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Bankruptcy Court Finds Note and Mortgage Unenforceable Based on Expired Statute of Limitations

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Our lender clients are aware of the importance of taking action timely and unambiguously. A recent decision by United States Bankruptcy Judge Robert E. Grossman in the Eastern District of New York provides a primer on this axiom. The opinion provides a stark warning of the potential pitfalls for foreclosing lenders who may run afoul of the six-year statute of limitations for bringing a foreclosure action in New York.

In *Barnard v. Nationstar Mortg. LLC (In re Kramer)*, No. 17-70741 (REG) (Bankr. E.D.N.Y. Nov. 27, 2019) (available at https://casetext.com/case/barnard-v-nationstar-mortg-llc-in-re-kramer) ("Decision"), Judge Grossman provides an excellent summary of important aspects of the law relating to mortgage foreclosures, notices of default, and related statute of limitations issues. In a decision involving analysis of "admittedly divergent opinions by New York courts," Decision, p. 3, Judge Grossman held that the six-year statute of limitations for lender's commencement of the foreclosure action expired, thus rendering the subject note and mortgage unenforceable.

In addition to serving as a warning to foreclosing lenders, the decision is an important refresher for lenders and their counsel. In his decision, Judge Grossman uses the opportunity to address several different issues, including the distinction between a note and a mortgage within the context of a foreclosure action, rules applying to notices of default and loan acceleration, and the vital importance of attention to statutes of limitation. Although this case is in the context of a Chapter 7 liquidation and discusses the powers of a Chapter 7 bankruptcy trustee under the provisions of the Bankruptcy Code, the crux of the decision deals with New York state law regarding foreclosures and calculation of the applicable six-year statute of limitation.

The case has a somewhat complex factual background but can be reduced to the following essential facts. The debtors defaulted on the underlying note and mortgage in June 2006 and the lender's servicer sent two notices of default to the debtors. The notices of default stated that mortgage payments "will be accelerated" if the default is not cured by a certain date. Decision, p. 8. The debtors did not cure the default by the deadline in September

2006, and the lender commenced a foreclosure action in state court in October 2006. Nearly six years later, in October 2012, the lender and the debtors signed a stipulation of discontinuance because the lender's servicer was apparently unable to verify that the underlying note and mortgage were assigned to the lender at the time of the commencement of the action. The lender then commenced a second foreclosure action in December 2012 (which was discontinued in March 2014), and a third foreclosure action in January 2017.

Debtors' chapter 7 bankruptcy filing in February 2017 stayed the third foreclosure action. The appointed trustee stepped into the shoes of the debtors and assumed the rights, responsibilities, and powers of the debtors as a result of the "strong arm clause" of Bankruptcy Code section 544. On competing motions for summary judgment in an adversary proceeding commenced by the trustee against the lender, the trustee argued that the lender's remaining foreclosure action was commenced beyond the six-year statute of limitations and the note and mortgage were rendered unenforceable by the statute of limitations. The lender made a number of arguments, including that the notices of default sent in 2006 were not sufficiently clear and unequivocal as to acceleration and that the commencement of the first foreclosure action did not accelerate the note because the lender lacked standing to commence that action. Alternatively, the lender argued that the acceleration in 2006 was revoked when the first foreclosure action was voluntarily discontinued in 2012. As such, the lender claimed, the acceleration occurred when the second foreclosure action was commenced in 2012 and thus, the third foreclosure action was within the six-year statute of limitations when it was commenced in 2017.

Under New York law, the six-year statute of limitations begins to run on the entire mortgage debt when the mortgage note is accelerated. Judge Grossman stated that "some affirmative action" is required to evidence lender's election to accelerate the loan. *Id.*, p. 21 (*citing Costa v. Deutsche Bank Nat'l Trust Co.*, 247 F.Supp.3d 329, 340 (S.D.N.Y. 2017). While the acceleration must be "clear" and "unequivocal," Judge Grossman continued, New York courts "are split on whether a notice of default can constitute a 'clear and unequivocal' assertion of an exercise of the option to accelerate the debt." *Id.*, p. 22. As explained by Judge Grossman, courts in the New York Appellate Division, First Department (which covers Manhattan and the Bronx), have adopted the position that a notice of default stating that the lender "will accelerate" (or that the debt "will be accelerated") after expiration of a cure period accelerates the loan if the default is not cured by the deadline. *Id.*, p. 22-23. By contrast, the New York Appellate Division, Second Department (which includes Brooklyn, Queens, Long Island and other parts of New York State) has held that similar "will accelerate" language in a notice of default does not constitute acceleration. *Id.*, p. 23-24.

Noting that federal courts in New York follow the First Department, Judge Grossman agreed with that line of cases and held that the underlying notice of default "provide[d] clear and unequivocal notice that the [note] would become due in its entirety upon expiration of the cure period" and thus "served to accelerate the [note]." *Id.*, p. 25. Thus, the loan was accelerated in September 2006 and the statute of limitations expired in September 2012 (prior to the commencement of the second and third foreclosure actions).

Addressing the argument that the stipulation discontinuing the first foreclosure action served to revoke the acceleration, Judge Grossman stated that New York "law is clear that once a debt underlying a note and mortgage is accelerated, the statute of limitations can be restarted by an affirmative act of the lender during the statute of limitations period," but that "New York Court of Appeals has not decided whether the voluntary discontinuance of

a foreclosure action suffice to revoke a prior acceleration" and lower courts are split. *Id*., pp. 29-30. Since, among other things, the stipulation of discontinuance did not include any reference to revocation of acceleration, Judge Grossman found that the evidence "support[ed] a finding that [the lender] had no intention of revoking the acceleration of the [note]" when it discontinued the first foreclosure action. *Id*., p. 31. Accordingly, Judge Grossman held that the six-year statute of limitations already expired before the lender commenced the second foreclosure action and that the underlying note and mortgage was unenforceable.

As noted by Judge Grossman, this case arose out of the mortgage crisis and "a significant factor in the rise of problematic foreclosure proceedings can be traced to the mutation of the traditional relationship between the borrower and the mortgagee," such that "[o]nce lenders stopped holding mortgages and commenced entering into complex transactions to sell the mortgages, which were then pooled and sold to trusts as collateralized debt obligations, the seeds of the mortgage crisis were planted." *Id*. p. 3. Although it has been more than ten years since the beginning of the "mortgage crisis," state and federal courts continue to grapple with (and disagree on) the legal issues raised by the resulting mortgage foreclosures. Judge Grossman's decision is unlikely to be the last word on the various issues raised in the decision. The New York Court of Appeals may be asked to weigh in and resolve the conflicts between the various appellate courts, and give lenders clarity in this uncertain area of the law. In the meantime, lenders and their counsel are strongly advised to heed the warning issued by Judge Grossman in this decision.

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