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Title Insurance Coverage Narrowed For Properties Sold Through Foreclosure

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The Reason?

• A new statute, Real Property Actions and Proceedings Law ("RPAPL") § 1302-a, which became effective December 23, 2019, effectively makes the defense of lack of standing non-waivable in the foreclosure of a home loan (as defined in RPAPL § 1304 (6)(a)).

• RPAPL § 1302-a completely upends decades of established case law and leaves the title devolving through the foreclosure susceptible to attack for years after the foreclosure sale and conclusion.

How Does a Plaintiff Establish Standing?

• Standing, which is required to foreclose a mortgage, is demonstrated by the plaintiff's possession of the note at the inception of the action and affords the plaintiff legal entitlement to judgment. This is most often accomplished by attaching the note to the complaint. (JPMorgan Chase Bank, National Association v. Escobar, 2019 NY Slip Op 08181).

• If the plaintiff is not the originator of the mortgage, it will have standing upon (i) receipt of an assignment of the note and mortgage (the mortgage goes with the note) *or* (ii) delivery of the note. As to the latter, if the note is delivered sans assignment, there still needs to be either a proper endorsement, on the note or affixed to it, or an alonge affixed to the note.

• A transfer in full of the obligation automatically transfers the mortgage as well unless the parties agree that the transferor is to retain the mortgage (Restatement [Third] of Property [Mortgages] § 5.4, Reporter's Note, Comment b).

• To establish standing, the foreclosing party must present a "prima facie" case that it has the legal ability to foreclose and is entitled to judgment. The basics that the plaintiff must prove are:

◦ the existence of the mortgage;
◦ proof that the plaintiff holds the mortgage; and
◦ a default under the mortgage.

Common Challenges to Standing

• Plaintiff/lender is not the originator of the mortgage, and an assignment is not recorded.

As a matter of law in New York, delivery of the mortgage documents with the intention that there is to be an assignment suffices – that is to say, there is no absolute need for a written assignment of mortgage (although it is strongly suggested). (Homar v. American Home Mtg. Acceptance, Inc., 119 A.D.3d 900, 989 N.Y.S.2d 856 [2d Dept. 2014]).

• Lender does not have possession of the mortgage.

To have standing, it is not necessary to have possession of the mortgage at the time the action is commenced. This conclusion follows from the fact that the note, and not the mortgage, is the dispositive instrument that conveys standing to foreclose under New York law.

Common Challenges to Standing Cont'd…

- The lender holds the note but not the mortgage.

This is not an infirmity to standing - the opposite is. A plaintiff with a mortgage but no note lacks standing to foreclose. (Knox v Countrywide Bank, 4 F Supp 3d 499, 508 [ED NY 2014]).

Once a note is transferred, "the mortgage passes as an incident to the note" (Bank of N.Y. v Silverberg, 86 AD3d 274, 280 [2d Dept 2011]). An assignment of the note brings with it the mortgage as an incident of the assignment. (Citibank, N.A. v. Herman, 125 A.D.3d 587, 3 N.Y.S.3d 379 [2d Dept. 2015]).

Any disparity between the holder of the note and the mortgagee of record does not stand as a bar to a foreclosure action because the mortgage is not the dispositive document of title as to the mortgage loan; the holder of the note is deemed the owner of the underlying mortgage loan with standing to foreclose. (14A Carmody-Wait 2d § 92:79 [2012]).

Common Challenges to Standing Cont'd…

- I was not personally served.

Under CPLR § 317, "[a] person served with a summons other than by personal delivery to him or to his agent for service...who does not appear may be allowed to defend the action within one year after he obtains knowledge of entry of the judgment, but in no event more than five years after such entry, upon the finding of the court that he did not personally receive notice of the summons in time to defend and has a meritorious defense."

Under CPLR Rule 5015 (a), the court which rendered a judgment may "relieve a party from it upon such terms that may be just" for the "lack of jurisdiction to render the judgment or order."

Additional Challenges to Standing

• Also under CPLR Rule 5015 (a), the court which rendered a judgment may "relieve a party from it upon such terms that may be just" upon the ground of "excusable default, if such motion is made within one year after service of a copy of the judgment or order with written notice of its entry upon the moving party, or, if the moving party has entered the judgment or order, within one year after such entry."

• In each instance, "the court may direct and enforce restitution", and New York courts generally uphold the rights of bona fide purchasers acquiring title out of a mortgage foreclosure. See, e.g., U.S. Bank, N.A., as Trustee, v. Bernhardt, 2010 WL 3565527 (Sup. Ct., Richmond), in which the Court granted a motion by the temporary guardian of the defendant property owner to vacate a default judgment of foreclosure and sale due to the lack of personal service and dismissed the Action. The Court held, notwithstanding, that the bona fide purchaser at the foreclosure sale would retain title.

What If The Defendant Does Not (directly) Challenge Standing?

• If a Defendant is not personally served and does not file an appearance, that Defendant may have recourse under CPLR § 317 (“Defense by person to whom summons not personally delivered”) and CPLR Rule 5015 (“Relief from judgment or order”) – these latter principles remain unchanged.

• Prior to RPAPL § 1302-a, standing was a waivable defense. Under Rule 3211 (“Motion to dismiss”) of New York’s Civil Practice Laws and Rules, a defense that “the party asserting the cause of action has no legal capacity to sue” had to be raised in a defendant’s answer or in a pre-answer motion to dismiss or it was deemed waived. (Wells Fargo Bank Min. V. Perez, 894 N.Y.S. 2d 509 [2nd Dept., 2010], and Wells Fargo Bank, N.A. v. Mastropaolo, 837 N.Y.S. 2d 247 [2nd Dept., 2007]).

RPAPL § 1302-a – The Consequences

"Notwithstanding the provisions of [CPLR § 3211(e)], any objection or defense based on the plaintiff's lack of standing in a foreclosure proceeding related to a home loan, as defined in [RPAPL 1304(6)(a)], shall not be waived if a defendant fails to raise the objection or defense in a responsive pleading or pre-answer motion to dismiss. A defendant may not raise an objection or defense of lack of standing following a foreclosure sale, however, unless the judgment of foreclosure and sale was issued upon defendant's default" (RPAPL § 1302-a).

- A challenge to standing is no longer a waivable defense (for mortgages categorized as home loans).

A home loan is defined under RPAPL § 1304(6)(a) as a loan in which (1) the borrower is a natural person, (2) the debt is incurred by the borrower primarily for personal, family, or household purposes and (3) the loan is secured by a mortgage on real estate improved by a one to four family dwelling, or a condominium unit, in either case, used or occupied, or intended to be used or occupied wholly or partly, as the home or residence of one or more persons and which is or will be occupied by the borrower as the borrower's principal dwelling.

RPAPL § 1302-a – The Consequences Cont'd…

• If a defendant appeared in the action, its ability to raise the defense continues to the moment when the hammer falls at the foreclosure auction sale.

• If a defendant did not appear, then the ability to pursue the defense survives the foreclosure sale, lurking to assault the foreclosure sale title for what is a potentially uncertain duration.

• RPAPL 1302-a contradicts the established law that a judgment of foreclosure and sale entered against a defendant is final as to all questions at issue between the parties and concludes all matters of defense which were or might have been litigated in the foreclosure action.

• This a serious concern for lenders and poses immediate increased risks for title insurers. With the seemingly perpetual litigation risk imposed by RPAPL § 1302-a, one must contend with questions over the marketability and insurability of a property when title devolves from a foreclosure sale upon default that is exposed to attack months and years after a final adjudication and sale.

• This leaves purchasers with the risk of litigation and, potentially, loss of title, despite the entry of a judgment of foreclosure and sale and a delivered referee's deed.

RPAPL § 1302-a and Title Insurance

• RPAPL § 1302-a creates new and increased risk to title insurers, most particularly when we encounter a transaction involving a home loan wherein the foreclosure sale has been completed and the defendant/mortgagor neither answered nor appeared. In such circumstances, the defendant's right to raise lack of standing as a defense continues post-foreclosure sale.

• Prior to the enactment of RPAPL § 1302-a, the purchaser of a property devolving through foreclosure was already taking on additional risk as reflected by the following "standard" exceptions:

(i) CPLR Section 317 within five years after entry of judgment of foreclosure if said defendant was served by means other than personal delivery;
(ii)CPLR Section 2003 within one year after a sale for irregularity in the judicial sale;
(iii)CPLR Rule 5015 (a)(1) within one year after service of a copy of the judgment for excusable default; or
(iv) CPLR 5015 Rule (a)(4) for the lack of jurisdiction to render the judgment or order.

RPAPL § 1302-a and Title Insurance Cont'd…

• Since RPAPL § 1302-a creates even greater risk, the underwriting standard for any policy insuring title to a one to four family residential dwelling or a residential condominium unit which is either being conveyed by a referee in a foreclosure action or which the property was previously the subject of a foreclosure action, and for which a default judgment has been entered (on or after December 23, 2019) against any of the defendants named in the action, must contain an exception for loss or damage arising from challenges to standing in the foreclosure action. The precise language one can expect to encounter is:

POLICY DOES NOT INSURE AGAINST LOSS OR DAMAGE, AND THE COMPANY WILL NOT PAY COSTS, ATTORNEYS' FEES OR EXPENSES THAT ARISE BY REASON OF ANY CLAIM CHALLENGING THE LACK OF STANDING OF THE PLAINITIFF IN THE MORTGAGE FORECLOSURE ACTION ENTITLED _____v. _____ UNDER INDEX NO. _____ IN THE SUPREME COURT OF THE STATE OF NEW YORK, _____ COUNTY.

RPAPL § 1302-a and Title Insurance Cont'd…

Production of the below is often sufficient to clear the 1302-a exception:

1. A Certificate of Merit signed by plaintiff's counsel, evidencing that the plaintiff was in fact the true holder and possessor of the note and mortgage at commencement of the action. True copies of the original note and mortgage must be exhibited to the Certificate; and

2. Affidavit or Affirmation from plaintiff's counsel re-confirming, for the benefit of the title insurer, that plaintiff was the holder of the note and mortgage and in possession of the original note and mortgage at the time the foreclosure action was commenced.

• Depending on the facts, some underwriters will omit the 1302-a exception based on the vacant status of the property. Of course, most referees and lenders are (understandably) reluctant to affirm that a property is in fact vacant.

RPAPL § 1302-a – Closing Thoughts

Since RPAPL § 1302-a took effect shortly before the foreclosure and eviction moratoriums were imposed, there is a dearth of case law and title claims to offer guidance.

Whether bidders will offer less because of the increased risk remains to be seen. How lenders will react, if at all, is unknown.

What we do know is that foreclosure bidders must account for additional underwriting time, certainly from a title perspective and perhaps on the lender side too.

Bidders will also need to account for (potential) litigation fees in the event of a post0sale standing challenge.

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TITLE INSURANCE

Title Insurance Coverage Narrowed for Properties Sold Through Foreclosure

By **Jason C. Bergman**

Because so many mortgage foreclosure actions are defended with particular zeal, and because the legal procedure (especially for home loans) is laden with traps, title companies have always been dubious about insuring such titles. Attorneys for foreclosing attorneys and sale bidders can readily attest to this. But passage of a recent statute creates a significant *new* impediment to title insurance for home loan mortgages devolving through a foreclosure sale.

That new statute (RPAPL §1302-a, effective December 23, 2019) provides, in essence, that the defense of lack of standing is (no longer) waivable where the mortgage is categorized as a home loan [the definition of a home loans is found at RPAPL 1304(6)(a)], even though a defendant has neglected to raise the defense in a pre-answer motion to dismiss or in a responsive pleading. If a defendant has appeared, their ability to raise the defense continues to the moment when the hammer falls at the foreclosure auction sale.

If, however, a defendant has defaulted in appearance, then the ability to pursue the defense survives the foreclosure sale, lurking to assault the foreclosure sale title for what is a potentially uncertain duration. However, trial court authority meaningfully clarifies that an excuse for lateness in interposing the defense is still required. [*JP Morgan Chase Bank, N.A.* v. *Carducci*, 67 Misc.3d, 124 N.Y.S.3d 642 (Sup. Ct. West. Co. 2020).] It is primarily that unpredictable exposure which understandably makes title companies more than timorous to insure, and which not incidentally creates problems for foreclosing lenders and foreclosure sale bidders.

The Break with Existing Standards

While revolutionary may be too strong a word to apply to the new statute, it is in any event a drastic alteration in what litigants—and title companies—have understood for as long as anyone can remember.

First, standing was long a defense which could be waived as a matter of statute—CPLR §3211(3)—if not asserted in a motion to dismiss. If not presented in that form, it had to be pleaded in an answer, lest it be waived, again as a matter of statute: RPAPL §1302. These statutes are clear enough and extensive case law supported them. [*US Bank N.A.* v. *Nelson*, 169 A.D.3d 110, 93 N.Y.S.3d 138 (2d Dept. 2019); *Wells Fargo Bank* v. *Halberstam*, 166 A.D.3d 710, 87 N.Y.S.3d 328 (2d Dept. 2018). For much more extensive citation see *2 Bergman On New York Mortgage Foreclosures* §19.07[1], LexisNexis Matthew Bender (rev. 2020).] Indeed, the Court of Appeals has

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recently addressed the point, clearly confirming the waivability of the standing defense, albeit upon events occurring prior to the effective date of the new statute. [*US Bank National Association* v. *Nelson*, ____ N.E.3d ____ 2020 WL 7390873 (Mem.), 2020 N.Y. Slip Op. 07661).] The statute was enacted during the pendency of the appeal and as to that the Court stated that it did not reach the issue of whether RPAPL 1302-a affords an opportunity to raise standing at the stage where the plaintiff had applied for judgment of foreclosure and sale. Rather, it opined that defendants were free to apply to the trial court for such relief as may be available under the statute.

While there was occasional nuance to the formulation of waiver, it was minor enough not to change the basic principle. In any event, the statutes (and case law) enunciating waiver lose their effect in home loan foreclosure actions.

Another bedrock principle was the finality of the judgment of foreclosure and sale. Once that was entered, all matters of defense which were—or significantly might have been litigated in the foreclosure action—were deemed concluded. [See, inter alia, *Chapman Steamer Collective, LLC* v. *Keybank National Association*, 163 A.D.3d 760, 81 N.Y.S.3d 501 (2d Dept. 2018); *Ciraldo* v. *JP Morgan Chase Bank, N.A.*, 140 A.D.3d 912, 34 N.Y.S.3d 113 (2016); *Feiber Realty Corp.* v. *Abel*, 265 N.Y. 94, 191 N.E. 847 (1934).] Thus, a party who defaulted was "locked in"; what they could have argued but did not (for our purposes, standing) was concluded.

Title companies, of course, relied upon this dependable state of affairs. Unless standing was part of an ongoing appeal, when the action ended with the foreclosure sale, a defendant hoping to suddenly raise standing was not a factor. Whatever other concerns title companies had with the sturdiness of the title, a standing defect was not among them.

Passage of a recent statute creates a significant new impediment to title insurance for home loan mortgages devolving through a foreclosure sale.

It is apparent to mortgage foreclosure litigants that the defense of lack of standing has been commonplace for a number of years. Mortgage commerce elicits assignments of mortgage paper frequently so that issues involving proper assignments or note endorsements can readily arise. And the foreclosing party must have been in possession of the mortgage note at the inception of its foreclosure.

While most often the foreclosing plaintiff does indeed have standing, there is room to stumble and so the defense is often interposed. As a practical matter, then, the issue (if there ever was one) will sometimes be resolved in the foreclosure action; that is, it will have been raised, addressed, and resolved (save for an appeal, which is irrelevant to this discussion).

Recalling that a primary concern of the new statute is that a standing defense survives as a threat even after a foreclosure sale, the peril prevails only when a defendant has defaulted. Might a defendant who answered and litigated the standing defense still pursue the claim after the foreclosure sale? They could (anyone can, of course, try anything), but overwhelmingly there would be no basis for it. If the defendant pursues it in federal court, it is barred by the Rooker-Feldman Doctrine. [See, inter alia, *Hachamovitch* v. *DeBuono*, 159 F.3d 687 (2d Cir. 1998); *Dockery* v. *Cullen & Dykman*, 90 F. Supp. 2d 233 (E.D.N.Y. 2000); *1 Bergman On New York Mortgage Foreclosures* 2.23, LexisNexis Matthew Bender (rev. 2020).] If the defendant renews the argument under the existing caption, it would be barred by the law of the case doctrine. [See, inter alia, *Weiss* v. *Phillips*, 157 A.D.3d 1, 65 N.Y.S.3d 147 (1st Dept. 2017); *2 Bergman On New York Mortgage Foreclosures* §21.01 [4], LexisNexis Matthew Bender (rev. 2020). And if a separate action in state court is begun, the doctrine of res judicata should vanquish it. [See, inter alia, *Chapman Steamer Collective, LLC* v. *Keybank National Association*, 163 A.D.3d 760, 81 N.Y.S.3d 501 (2d Dept. 2018); *Dupps* v. *Betancourt*, 121 A.D.3d 746, 994 N.Y.S.2d 633 (2d Dept. 2014); *3 Bergman On New*

York Foreclosures §27.02[1], LexisNexis Matthew Bender (rev. 2020).]

This still leaves a significant portion of home loan foreclosures deleteriously affected by the new statute: cases where a defendant who *might* want to challenge a plaintiff's standing has defaulted in the action. Because the defense of standing is no longer waivable by neglect to raise it in a motion or an answer, a defaulting defendant remains a risk (if not a stalking menace) presumed poised to suddenly emerge post-sale with an attack on the action and the title derived through it. It is that in the end which creates the title insurance problem.

How Long The Post-Sale Attack Lurks

That the possibility of a furtive assault after the foreclosure sale exists can readily be understood as a basis for some title insurers to avoid the risk—either with an exception for the defense arising, or an absolute declination to insure. While it may be that the title company could conclude that the standing was unassailable, even a baseless claim incurs litigation expense (i.e., litigation risk), and that possible expenditure could be reason enough to decline insurance.

Exacerbating the dilemma is the uncertainty in assessing how long a defendant in hiding can remain concealed until emerging. To be sure, laches has proven to be a defense to a post-sale offensive.

Laches can be invoked to preclude relief where a party's action has caused prejudice to another party thereby rendering inequitable the granting of relief. [*First Nationwide Bank* v. *Calano*, 223 A.D.2d 524, 636 N.Y.S.2d 122 (2d Dept. 1966).] Examples of how much delay can call for laches are one year [Id.] or eighteen months. [*Chase Manhattan Mort. Corporation* v. *Anatian*, 22 A.D.3d 625, 802 N.Y.S.2d 743 (2d Dept. 2005).] Helpful though they are, the factors involving laches can vary too much to provide predictability—in any case the time during which a title company could be left wondering appears at least to be lengthy.

Statutes might in theory offer more precision, but examining those which could have application—CPLR §2003, RPAPL §231, CPLR §317, CPLR §5015(a)(1) and CPLR 5010(a)(3)—do not quite connect to the dictates of the new RPAPL §1302-a. They too are uncertain. A discussion of them here would be lengthy and obscure and would not readily underwrite a conclusion. Readers may wish to examine them for an independent evaluation.

Conclusion

The dangers posed by RPAPL §1302-a are such that title insurers now require inclusion of an exception for all applicable policies for (the possible) interposition of a standing defense. This results in the bidder taking on both the cost of defending such a claim and the risk of loss of title. Consequently, the utility of a title policy in certain situations may now become open to some question. The ultimate result may be a chill on the bidding process since more risk is involved. (It may also serve to devalue properties subject to home loans being sold through foreclosures).

That noted, most title insurers will omit the exception if an examination of standing confirms that the plaintiff clearly had standing at the inception of the action. Others, however, will feel compelled to issue policies with the exception regardless of what a standing analysis may reveal. Perhaps not unexpected, one title insurer has concluded that the risk associated with RPAPL §1302-a is so great that it will no longer insure any titles whatsoever conveyed through foreclosures. There are assuredly some concerns here and additional diligence is required to satisfy your title insurer.