

## REAL ESTATE

# Foreclosure Considerations When Representing Private Lenders

By Andrew Lieb and Jay P. Sheryll

Foreclosure litigation involves much more than simply enforcing a contract. Follow this top 10 checklist when representing private lenders to successfully navigate the nuances of foreclosure practice:

## Mortgage Banker License requirement

Pursuant to Banking Law §§ 589-599, when a private lender makes more than three mortgage loans in any calendar year, or more than five in a two-year period, on one-to-four family owner-occupied residential real properties located in New York State, such lender is required to be licensed. To obtain the requisite license, the lender must, *inter alia*, have a net worth of at least \$250,000.00 and post a bond of up to \$500,000.00. Making mortgage loans without a license is a Class A Misdemeanor and will subject the lender to civil penalties. Foreclosure counsel must confirm compliance before proceeding to action.

## Statute of limitations

The statute of limitations in a foreclosure action is six years, which accrues at each missed payment, unless

the note has been accelerated, in which case, the six-year statute of limitations on the entire debt runs from the date of acceleration. In such, counsel must initially determine if the loan has an acceleration clause (the short form mortgage at Schedule M, ¶4 of RPL §258 contains such a clause), and if so, counsel must accelerate the loan prior to commencement or as an allegation in the complaint. Next, throughout the litigation, counsel must be mindful of the expiration of the statute of limitations because a dismissal of the action may bar future foreclosure actions and actions on the note. Specifically, if dismissal is on the merits, counsel will be barred from recommencing, except if counsel had effectively deaccelerated the debt prior to the running of the statute of limitations. Alternatively, if dismissal is procedural, the statute of limitations is of no consequence because CPLR §205 permits recommencement within six months of such a dismissal. Irrespective, counsel must continuously



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make risk assessments throughout the case in order to strategically determine if discontinuance, deacceleration and recommencement is in the best interest of their client.

## Compliance with all conditions precedent contained in the note and mortgage

A general condition precedent to foreclosure is that the lender serves a notice of default on the debtor. Careful review of the note and mortgage terms will reveal the existence of such a condition precedent and also, the notice provisions to effectuate the same. Affidavits of service should be executed and detailed records should be maintained upon serving a notice of default. Counsel without such records will be hard pressed to obtain an order of reference in a contested action. The name of the game is records, records, records; plus, all such records must be capable of qualifying as competent evidence.

## Strict compliance with RPAPL §1304

Pursuant to RPAPL §1304, licensed mortgage bankers (e.g., only those private lenders that make more than three mortgage loans in a calendar year or more than five in a two-year period, as discussed above) are required to serve a notice, containing the express statutory language, at least 90 days prior to commencement of a foreclosure action. A lender's failure to plead and prove its strict compliance with this requirement will result in the dismissal of the foreclosure action. As set forth above, Affidavits of Service should be executed and detailed records should be maintained so that the foreclosure action may be disposed of on a motion for summary judgment.

## Name all necessary parties

Pursuant to RPAPL §1311, all persons and entities with interests claimed to be subject to or subordinate to the foreclosing lender's lien (e.g., tenants and subordinate lien holders), are necessary parties to the foreclosure action. Consequently, counsel must undertake proper due diligence in conducting title searches prior to commencement.

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## COMMERCIAL LITIGATION

# Sanctions Issued Against Party for Spoliation of Evidence

By Jeffrey Basso

A crucial issue for any business named in a lawsuit or that is on notice that it will be named in a lawsuit is the preservation of evidence, specifically electronically stored information (ESI). Attorneys will typically send "litigation hold" letters to their own clients or opposing parties in litigation to ensure that all steps are taken to preserve all documents and ESI that could be relevant to the litigation. Essentially, businesses are instructed that nothing should be deleted, removed, modified, etc. by anyone within the company while the litigation is pending. When a client destroys evidence, or is negligent in preserving evidence, it is considered "spoliation" of evidence and can lead to sanctions imposed by the court against the party that is guilty of spoliation including, but not limited to, dismissal or striking of a pleading, monetary penalties, or a negative inference at trial.

The negative inference at trial can be incredibly damaging to a party because it permits a jury to infer that any missing evidence is missing because it negatively impacted that party's case or defense.

The Commercial Division in Queens County recently dealt with this spoliation of evidence issue in *Ferrara Bros. Bldg. Materials Corp. & Best Concrete Mix Corp.* ("Ferrara") v. *FMC Constr. LLC, et al.* (Dufficy, J.). Plaintiff Ferrara commenced the lawsuit against FMC Construction LLC (FMC) and Casa Redimix Concrete Corp (Casa) claiming that Casa interfered with the contract Ferrara had with FMC to provide cement for a construction project. Casa's defense was that it did not know about the contract between Ferrara and FMC at the time it entered into its contract with FMC. However, Ferrara alleged that Casa purposely backdated its contract with FMC to give the impression that it was entered into prior to Ferrara's contract rather than after Casa's principals became aware of Ferrara's contract.

Given the issue with the timing of the contract between Casa and FMC, Ferrara sought in discovery (over seven years after the case had been commenced) the electronic data, specifically metadata that would reveal the true dates that the contract between



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Casa and FMC was prepared, modified, and executed. In response to the request, an IT specialist submitted an affidavit on behalf of Casa, claiming that two years after this litigation was commenced, the computers on which the native information was stored had been replaced and discarded due to a need to update Casa's computer system. The court made a point to note that this computer system replacement was not done through an automatic process but rather was a conscious decision by Casa to update its computer system in the midst of litigation.

As a result of the discarding of the information by Casa, Ferrara brought a motion seeking sanctions against Casa for spoliation of evidence. The court noted that a party seeking sanctions based on spoliation of evidence must show the following: the party having control over the evidence possessed an obligation to preserve it at the time of its destruction; the evidence was destroyed with a "culpable state of mind;" and the destroyed evidence was relevant to the party's claim or

defense such that the trier of fact could find that the evidence would support that claim or defense. *VOOM HD Holdings LLC v EchoStar Satellite L.L.C.*, 93 AD3d 33, 45 (1st Dep't 2012), quoting *Zubulake v UBS Warburg LLC*, 220 FRD 212, 220 (S.D.N.Y. 2003)

Considering that the timing of the contract between Casa and FMC was at the heart of Casa's defense in the case regarding its knowledge of the contract between Ferrara and FMC, the court found that the metadata Ferrara sought was relevant to the case. The court also found that, considering that the parties were in the midst of litigation at the time and Casa knew or should have known that the ESI regarding its contract with FMC would be relevant to the litigation, Casa had an obligation to preserve this ESI. Lastly, the court held that Casa had not presented any evidence to rebut the presumption that Casa was negligent and possibly even grossly negligent in failing to suspend its destruction of the computer system containing ESI relevant to the litigation. As such, the court found that Ferrara had established the factors nec-

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### Strict compliance with RPAPL §1303

Pursuant to RPAPL §1303, additional notices must be served on the mortgagor(s) and tenant(s) incident to service of process where the subject property of the foreclosure is an owner-occupied one-to-four family dwelling. A lender's failure to plead and prove strict compliance with RPAPL §1303 will result in the dismissal of its foreclosure action. Detailed Affidavits of Service describing the 1303 Notice served (color paper, size of font, etc.) should be executed and maintained. In such, counsel must manage their process server in order to ensure that competent evidence exists to prove not only the fact of service of the RPAPL §1303 Notice, but also that the specific notice served complies with the statutory requirements.

### Register and maintain vacant and abandoned properties

Pursuant to RPAPL §1308, lenders are required to conduct an exterior inspection of the subject property every 25 to 35 days. Notably, this obligation arises when the borrower first defaults on the note, not on the commencement of the foreclosure action. Moreover, when a lender has a reasonable basis to believe that the subject property is vacant and abandoned, such lender must secure and maintain the premises and register the property with the New York State Superintendent of Financial Services within 21 days thereof. Local laws, such as those in the Town of Babylon, may impose additional obligations upon lenders. Failure to comply with these obligations may result in the imposition of civil penalties. Therefore, counsel must

advise of these state and local obligations in a signed writing and it is suggested, albeit not required, that counsel audits their clients' compliance therewith.

### Attorney Certificate of Merit required

Pursuant to CPLR §3012-b, plaintiff's counsel, in an owner-occupied residential foreclosure action, must file a Certificate of Merit along with the foreclosure complaint. The Certificate of Merit certifies, *inter alia*, that the attorney has reviewed the facts of the case, consulted with representatives of the lender, reviewed the pertinent documents and that to the best of the attorney's knowledge there is a reasonable basis for the commencement of the foreclosure action.

### Mandatory Settlement Conferences

Pursuant to both CPLR Rule 3408 and 22 NYCRR 202.12-a, where the borrower resides in the subject property, a Mandatory Settlement Conference is required and a Request for Judicial Intervention (RJI) must be filed within 20 days after service of the Summons and Complaint. It is also noted that there is a specific to foreclosure actions RJI addendum, (UCS-840F), which must be completed. Failure to promptly file the RJI with addendum may result in a toll of the accumulation of interest, costs and fees otherwise due to the lender.

As to the Mandatory Settlement Conference, the lender must attend with, *inter alia*: a detailed payoff and/or reinstatement letter; copies of the note

and mortgage; and the loss mitigation options available to the borrower (e.g., loan modification, short sale or deed-in-lieu). Failure to comply may result in a "bad faith" hearing, which may subject the lender to penalties, including a toll of the accumulation of interest, costs and fees during the undue delay caused by such lender's failure; a civil penalty up to \$25,000.00; and/or actual damages, attorneys' fees and expenses incurred by the borrower.

As a separate effect, it is noted that a borrower's appearance at the Mandatory Settlement Conference provides a reasonable excuse for default in the action, whereby such an otherwise defaulting defendant may cure their default, as of right, by simply filing an answer within 30 days of their Mandatory Settlement Conference. Counsel would be well served to detail each of these burdens and effects in their initial retainer agreement (i.e., informed consent letter) as the exposure to an uninformed lender could result in a motivated malpractice claim against their lackadaisical attorney.

### Disposition in your client's favor

In order to establish a prima facie case to foreclose in a contested action, competent evidence is required that: the lender was the assignee and/or holder of the note and mortgage at the time of the commencement of the foreclosure action; the borrower has defaulted; and the lender has complied with all conditions precedent.

Alternatively, pursuant to RPAPL §1309, where the subject property is vacant and abandoned, and no party has appeared in the action, a motion for

summary judgment is not required and an expedited application for judgment of foreclosure and sale may be made, thereby bypassing the traditional foreclosure process.

### Bonus concept — the Notice of Pendency

Pursuant to Article 65 of the CPLR, a Notice of Pendency should be filed to both hinder the borrower's right to transfer the subject property and to bind all subsequent purchasers and lienors to the judgment of foreclosure and sale. A Notice of Pendency is effective only if the foreclosure summons is served within 30 days after the notice's filing. A properly filed Notice of Pendency is initially effective for three years, but can be extended for additional three-year periods upon a showing of good cause. In order to protect the lender's investment, strict compliance with the intricate requirements of Article 65 is required. Counsel must not only make the initial filing, but must also calendar and effectuate each three-year extension throughout the foreclosure litigation.

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## Sanctions Issued Against Party for Spoliation of Evidence (Continued from page 16)

essary to prove spoliation and turned to the issue of sanctions.

In reviewing sanctions to be imposed against Casa, the court noted that spoliation sanctions are often based on the degree of willfulness with respect to the refusal or failure to disclose information which ought to have been disclosed. *Hameroff & Sons, LLC v. Plank, LLC*, 108 A.D.3d 908 (3d Dep't 2013). Further, when the party seeking sanctions is still able to prove its case or defense, less severe sanctions are generally appropriate. *De Los Santos v. Polanco*, 21 A.D.3d 397, 398 (2d Dep't 2005).

After reviewing the facts of this case

and based on the fact that the court believed that Ferrara could still prove its case even without the missing evidence, the court determined that the appropriate sanction would be a negative inference at trial to the jury. Essentially, what this means is that if the case goes to trial, the jury will be permitted to infer that the reason the metadata was not disclosed is because it would act against Casa's defense that it was unaware of Ferrara's contract with FMC prior to its own contract with FMC.

The importance of preserving evidence in anticipation of litigation cannot be stressed enough. While it is entirely possible that Casa simply

needed a computer system upgrade and did not realize it would be destroying evidence pertinent to the pending litigation, as seen here, courts will impose a duty on the business and its employees to have those holds in place to ensure that everything is preserved. The fact that Casa was already two years into the litigation at the time of the computer system replacement made the discarding of ESI even more egregious and should serve as an important lesson to business owners as well as attorneys counseling their clients at the start of and throughout litigation.

*Note: Jeffrey Basso is a litigator at Campolo, Middleton & McCormick, LLP, where he represents business owners, corporations, corporate officers, shareholders, and investors in a variety of litigation matters in state and federal court involving business and contractual disputes. Jeff has vast experience prosecuting and defending matters on behalf of clients in actions involving employment contracts, non-compete agreements, trade secrets, fiduciary duty, breach of contract, hour and wage disputes, real estate transactions, investments, and construction matters. Contact Jeff at jbasso@cmmlp.com.*

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