Bankruptcy Court Strikes Mortgage on Statute of Limitations Grounds

By Craig D. Robins

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One of the trendiest topics in foreclosure defense these days is whether a mortgage can be stricken because of the statute of limitations. Since many foreclosure cases brought about 10 years ago were dismissed due to having been improperly filed, mortgagees have been recommencing these suits, many of which involve periods of no payments exceeding six years — the statute of limitations for collecting on a mortgage.

Consequently, there have been an increasing number of decisions addressing whether the mortgage debt was actually accelerated, and, if so, whether the statute of limitations is applicable. Almost all such litigation has been in state court.

However, this rapidly evolving issue just spilled over into our very own Bankruptcy Court where Judge Robert E. Grossman, sitting in Central Islip, determined that a mortgagee failed to bring its foreclosure suit within the six-year statute of limitations after the mortgage was accelerated, and that the mortgage was therefore no longer valid and enforceable. *Barnard v. Nationstar Mortgage LLC (In re Kramer),* Case No. 18-08002 (Bankr. E.D.N.Y. Nov. 27, 2019).

In the early 2000s, many banks would send notice of default letters to borrowers with wording such as: "If you do not cure the default, the mortgage loan will be accelerated if the default is not cured within 30 days." Some astute foreclosure defense attorneys presented with this situation thought they had a slam-dunk statute of limitations argument. They argued that the notice of default letter accelerated the mortgage and, because more than six years elapsed since the date of the letter, the mortgage was unenforceable, thanks to the statute of limitations.

Those whose cases were pending in the First Department were quite fortunate: Those courts ruled in favor of the homeowner. Meanwhile, here in the Second Department, in cases involving the exact same letter, the homeowners lost. As noted by Judge Grossman, "New York intermediate appellate courts are split on the critical questions about the 'start date' for the statute of limitations."

New York case law requires that in order for a notice of default to accelerate the entire mortgage debt, it must be clear and unequivocal. However, there is a split between the First and Second departments as to how this applies to the wording in the notice of default letter. The First Department holds that a notice of default stating that the lender "will accelerate" after the expiration of a cure period does accelerate the maturity of the loan if the default is not cured by the deadline. This is because though the acceleration is based on a future event, it is a definite event. However, the Second Department holds that the "will accelerate" language is not "clear and unequivocal" and therefore does not accelerate the debt as it relates to a future event.

In the *Kramer* case before Judge Grossman, the debtor homeowners defaulted on their mortgage in June 2006. One month later, the servicer, Countrywide Home Loans, sent a notice of default stating that the loan will be accelerated if the default was not cured by Aug. 7, 2006. The debtors did not cure the default by the deadline.

In Oct. 2006, the holder of the mortgage at the time, Wells Fargo, commenced a foreclosure action against the debtors in Suffolk County Supreme Court. Six years later, in 2012, the parties executed a stipulation of discontinuance, the stated reason being to allow Wells Fargo to verify the assignment chain. The stipulation did not indicate that the acceleration was being revoked.

Wells Fargo commenced a second foreclosure action in December 2012. However,

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the plaintiff, as named in the complaint, contained an incorrect reference to the trust series. In other words, the pleadings contained the wrong plaintiff. This led to the parties executing a stipulation of discontinuance in 2014.

Believing it finally got its act together, Wells Fargo commenced a third action in January 2017. A month later, the debtors filed their bankruptcy, staying the foreclosure action.

The Chapter 7 trustee, Ken Bernard, brought a motion for summary judgment in an adversary proceeding against the lender seeking to have the Wells Fargo note deemed unenforceable. Wells Fargo also sought summary judgment seeking a determination that the foreclosure action was properly commenced within the six-year statute of limitations. The parties agreed on the facts.

Judge Grossman addressed this dispute as being essentially a claims objection — something he stated Bankruptcy Courts are asked to rule on every day. However, he stated that the challenge facing the court involved the application of New York real property and contract law to the relevant bankruptcy law.

Judge Grossman immediately observed that there are admittedly divergent opinions by New York courts, citing the split between the First and Second departments, and that the current state of the law is unsettled with respect to whether such notices of default constitute an acceleration of the mortgage debt. He placed a great deal of weight on some decisions in the Eastern and Southern districts of New York which follow the First Department. He therefore determined that the mortgage was accelerated as of Aug. 7, 2006, which meant the statute of limitations had lapsed before the mortgagee commenced the second action.

However, the mortgagee had argued that the discontinuance of the first action acted to revoke the notice of acceleration. Although Judge Grossman pointed out that a lender can restart the statute of limitations by engaging in an affirmative act before the statute of limitations expires, he ruled that the mortgagee had not done so. He also noted that New York courts were split on this issue as well. He held that since the 2012 stipulation of discontinuance did not refer to revocation of acceleration, the mortgagee had not revoked acceleration. Thus, Judge Grossman found the mortgage to be invalid and unenforceable as a matter of law.

The 36-page decision was replete with colorful verbiage. The judge referred to the "human carnage" that courts have been exposed to from the mortgage crisis. He noted while compassion is an essential element of the bankruptcy process, creditors must abide by the rules, just as the borrowers must play by the rules.

Practical tips: Even if you have a statute of limitations issue in state court, you should read Judge Grossman's *Kramer* decision, easily obtained on the court's website, as it provides an excellent review of all of New York's leading statute of limitations cases, as well as a summary of the law in such matters.

Also, if you have a case involving a notice of default similar to the one discussed above and your client is in the Second Department, you will likely lose in state court but may prevail in Bankruptcy Court. Therefore, consider raising this issue in a bankruptcy proceeding.

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