 25. So long as you have no actual knowledge of Mortgage X, your mortgage is superior as a matter of law (in New York).

The holder of Mortgage X might not know that is so, or might not agree, or might choose to name you as a party defendant just to see what could happen. In a case like that, if the junior mortgagee receives the summons and complaint and sends it to its counsel with the directive to put in the usual notice of appearance (and claim to surplus monies) it will have made a mistake.

Avoiding the unfortunate

A new case tells us just such an unfortunate event can occur: **[*Household Finance Realty Corporation v. Delmarico*, _A.D.2d_, 609 N.Y.S.2d 310 (2d Dept. 1994)]**.

There, the supposedly junior mortgagee read the complaint and apparently assumed that the allegations were accurate. It thereupon defaulted in the senior action (which is the worst choice that can be made) and only later realized the error of its ways.

Then it moved to vacate the default so it could answer and allege its true superiority to the supposedly senior mortgage. The court rejected the entreaty, ruling that when served with the pleadings, the lender imprudently relied upon the accuracy of the plaintiff's allegations rather then checking its own files to determine whether it had priority.

This mishap was held **not** to be the kind of excuse needed to vacate a default.

So, the careless lender lost when it should not have. Do not let that happen to you. SM