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The Impact of Workouts on Deadlines to Act: Be Attentive to Statutes of Limitations

May 30, 2019

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It is not uncommon for lenders to enter into forbearance or other workout agreements with their borrowers after a loan has been accelerated because of a default of some sort. Often overlooked in negotiating the forbearance agreement is the effect of the statute of limitations on a future action if the borrower defaults under the workout agreement itself. Under New York State law, a lender has 6 years to commence an action to enforce a default which runs from the date of acceleration. Without an intervening agreement, the statute of limitations would ordinarily not be an issue for the lender.

However, what happens if a workout agreement is negotiated and the borrower defaults under that workout agreement? If the lender is lucky, the default will occur within the original 6 year statute of limitations, and the lender can then commence an appropriate action. If the lender does not want to press its luck, however, it should deaccelerate the loan. This issue was recently addressed by the Kings County Supreme Court.

In Sterling National Bank v. Manheimer, the lender accelerated the defaulted debt of its borrower by commencing an action in 2011. That initial action was ultimately dismissed. The lender thereafter commenced another action to foreclose its mortgage in 2018, more than 6 years after the initial acceleration. The borrower sought to dismiss the 2018 action on statute of limitation grounds. In response, the lender claimed that it sent a “deacceleration notice” to the borrower in 2015, after which the borrower again defaulted, and that the 2018 action was therefore within the 6 year statute of limitations from the time of the 2015 notice. The Supreme Court addressed the criteria for valid deacceleration notices. The Court, in relying on the Second Department case of Milone v. US Bank Nat’l Ass’n, 164 A.D. 3d 145 (2d Dep’t 2018), reaffirmed that a valid deacceleration notice

must be clear, unambiguous, and not pretextual [i.e., a true deacceleration as opposed to only a pretext to avoid an impending statute of limitations expiration]. A notice is not pretextual if it contains an express demand for monthly payments on the note, or, in the absence of such express demand, it is accompanied by copies of monthly invoices transmitted to the [borrower] for installment payments, or is supported by other forms of evidence demonstrating that the lender was truly seeking to de-accelerate and not attempting to achieve another purpose under the guise of de-acceleration.

Manheimer, citing Malone, 164 A.D. 3d at 154.

The Manheimer Court further stated that a notice would be non-pretextual if it allows a borrower to return to making monthly payments, a genuine benefit that protects the borrower against a subsequent foreclosure absent a new default. The notice at issue in Manheimer was not ruled upon in the Court's decision, based on the issues of fact that were raised. Specifically, the notice clearly stated that the acceleration was rescinded, but did not contain an express demand for monthly payments, and an affidavit of the lender also called into question whether the deacceleration was to avoid the effect of an approaching statute of limitations.

While the notice was not formally ruled upon in this case, the message to lenders is clear: If a workout agreement is negotiated after the initial acceleration of a debt, the lender should either put very specific, non-pretextual language in that agreement itself, or send a deacceleration letter containing appropriate language.

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