WITHER THE DEED IN LIEU OF FORECLOSURE? — THE PROBLEM OF A DEED AS A MORTGAGE*

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Editorial Comment: We continue to be favored with the excellent comments of Bruce Bergman on the mortgage foreclosure procedure with his piece on deeds in lieu of foreclosure which follows. Those who may be confronted with a situation of distress in a mortgage transaction should be aware of the "deed-in-lieu" device and what it implies, and Bruce's piece is an aid in that direction.

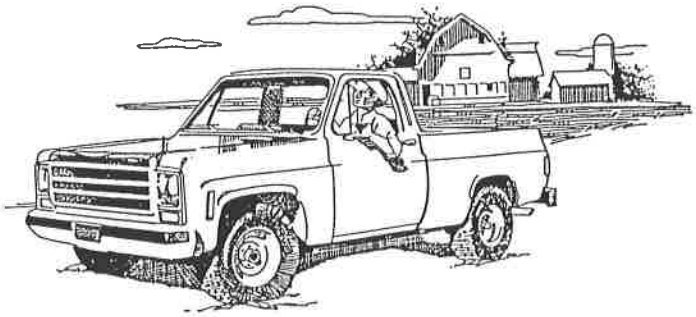
To immediately answer the question raised by the title, no, the long accepted deed in lieu of foreclosure is not in danger of being banished to uselessness, even though a recent decision suggests to some that such is the case. *[Basile v. Erhal Holding Corp.*, 538 N.Y.S.2d 831 (2d Dept. 1989)].

Why the holding in the noted case might be a source of consternation arises from the contemplation that deeds in lieu of foreclosure can have some distinct benefits for both mortgagee and mortgagor. (A deed in lieu also has considerable flaws in many circumstances which will not be explored here.) From a mortgagor's vantage point, insofar as foreclosures tend to be traumatic, the discomfort of being subjected to the action evaporates when the mortgaged premises are conveyed. Similarly, most of the legal expense a mortgagor might have incurred in battling the foreclosure can be dispensed with. (To the extent counsel is sought with regard to the conveyance, however, some legal expense remains.)

Depending upon the relationship between the debt owed to the mortgagee and the value of the property, there is the possibility that deficiency judgment liability could attach to the mortgagor upon completion of the foreclosure. If that liability is a reasonable possibility, and particularly if the mortgagor has assets other than the mortgaged premises which could be subject to execution, the deed in lieu of foreclosure presents a solution. Since conveyance of the property to the mortgagee can preclude prosecution of the foreclosure against the grantor, no deficiency judgment against that grantor can be pursued or obtained.

During the course of any foreclosure, the mortgagor-owner may be constrained to maintain the premises, at least to the extent his own comfort (in the case of a residence) or business judgment (in the instance of a commercial parcel) may suggest. Conveying the property pursuant to a deed in lieu of foreclosure eliminates that need to maintain.

Similarly, during a foreclosure, there is always the possibility that a mortgagee could obtain the appointment of a receiver of the rents and profits. While the income collected by the receiver serves to reduce the mortgage debt, that benefit is diminished by the quantum of the receiver's compensation. There are also expenses a receiver could incur, such as payments to counsel or to managing agents — all of which could ultimately increase the possibility of deficiency judgment liability. Furthermore, there is the unpleasantness of having a stranger as caretaker of one's property. None of that can impact adversely upon a mortgagor once a deed in lieu of foreclosure has been delivered and the mortgagor departs the premises.



Finally, an otherwise hopeless situation can yield some income by way of payment to the mortgagor for the deed in lieu of foreclosure. There could be any number of reasons why a mortgagee would prefer a deed in lieu of foreclosure to the task of prosecuting a foreclosure through to its conclusion. If such an attitude on the mortgagee's part prevails, it **may** be willing to offer some monetary compensation to the mortgagor as an inducement to quickly convey a deed in lieu of foreclosure. What that payment might be will depend upon the circumstances, but where a mortgagor once faced loss of the property, the inevitable can be assuaged by monetary consideration.

From the mortgagee's point of view, generally, an experienced and careful lender should only very rarely find the acceptance of a deed in lieu of foreclosure to be an appropriate avenue to settle or conclude a foreclosure action. A prudent appraisal at the inception of a loan should most often mean that the property will be worth more than the debt. Meticulously conceived mortgage documents should provide recompense for any expenditures to protect the mortgage lien and to prosecute the foreclosure. Faithful adherence to vigorous prosecution of the foreclosure should avoid undue protraction of the action during which interest accrual can threaten the equity cushion.

But observing what should generally prevail does not account for the inevitable exceptions. Moreover, not all lenders are of the institutional variety. This immediately suggests that some loans were never based upon the value of the property in the first instance. The mortgage

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prepared without a legal fee clause renders the mortgagee responsible to pay the legal expense engendered by the foreclosure. Moreover, a diffident attitude to prosecuting the case, or the engagement of counsel inexperienced in foreclosure actions portends unfortunate delay of the action, as does the possibility that a mortgagor might feel compelled to stridently defend the foreclosure. In sum, it should be apparent that in some instances, a deed in lieu of foreclosure can be of value to a foreclosing mortgagee.

Thus, for example, a deed in lieu of foreclosure removes from concern the possibility that the secured property may physically deteriorate or otherwise decline in value during the course of a contentious foreclosure. While the appointment of a receiver can serve to avoid such problems, receiverships can sometimes be delayed by vigorous opposition. Even when appointed with dispatch, a receiver's engagement alone does not assure that all jeopardy to the property can be eliminated. Since the deed in lieu of foreclosure conveys title to the mortgagee, avoidance of this danger is something over which the mortgagee can have direct control.

Where for whatever reason the value of the property is likely to be less than the mortgage debt at the time of a foreclosure sale, whatever time is attendant to prosecution of the foreclosure action increases the debt as interest accrues. When a foreclosure under this scenario finally concludes, there are only two ways for the mortgagee to recoup its investment. First, it can pursue a deficiency judgment against the parties so liable. Collection of deficiency judgments often tends to be problematical so that this remedy is of somewhat tenuous benefit. Second, with the mortgagee as the likely purchaser at the foreclosure sale, it can then sell the property with the hope of reducing the loss. The sooner the property can be sold, the less is the interest component of the debt. A deed in lieu of foreclosure secures title to the property faster than would a purchase by the mortgagee at the foreclosure sale.

In addition to saving time, the deed in lieu of foreclosure avoids spending whatever non-reimbursable expense the mortgagee might have incurred in the foreclosure. While a well-drafted mortgage should leave little room for advancement of sums that cannot be recouped, not every mortgage will be perfect. Moreover, even if the mortgage contains an efficacious legal fee clause, presence of the provision is not an absolute guaranty that a court will assess the amount requested. Therefore, insofar as any particular foreclosure could constrain expenditure of monies not subject to full recovery, the deed in lieu of foreclosure removes this concern.

Still further, there is always at least a theoretical uncertainty as to the final result of any foreclosure. To be sure, losing a foreclosure is an extremely remote occurrence from a mortgagee's perspective. That does not mean, however, and quite obviously, that there is never a foreclosure case which fails. Insofar as some cases could be lost, the deed in lieu of foreclosure avoids that possibility as well.

If the property to be conveyed is worth less than the amount of the mortgage debt, taking a deed in lieu of foreclosure does not preclude pursuing the obligation. Although credit for the value of the premises conveyed must be given, the mortgagee can keep the mortgage alive either by inserting non-merger language in the deed or by causing the conveyance to be made to mortgagee's nominee. Even though a release may be given to the mortgagors, guarantors and other obligors can still be pursued for the mortgage debt. Or, the foreclosure can proceed should that fit the circumstances.

Finally, just as foreclosures can have an emotional component for mortgagors, such can obtain in some instances for mortgagees as well. To the extent that prosecuting a foreclosure is uncomfortable for a mortgagee, or is perceived as having deleterious consequences for public relations, the deed in lieu of foreclosure casts aside these concerns.

One of the possible problems with a deed in lieu of foreclosure, however, is the maxim that, although absolute on its face, a deed given solely as security for an obligation is a mortgage. [See, *inter alia, Mooney v. Byrne*, 163 N.Y. 86, 57 N.E. 163 (1900); *Odell v. Montross*, 68 N.Y. 499 (1877); *Booth v. Landau*, 103 A.D.2d 733, 477 N.Y.S.2d 195 (2d Dept. 1984), *aff'd*, 63 N.Y.2d 764, 481 N.Y.S.2d 686, 471 N.E.2d 458 (1984); *Peerless Constr. Co. v. Mancini*, 96 A.D.2d 666, 466 N.Y.S.2d 497 (3rd Dept. 1983); *Maher v. Alma Realty Co.*, 70 A.D.2d 931, 417 N.Y.S.2d 748 (2d Dept. 1979); *Corcillo v. Martut, Inc.*, 58 A.D.2d 617, 395 N.Y.S.2d 696 (2d Dept. 1977), *aff'd*, 43 N.Y.2d 792, 402 N.Y.S.2d 393, 373 N.E.2d 287 (1977); *Ressequie v. Adams*, 55 A.D.2d 698, 388 N.Y.S.2d 955 (3rd Dept. 1976), *aff'd*, 42 N.Y.2d 1022, 398 N.Y.S.2d 658, 368 N.E.2d 836 (1977); *Johnston v. DeHaan*, 37 A.D.2d 1028, 325 N.Y.S.2d 762 (3rd Dept. 1971)].

Whether a deed will be construed as a mortgage is dependent upon the intent of the parties [See, *inter alia, Booth v. Landau*, 103 A.D.2d 733, 477 N.Y.S.2d 195 (2d Dept. 1985); *Pioneer Village Dev. Corp. v. XAR Corp.*, 55 A.D.2d 769, 389 N.Y.S.2d 498 (3rd Dept. 1976); *Bielawski v. Bazar*, 47 A.D.2d 435, 367 N.Y.S.2d 322 (3rd Dept. 1975); *King v. WNY Holding Corp.*, 38 A.D.2d 685, 327 N.Y.S.2d 258 (4th Dept. 1971)] and parol evidence is acceptable to show such intent. [*Corcillo v. Martut, Inc.*, 58 A.D.2d 617, 395 N.Y.S.2d 696 (2d Dept. 1977), *aff'd*, 43 N.Y.2d 792, 402 N.Y.S.2d 393, 373 N.E.2d 287 (1977); *Bielawski v. Bazar*, 47 A.D.2d 435, 367 N.Y.S.2d 322 (3rd Dept. 1975); *Johnston v. DeHaan*, 37 A.D.2d 1028, 325 N.Y.S.2d 762 (3rd Dept. 1971)].

While there is a strong presumption that a deed absolute in form expresses the entire agreement of the parties [*Hurwitz v. Natruth Holding Corp.*, 194 Misc. 56, 86 N.Y.S.2d 65 (1945), *aff'd*, 277 App. Div. 1028, 100 N.Y.S.2d 1011 (1st Dept. 1950)], that there is a heavy burden of proof upon the party seeking to assault the deed [*Peerless Constr. Co. v. Mancini*, 96 A.D.2d 666, 466 N.Y.S.2d 497 (3rd Dept. 1983); *Johnston v. DeHaan*, 37 A.D.2d 1028, 325 N.Y.S.2d 762 (3rd Dept. 1971)], that to overcome the prevailing presumption the proof must be clear and convincing [*Zivotsky v. Max*, 190 Misc. 1044, 75 N.Y.S.2d 553 (1947), *aff'd*, 276 App. Div. 792 (3rd Dept. 1949), and that the terms of the mortgage must be clearly and conclusively established [*Ressequie v.*

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Adams, 55 A.D.2d 698, 388 N.Y.S.2d 955 (3rd Dept. 1976), *aff'd*, 42 N.Y.2d 1022, 309 N.Y.S.2d 658, 368 N.E.2d 836 (1977)], nevertheless, the possibility exists at law that a deed in lieu of foreclosure could be declared to be a mortgage.

Significantly, attempts to argue that a deed in lieu of foreclosure is in actuality a mortgage have often been found wanting. [*Randall v. Sanders*, 87 N.Y. 578 (1882); *Johnston v. DeHaan*, 37 A.D.2d 1028, 325 N.Y.S.2d 762 (3rd Dept. 1971); *Braun v. Vollmer*, 89 App. Div. 43, 85 N.Y.S. 319 (1st Dept. 1903); *Hurwitz v. Natruth Holding Corp.*, 194 Misc. 56, 86 N.Y.S.2d 65 (1945), *aff'd*, 277 App. Div. 1028, 100 N.Y.S.2d 1011 (1st Dept. 1950); *515-2nd St. Corp. v. Bisnoff*, 250 App. Div. 642, 295 N.Y.S. 94 (2d Dept. 1937)]. But an exception to the traditional judicial inclination not to find a deed in lieu to be a mortgage is found in the mentioned recent case, *Basile v. Erhal Holding Corp.*, 538 N.Y.S.2d 831 (2d Dept. 1989), under what must be viewed as atypical circumstances.

There, it was the borrower who was the plaintiff, seeking to set aside a mortgage as usurious. On the eve of trial, the matter was settled in open court by the mortgagor giving **both** a new mortgage (presumably in form to purge the original mortgage of usury) and what purported to be a deed in lieu of foreclosure, which was not to be recorded so long as the borrower-grantor complied with the obligations of the new mortgage. When the borrower ultimately defaulted, the lender moved to declare the right of redemption extinguished by prior delivery of the deed, while the borrower cross-moved to compel acceptance of the balance due on the new mortgage. Finding that the purported deed in lieu of foreclosure was not intended to be an absolute conveyance, but instead was designed as further security for the loan and therefore a mortgage, redemption was permitted.

Although the case serves to highlight the concept that any deed in lieu of foreclosure must be carefully analyzed to avoid its declaration as a mortgage, the fact pattern is not, or should not be typical of deed in lieu of foreclosure cases. It is thus not a condemnation of the general efficacy of a deed in lieu of foreclosure. It is, however, an abject lesson in how not to settle a mortgage foreclosure action.

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NEW COMMITTEES

Attention is called to the establishment by the Section's Executive Committee of a **Committee on Commercial Leasing** and of a **Committee on Residential Leasing**. These replace the Committee on Landlord and Tenant.

The Committee on Commercial Leasing will be concerned with all aspects of that type of relationship, and it will continue the project now under way of writing a short form of commercial lease. The Committee will be chaired by Arthur Anderman.

The Committee on Residential Leasing will concern itself with all phases of residential occupancies, including rent regulations, dispossession, loft problems, agency relations and similar areas of concern. The Committee will be chaired by Carol Lilienfeld.

Of course, there may be overlapping occurring with particular problems of concern, as happens with other committees. However, it is expected, as is the experience with other committees, that these areas of overlap will be worked out in a functional way by the new committees so that a better involvement with our work will be achieved — the basic reason for establishing the new committees.

Those who have not been members of the old Landlord and Tenant Committee are invited to consider joining one of the new committees. As to members of the old committee who have not yet made a selection, you are asked to do so now by writing the State Bar, Attention: Lisa Sarinelli, and indicate your preference; failing which your name will not appear on the rolls of either of the new committees. It is therefore imperative that you make a choice immediately.