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New York's Highest Court Makes Key Rulings in Favor of Lenders Clarifying What Accelerates and De-Accelerates a Mortgage Debt for Statute of Limitations Purposes

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The New York Court of Appeals has resolved a split between two intermediate state appellate courts regarding whether a default letter clearly and unequivocally affirmatively accelerates a mortgage debt and provided much needed clarity on what conduct sufficiently accelerates a mortgage debt and revokes acceleration. The authors of this article discuss the decisions.

The highest court in New York, the New York Court of Appeals, has issued a decision reversing the Appellate Division, First Department ("First Department") and Appellate Division, Second Department's ("Second Department") decisions in *Freedom Mortgage Corp. v. Engel*, *Ditech Financial, LLC v. Naidu*, *Vargas v. Deutsche Bank National Trust Company*, and *Wells Fargo Bank, N.A. v. Ferrato*.

Specifically, the Court of Appeals held, *inter alia*, that:

1) A default letter stating that the lender "will" accelerate the debt referred to a future event and therefore did not accelerate the debt;

2) The voluntary discontinuance of a foreclosure action (whether by motion or stipulation) within six years of acceleration, alone, revokes acceleration as a matter of law, unless the noteholder expressly states otherwise;

3) The reason for a noteholder's revocation is irrelevant, thereby expressly rejecting the concept that a noteholder's revocation of acceleration cannot be

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"pretextual" to merely avoid the expiration of the statute of limitations; and

4) A verified foreclosure complaint that accelerates the mortgage debt must clearly and accurately refer to the loan documents and debt at issue.

The Court of Appeals' decision resolves a split between the First and Second Departments regarding whether a default letter clearly and unequivocally affirmatively accelerates a mortgage debt and provides much needed clarity on what conduct sufficiently accelerates a mortgage debt and revokes acceleration.

Freedom Mortgage Corp. v. Engel and *Ditech Financial, LLC v. Naidu*

In *Freedom Mortgage Corp. v. Engel* ("*Freedom Mortgage*") and *Ditech Financial, LLC v. Naidu* ("*Ditech*"),[1] the Court of Appeals reversed the Second Department's decision and held that Freedom Mortgage's foreclosure action was timely because the acceleration of the mortgage loan was revoked by the voluntary discontinuance of a prior foreclosure action.

Summary of Facts and Background

In *Freedom Mortgage*, Freedom Mortgage commenced an action in July 2008, to foreclose upon Engel's mortgage. Engel moved to dismiss the complaint for lack of personal jurisdiction due to improper service. By stipulation, dated January 23, 2013, which was so-ordered by the state trial court, the parties agreed that (1) Engel was served with a copy of the summons and complaint and would withdraw his motion to dismiss, and (2) the action would be discontinued without prejudice. The stipulation further provided that the parties "desire[d] to amicably resolve this dispute and the issues raised in [Engel's motion] without further delay, expense or uncertainty."

Freedom Mortgage subsequently commenced a second foreclosure action on February 19, 2015. Engel moved for summary judgment to dismiss the second foreclosure action on the ground that the action was time-barred; Freedom Mortgage cross-moved for summary judgment. The Orange County trial court denied Engel's motion and granted Freedom Mortgage's cross-motion on the grounds that the stipulation of discontinuance in the prior foreclosure action had revoked the acceleration of Engel's mortgage loan.

The Second Department, reversed the lower court's decision and held that "[Freedom Mortgage's] execution of the January 23, 2013, stipulation did not, in itself, constitute an affirmative act to revoke its election to accelerate, since, inter alia, the stipulation was silent on revocation, and did not otherwise indicate that [Freedom Mortgage] would accept installment payments from [Engel]."

In *Ditech*, a predecessor-in-interest to Ditech commenced a foreclosure action on July 28, 2009, against the borrower, Naidu. This first foreclosure action was voluntarily discontinued, without prejudice, by a stipulation between the parties entered into in February 2014. The stipulation did not contain any express clause revoking the noteholder's election to accelerate the debt. On January 14, 2016, Ditech commenced a second foreclosure action. Naidu moved to dismiss the complaint as time-barred, and Ditech cross-moved for summary judgment.

The Queens County trial court denied

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Naidu's motion to dismiss and granted the Ditech's cross-motion, holding that the stipulation to discontinue the prior foreclosure action revoked acceleration of the debt. The Second Department reversed the lower court's decision and held that "the stipulation, which discontinued the prior foreclosure action, was silent on the issue of the revocation of the election to accelerate, and did not otherwise indicate that [Ditech] would accept installment payments from the appellant."

The Court of Appeals Decision

The New York Court of Appeals reversed the Second Department's decisions in both *Freedom Mortgage* and *Ditech* by holding that a stipulation to withdraw a foreclosure action is, by itself, an affirmative act of revocation of the acceleration effectuated via filing the foreclosure complaint.

In so holding, the Court of Appeals noted that the contrary rule, which the Second Department and the First Department had adopted, requires a court to "scrutinize the course of the parties' post-discontinuance conduct and correspondence, to the extent raised, to determine whether a noteholder meant to revoke the acceleration when it discontinued the action." This approach would "turn[] on an exploration into the bank's intent, accomplished through an exhaustive examination of post-discontinuance acts."

The Court of Appeals opined that "[t]his approach is both analytically unsound as a matter of contract law and unworkable from a practical standpoint . . . [because] either the noteholder's act constituted a valid revocation or it did not; what occurred thereafter may shed some light on the parties' perception of the event but it cannot retroactively alter the character or efficacy of the prior act."

Accordingly, the Court of Appeals provided a bright-line rule that "when a bank effectuated an acceleration via the commencement of a foreclosure action, a voluntary discontinuance of that action—i.e., the withdrawal of the complaint—constitutes a revocation of that acceleration." Notably, the Court of Appeals highlighted that its holding regarding the sufficiency of a voluntary discontinuance, alone, "comports with our precedent favoring consistent, straightforward application of the statute of limitations, which serves the objections of 'finality, certainty and predictability,' to the benefit of both borrowers and noteholders."

Vargas v. Deutsche Bank National Trust Company

In *Vargas v. Deutsche Bank National Trust Company*[2] ("*Vargas*"), the Court of Appeals reversed the First Department's decision and held that a default letter sent by Deutsche Bank's predecessor-in-interest did not accelerate the debt because it was not an unequivocal and overt act of acceleration.

Summary of Facts and Background

The borrower, Vargas, commenced a quiet title action against Deutsche Bank seeking to discharge his mortgage by claiming that the statute of limitations to foreclose had expired. Deutsche Bank moved to dismiss, and, in opposition, Vargas argued that an August 2008 default letter sent by Deutsche Bank's predecessor-in-interest had accelerated the debt and therefore the limitations period had expired before commencement of the quiet title action. The default letter stated that Vargas's loan was in "serious default" because

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he had not made his "required payments," but that he could cure the default by making a payment "on or before 32 days from the date of [the] letter."

Further, the default letter advised that, should Vargas fail to cure his default, the noteholder "*will* accelerate [his] mortgage with the full amount remaining accelerated and becoming due and payable in full, and foreclosure proceedings will be initiated at that time." (Emphasis added). In addition, the letter stated that "[f]ailure to cure your default may result in the foreclosure and sale of your property." The Bronx County trial court granted Deutsche Bank's motion to dismiss.

However, on renewal, the lower court denied Deutsche Bank's motion to dismiss, granted summary judgment to Vargas, and declared the mortgage unenforceable and the property free from any encumbrances. The First Department affirmed the lower court's ruling.

The Court of Appeals Decision

The Court of Appeals held that the 2008 default letter did not constitute a clear and unequivocal acceleration of the debt as a matter of law.

Specifically, the Court of Appeals explained that the default letter: (1) "did not seek immediate payment of the entire, outstanding loan"; (2) "referred to acceleration only as a future event, indicating the debt was not accelerated at the time the letter was written"; and (3) was not a "pledge that acceleration would immediately or automatically occur upon expiration of the 32-day cure period," as it contained the statement that failure to cure "may" result in the foreclosure of the property.

Notably, the Court of Appeals indicated that *Vargas* illustrates why acceleration "should not be deemed to occur absent an overt, unequivocal act," as "default notices provide an opportunity for pre-acceleration negotiation - giving both parties the breathing room to discuss loan modification or otherwise devise a plan to help the borrower achieve payment currency, without diminishing the noteholder's time to commence an action to foreclose on the real property, which should be a last resort."

Wells Fargo Bank, N.A. v. Ferrato

In *Wells Fargo Bank, N.A. v. Ferrato*[3] ("*Ferrato*"), the Court of Appeals held that prior foreclosure complaints filed by the lender did not accelerate the mortgage debt because such complaints attempted to foreclose upon the original note and mortgage, even though the loan had been modified; thus, the filing of the prior foreclosure complaints were not "unequivocal overt acts" necessary to accelerate the loan.

Summary of Facts and Background

Wells Fargo Bank, N.A. ("Wells Fargo") commenced five foreclosure actions on Ferrato's mortgage loan. The first action was settled after Ferrato's mortgage loan was modified. The second and third actions were dismissed on Ferrato's motions to dismiss for failure to reference the modified mortgage loan. In the fourth foreclosure action, Wells Fargo moved to voluntarily dismiss its claims and to revoke the acceleration; the New York County trial court allowed the voluntary discontinuance but held that "the acceleration of the subject loan is NOT revoked."

Subsequently, Wells Fargo commenced a fifth foreclosure action, which Ferrato moved to dismiss as time-barred; the New York

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County trial court denied Ferrato's motion to dismiss because neither the second nor the third foreclosure actions validly accelerated the debt since the complaints reflected an attempt to foreclose upon the original note and mortgage, despite the 2008 loan modification.

The First Department affirmed the denial of Wells Fargo's motion to revoke in the fourth foreclosure action, as the voluntary discontinuance was insufficient to constitute an affirmative act of revocation and "Wells Fargo could not de-accelerate because it 'admitted that its primary reasons for revoking acceleration of the mortgage was to avoid the statute of limitations bar.' "

The First Department also reversed the lower court's decision denying Ferrato's motion to dismiss in the fifth foreclosure action and held that the debt had been accelerated when Wells Fargo commenced its second foreclosure action on September 16, 2009; thus, the fifth foreclosure action, commenced in December 2017, was time-barred.

The Court of Appeals Decision

The Court of Appeals reversed the First Department's decision and reinstated the fifth foreclosure action, holding that the second and third foreclosure complaints did not accelerate the modified mortgage debt because those complaints attached the original note and mortgage (with the incorrect principal balance) and failed to acknowledge that the parties had entered into a modification agreement. "Under these circumstances - where the deficiencies in the complaints were not merely technical or *de minimis* and rendered it unclear what debt was being accelerated - the commencement of these actions did not validly accelerate the modified loan." Further, Ferrato had successfully moved to dismiss those foreclosure actions based on these deficiencies.

In addition, the Court of Appeals reversed the portion of the First Department's decision affirming the denial of Wells Fargo's motion to revoke in the fourth foreclosure action.

Importantly, the Court of Appeals expressly rejected the theory adopted by the First, Second, and Third Departments that "a lender should be barred from revoking acceleration if the motive of the revocation was to avoid the expiration of the statute of limitations on the accelerated debt. A noteholder's motivation for exercising a contractual right is generally irrelevant." Moreover, the Court of Appeals held that "while a noteholder may be equitably estopped from revoking its election to accelerate . . . defendant Ferrato did not allege that she materially changed her position in detrimental reliance on the loan acceleration, and the courts conducted no equitable estoppel analysis."

Conclusion

This decision from New York's highest court is a significant win for the mortgage lending and servicing industry because, in the past two years, New York's intermediate appellate courts had severely limited a mortgagee's ability to recover on debts involving prior discontinued foreclosure actions or default letters stating that the debt "will" be accelerated if the default is not cured.[4]

Prior to this decision, the sufficiency of acceleration and de-acceleration were moving targets, but now, mortgagees have clear guidance:

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1) Default letters, even if they state that the debt "will" be accelerated, do not affirmatively accelerate the debt;

2) A voluntary discontinuance, in itself, affirmatively revokes acceleration, unless the noteholder contemporaneously states otherwise;

3) Foreclosure complaints must reference the correct loan documents to accelerate the debt; and

4) The reason for de-acceleration is irrelevant as a matter of law even if the mortgagee is merely trying to avoid the expiration of the statute of limitations.

The Court of Appeals' reversals in *Freedom Mortgage*, *Ditech*, *Vargas*, and *Ferrato* will allow servicers, lenders, and other financial institutions to commence foreclosure actions on loans that may have been time-barred under the previous appellate court rulings. Based on the Court of Appeals' decision, lenders, servicers, and other financial institutions should review their New York loans to determine whether they can now rebut a borrower or record owner's statute of limitations defense in pending foreclosure actions, quiet title actions, and contested bankruptcy matters.

To the extent appeals or motions are pending, mortgagees should advise the courts of this controlling precedent. Notably, the Court of Appeals also signaled the importance of finality and predictability regarding the statute of limitations throughout its decision, which should guide the courts in determining future statute of limitations issues.

Takeaways

The New York Court of Appeals' decision set bright-line rules that a noteholder's voluntary discontinuance of a foreclosure action, in itself, revokes the acceleration of a mortgage debt, and a default letter stating that the debt "will" be accelerated does not accelerate the debt. The Court of Appeals also held that a verified complaint that failed to reference the modification agreement did not accelerate the debt.

Accordingly, lenders, servicers, and other financial institutions should review their portfolios for loans that:

(1) Had a prior foreclosure action filed more than six years ago and that was voluntarily discontinued;

(2) May have been deemed accelerated by a default notice letter stating that the loan "will" be accelerated after the cure period; or

(3) Were purportedly accelerated by prior foreclosure complaints that referenced the incorrect loan documents or debt.

NOTES:

[1] *Freedom Mortgage Corporation v. Engel*, 2021 WL 623869 (N.Y. 2021).

[2] *Freedom Mortgage Corporation v. Engel*, 2021 WL 623869 (N.Y. 2021).

[3] *Freedom Mortgage Corporation v. Engel*, 2021 WL 623869 (N.Y. 2021).

[4] This victory for lenders may be short-lived, as immediately after the Court of Appeals issued *Engel*, the New York legislature introduced a bill to overturn it. Specifically, Senate Bill S5473, the Foreclosure Process Abuse Prevention Act, proposed new provisions and amendments to the New York Civil Practice Law and Rules and the General Obligations Law to expressly overrule *Engel* and to clarify, among other things, that (i) the General Obligations Law would be the exclusive means by which parties may reset or revive the statute of limitations to foreclose on a mortgage loan; and (ii) the discontinuance of a foreclosure action shall not "act

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as a waiver, postponement, cancellation, resetting, or tolling of" the statute of limitations to foreclose. As of May 28, 2021, S5473 has been sent to the Assembly as A7922A.

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