



Mortgage Foreclosure to Proceed Without Requiring a Copy of Promissory Note

December 19, 2017

In a precedent-setting and divided opinion, on November 21, 2017, the Appellate Division, First Judicial Department of the New York State Supreme Court held in *Weiss v. Phillips* that a mortgagee's interest in the property was not rendered null and void because his borrowers, the mortgagors, had acquired the property through fraudulent means.

The Appellate Division also held that the plaintiff, Weiss, met his burden for entitlement to summary judgment in a foreclosure action by his submission of the mortgage and a subsequent extension and modification agreement, (the "**CEMA**") along with "undisputed evidence establishing both the existence of the note, which obviated the need to submit the note as proof that Weiss had the right to foreclose, and the nonpayment."

Here are the facts as stated in the Appellate Division's majority opinion:

The Transfers

Defendant Phillips had previously deeded the subject property (referred to here as the "**First Transfer**") he owned to a relative (referred to here as "**A**") for no consideration so that A could obtain a mortgage loan for Phillips to make repairs and pay accumulated debt. A held title with the understanding that Phillips would pay the loan and that A would transfer the property back to Phillips at a later date.

Subsequently, Phillips's lawyer told Phillips that he was sending his paralegal, (referred to here as "**B**"), to obtain A's signature on the deed transfer back to Phillips. B provided A with a blank deed. However, rather than filling in Phillips's name on the deed as the transferee, B inserted his own mother's name (referred to here as "**C**") as the grantee for no consideration (referred to here as the "**Second Transfer**").

Eighteen months later, C "unlawfully deeded" the property to herself, C, and B (referred to here as the "**Third Transfer**").

At the time of the Third Transfer, Weiss allegedly lent \$500,000.00 to B and C, pursuant to their signing a note and mortgage. B and C breached that note and mortgage by failing to make required payments.

When Phillips learned of the Second Transfer, he sued A to recover the property but later abandoned that lawsuit. A subsequently sued B and C to recover the property from them. That lawsuit allegedly settled when B

and C agreed to transfer title back to Phillips.

The CEMA

Once Phillips learned of Weiss's intention to foreclose, Phillips executed a CEMA with Weiss which stated, among other things that:

- B and C were conveying the property to Phillips;
- Phillips consented to the conveyance of the property and understood that he was not personally assuming payment of the note executed by B and C;
- B and C had no counterclaims, defenses, or offsets to the note or mortgage;
- The note and mortgage remained in full force and effect and were fully enforceable in accord with their terms and the modification in the CEMA.

The CEMA also included language whereby Phillips (1) ratified and reaffirmed that the terms and revisions of the note and mortgage remained in effect, and (2) represented and warranted that there were no counterclaims, defenses, or offsets of any nature whatsoever to any of his obligations under the note or mortgage, as modified by the CEMA. Weiss also agreed to forbear from foreclosing for one year to permit Phillips to obtain refinancing.

After the expiration of the extension period, Weiss commenced foreclosure. On his summary judgment motion, Weiss provided a copy of the mortgage and CEMA, but not the note. Phillips opposed, arguing, among other things, that the mortgage was unenforceable as it was based on a void deed. Weiss was granted summary judgment and Phillips appealed.

The Appellate Division's Analysis

In affirming the grant of summary judgment, the Appellate Division cited the "unique facts" of the case and stated that "unlike the dissent, we do not view this action as a typical mortgage foreclosure action." The Appellate Division covered a range of legal issues in arriving at its decision.

Why Not Require a note to Foreclose?

As indicated by the dissent, N.Y. case law generally requires the production of a note, mortgage, and undisputed evidence of nonpayment in order for a foreclosing plaintiff to set forth a *prima facie* case for judgment of foreclosure.

Here, the Appellate Division majority found as follows:

A *prima facie* case was established by plaintiff's submission of the mortgage and the CEMA, in which Phillips acknowledged the existence and validity of the unpaid note and mortgage, as well as deposition testimony in which the existence of the note was unchallenged.

The dissent's reliance on UCC 3-804, which addresses lost, stolen or destroyed instruments were inapplicable here where the plaintiff is "the undisputed holder" of the note.

There was no risk of double liability if the note later turns up in the possession of another claiming to be a holder in due course since Phillips assumed no personal liability for the note and the mortgage would be extinguished upon foreclosure.

The dissent noted as follows:

The majority makes the unprecedented holding today that plaintiff may make out a *prima facie* case for foreclosure without either producing the note or explaining its absence and proving its terms.

The record does not include any explanation for the absence of the note. One possible conclusion is that the note does not exist.

Plaintiff has offered no explanation whatsoever for the note's absence, and no proof of its contents. Furthermore, the majority may not rely on the [C]EMA to take the place of the missing note, because that document does not set forth the terms of the alleged note.

However, the majority maintained that “the note's absence is accounted for by the CEMA and there is no legitimate question that Weiss is the party entitled to enforce under the note, as evinced by the mortgage contract and the CEMA, in which Phillips acknowledges Weiss's right under the note and mortgage, and the deposition testimony indicating the existence of the note. When he entered into the CEMA, Phillips was represented by counsel and he knew that Weiss remained the lawful holder of the note and mortgage.”

With Weiss having met his burden on summary judgment, the majority addressed Phillips’s opposition by finding that Phillips’s waiver of the right to assert defenses and counterclaims was enforceable and not violative of public policy.

Void vs. Voidable Deed

However, Phillips also maintained that the mortgage was not enforceable because it was based on a “fraudulent/forged deed.”

The issue was whether the deed in connection with the Second Transfer was void from the beginning (void *ab initio*) or merely voidable. Forged deeds and/or encumbrances are those that are executed under false pretenses and are thus void *ab initio* and even *bona fide* purchasers and encumbrancers are not protected when a title is derived from such void deeds.

In contrast, a fraudulently induced deed is merely voidable.

Here, the majority found that the Second Transfer was fraudulently induced and thus merely voidable. This was because the owner, A, actually signed the deed, although it was blank (with the name of the transferee to be filled in later), believing that it would transfer the property back to Phillips.

Nevertheless, the dissent maintained that there was an issue of fact as to whether Weiss was a *bona fide* encumbrancer entitled to protection. This depended on whether he was on constructive notice of any fraud. If he

had such constructive notice, that could constitute a defense to foreclosure.

However, the majority found that the CEMA addressed this issue because, again, Phillips waived all claims and defenses, and because Phillips “may not avoid a mortgage obligation on his property on the ground of fraud where, after acquiring knowledge of the fraud, he affirmed in the CEMA that his property was subject to Weiss’s lien . . .” The majority had found that Phillips, through the language in the CEMA, as well as his conduct, had ratified Weiss’s mortgage.

It should be noted that both borrower and lender here were individuals, with the dissent indicating that there was a disparity in educational level and sophistication between them as Weiss was a college graduate, in the business of lending money and Phillips had no formal education after the age of 14. The majority did not seem to indicate that this was an issue as Phillips was represented by counsel at the time he signed the CEMA.

Interestingly, although the dissent cited to Appellate Division decisions from the First, Second, and Third Judicial Departments on the issue of whether evidence of the note was required to set forth a *prima facie* entitlement to foreclosure, we are not currently aware of a further attempt to reargue this decision or to appeal it further to the New York Court of Appeals. Thus, for now, this opinion sets forth the law in the First Judicial Department, which covers the Bronx and New York Counties. At first glance, it seems that since the majority does rely significantly on the language in the CEMA in arriving at its decision, lenders can attempt to tailor language in CEMAs for their protection under similar circumstances. However, as indicated by the majority decision, this case is unique indeed, and since it involves additional facts that may not be applicable in other situations, best practices still dictate that a promissory note be obtained at closing and properly maintained.

If you have any questions regarding this opinion or would like assistance on matters involving similar issues, please feel free to contact Samit G. Patel at [212-510-2286](tel:212-510-2286) or via email at spatel@cullenanddykman.com

1. In her dissent, Justice Ellen Gesmer indicated that there was no evidence of a \$500,000.00 payment having been made by Weiss.
2. The dissent indicated that there was no proof of any such settlement.

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