

LAW CURRENTS An informational newsletter from Richard A. Klass, Esq.

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Feeling a Million Bucks Better!

Bad economic times over the past few years have seen the foreclosure of tens of thousands of properties across New York State (as well as around the country). One corporate landlord had two commercial rental buildings located in Brooklyn. Spread across those two buildings was a 'blanket' mortgage of \$1.1 million (the term 'blanket mortgage' refers to one mortgage recorded against two or more properties). The buildings fell into foreclosure as a result of the landlord's inability to pay the mortgage loan and the general economic downturn in the area. The corporation that owned the buildings and the individual owner who signed a personal guaranty of the mortgage loan were sued in the mortgage foreclosure proceeding.

On September 30, 2010, the two buildings were sold at the foreclosure auction sale by the court-appointed Referee as one combined lot for \$574,000. The mortgage lender's attorneys prepared the Referee's Report of Sale and Statement of the balance due to the lender on the mortgage loan after the auction sale (the "deficiency"), which was computed as follows: Total due Plaintiff: \$1,408,111.61. Amount of Bid: \$574,000. Deficiency: \$834,111.61.

After the foreclosure auction sale, the plaintiff-mortgage lender filed a motion with the court, asking the judge to grant a Deficiency Judgment against the corporation and the individual owner based upon his personal guaranty.

The defendants did not receive notice of the motion. The motion was granted and the court entered a Deficiency Judgment against them for \$902,506.17.

The individual guarantor (and now judgment debtor), came to **Richard A. Klass, Your Court Street Lawyer**, for legal advice to challenge the Deficiency Judgment.

Deficiency Judgment:

Mortgage foreclosures in New York are governed by Article 13 of the Real Property Actions and Proceedings Law (RPAPL). The normal flow of a mortgage foreclosure proceeding is: (a) filing and serving the Summons and Complaint; (b) having the court appoint a referee to determine

how much is due to the lender on the mortgage loan; (c) granting the Judgment of Foreclosure and Sale, allowing the mortgage lender to "foreclose" the mortgage upon its collateral (security for the loan) – the house; and then (d) conduct an auction sale of the house to satisfy the debt owed.

Many times, the foreclosure auction sale of the property does not sell for enough money to pay off the debt due to the mortgage lender/bank. When a property is worth less than the amount due on the mortgage, the property is considered "underwater." If, after the sale, the lender is still due money for its debt under the Judgment of Foreclosure and Sale, the lender may bring a request for the judge to award a judgment for the balance of



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the money due for its debt – it is asking for a Deficiency Judgment to be entered against the person or people liable under the mortgage note (the term “deficiency” referring to the remaining shortage due to the bank). The procedure for requesting the Deficiency Judgment is laid out in RPAPL Section 1371, and it must be strictly followed.

Attacking the Validity of the Deficiency Judgment:

At the stage that the client retained Richard A. Klass, *Your Court Street Lawyer*, to help, a game plan to attack the Deficiency Judgment had to be formulated and put into action. The entire file in the mortgage foreclosure proceedings, including all of the pleadings, motions, and court orders had to be obtained from court and reviewed to see whether every step taken by the mortgage lender was proper – in other words, did the mortgage lender cross every “t” and dot every “i”?

1. Motion made after 90-day time limit. The Referee’s Deed from the auction sale was dated October 9, 2010. The date that the motion was served upon the defendants, January 11, 2011, exceeded the 90-day time limit specified in RPAPL 1371(2) by four days. New York case law has held that the 90-day time period in which to request that a deficiency be granted is considered a “statute of limitations” and, if not made within this period, it is time-barred. Thus, it was argued that the plaintiff-mortgage lender made the motion too late.

2. Improper calculation of the deficiency. In RPAPL 1371(2), it states that the deficiency is the amount owing less “the market value determined by the court or the sale price of the property whichever shall be the higher.” The plaintiff calculated the deficiency based upon the lower sale price (\$574,000) instead of the higher appraised fair market value (\$675,000), which would have resulted in a lower deficiency amount (by over \$100,000).

3. Both properties were sold together as one combined lot. For some reason, the plaintiff opted to lump together two separate and distinct properties into one foreclosure sale. By conducting the sale of both properties at the same time, it was

argued the plaintiff waived the right to claim a deficiency against the defendant. In *Sanders v. Palmer*, 68 NY2d 180 [1986], the Court of Appeals held that “there shall be separate sales of the security in such order as the court may fix, and an application after each sale and before the next occurs for determination of the deficiency resulting from the sale, for otherwise what remains due and payable from the additional security provided cannot be known.” Here, the plaintiff decided to sell both properties as a “package deal” without selling each property separately; therefore, the proper deficiency could not have been determined.

4. The personal guaranty was “limited” to \$55,000. But, perhaps, the most glaring mistake in the foreclosure proceedings was that the personal guaranty of the individual owner (attached to the Complaint) stated on its face that it was limited to only \$55,000 of the mortgage debt plus the legal expenses and costs associated with protecting the collateral. This was not brought to the attention of the judge when the plaintiff made the motion for the deficiency.

Based upon the several errors in the motion and procedures taken to obtain the Deficiency Judgment, the plaintiff-mortgage lender agreed to vacate and dismiss the Deficiency Judgment against the individual guarantor. Instead of owing the bank close to \$1 million, he wound up owing \$0!

— Richard A. Klass, Esq.

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