New York Law Journal

Real Estate Update

Wednesday, June 8, 2011

# Construing the HETPA Foreclosure Procedures

BY ADAM LEITMAN BAILEY AND DOV TREIMAN

As governments continue to wage war in the form of legislation against lending institutions, we move one step closer to economic chaos and the collapse of marketable title. When business cannot rely on government and courts to enforce contracts and provide for the smooth transfer of assets, then traditional business will cease and the transfer of property shall continue only in primitive form. Since real estate is most families' greatest investment and asset, our economy cannot afford to allow economic Armageddon. One such statute is the Home Equity Theft Prevention Act (HETPA). Now an anachronism, and fueled by the former free flow of credit to persons without income, jobs or assets, the statute targeted scam artists who would convince a home owner to "refinance" their property and then steal it from the homeowner. Besides providing a two-year right of rescission for investment residential home purchases, the statute is also loaded with so many procedural landmines as to imperil every residential foreclosure filed.

In May 2011, the Second Department came down with only the second appellate decision to construe the collection of procedures in mortgage foreclosure under HETPA, Aurora Loan Services v. Weisblum,1 reversing trial term but adhering to the larger trend in trial terms through the state to construe the procedures strictly against allowing the foreclosure to proceed. While such construction is intended to maximize consumer protections, it also presents additional hazards to the title industry unless it takes appropriate precautions.

Since their enactment in 2006, these procedures have seen annual amendment ever since.2 Most, but not all of those amendments have dealt with purely procedural aspects of the process, but the Legislature has also effected changes in the actual substantive relationships not only of the mortgagor and mortgagee, but also of all other persons to be found in smaller buildings that have owner occupancy. In spite of sparse appellate case law under these enactments, there has been enough activity in the trial courts to spot certain trends now ratified by both appellate

*Adam Leitman Bailey*

*Dov Treiman*

cases. The clearest is that the trial courts are giving far greater attention to the procedural aspects of a foreclosure case.

**First Appellate Impression**

As the first appellate case to discuss procedural HETPA, First Natl. Bank of Chicago v. Silver3 found that the special notices of enlarged font on colored paper are procedural prerequisites to the bringing of the proceeding, unamendable after the proceeding has started, and, when defective, raisable by the defendant at any point. Weisblum specifically built on Silver, finding not only that defects in notices could be raised at any time, but defects in the notices are defects in the foreclosure proceeding regardless of prejudice to mortgagor.

There is no case to say what happens if the mortgagor does not raise the defects in the pre-litigation notices until after the foreclosure auction, but the implication of Silver/Weisblum is clear enough that the question can be raised any time, impliedly even to avoid the referee's deed. If, however, a title company excepts from coverage any and all defects under the procedural aspects of HETPA, the title company may issue the policy so as to cover all other aspects of the title. This casts the risk back on the mortgagee to ensure that all HETPA procedures have, in fact, been meticulously observed, or the price it realizes at the auction will be severely impaired by the lack of marketability.

**The Larger Trends**

Verifying trends is complicated by the constantly changing text of the law. The Legislature and the case law will certainly continue to make the procedure increasingly difficult for plaintiffs. Included in these difficulties are sections of the law with special requirements in unexpected places in the law so that those who do not practice foreclosure law on a daily basis are unlikely to find them. They are to be found principally in RPAPL Article 13 and CPLR 3408.

While the entire collection of legislation reflects an attempt to fight victimization of those who can't really afford houses by lenders who saw how high risk could be leveraged into high profit, the inevitable result of the legislation was to create a species of class warfare and to accord numerous opportunities to creative judges to frustrate even completely legitimate mortgaging practices.

The entire bundle of legislation of which HETPA forms a part defines in some detail certain kinds of disfavored mortgage loans that, to avoid straying into terms of art we refer to generically as "predatory."4 Later amendments to the law have applied many of these same procedures to non-predatory loans as well.

**Unsettling Requirements**

One of the camouflaged sections of the law is CPLR 3408 making settlement conferences mandatory in all cases within the first two months of the service of the foreclosure summons and complaint. While the statute only requires attendance at that conference by plaintiff's attorney with authority to settle the case, Deutsche Bank v. McCoy,5 imposes a further requirement that the conference be personally attended by the plaintiff's officer and the officer's notary. While the plaintiff may have power over its officers making their continued association with the plaintiff reasonably likely, that is hardly the case with notaries. Further, the plaintiff could be a bank that has branches in Manhattan, but a mortgage department with the actual custodian of the records far away. The verifier on the complaint may have to bring her notary hundreds of miles with her to this conference which may be adjourned any number of times.

In GRP Loan, LLC v. Ivery,6 (Sup. Kings 2009) the court found foreclosure conferences so valuable that it was willing to forego any establishment of the statutory criteria for scheduling one. Indeed, the hostility to the entire process of foreclosure is evident from Emigrant Mortgage v. Fitzpatrick,7 where a bank is knocked out of a motion for summary judgment when it showed proper proof that it complied with the special procedures required for predatory loans, but failed to provide sufficient proof that the loan was predatory.

In Butler Capital Corporation v. Cannistra,8 the court held in effect that the plaintiff has the burden of proof that a loan is non-predatory and required proof in evidentiary form that the loan did not come under each of the several statutory definitions in order to elude the requirement for the CPLR 3408 mandatory settlement conference. Most notably, the court wrote, "(I)n keeping with the obvious homeowner-protective legislative intent of the relevant foreclosure statutes, the Court errs on the side of those protections…"

## Incurable Flaws

For some of these cases, the flaw in the proceeding is so fundamental that, on a practical basis, the plaintiff will never be able to cure it and the mortgagee's successor's ability to foreclose is essentially permanently extinguished. In such cases, the mortgagee may try very hard to short circuit the process by offering to take back a deed in lieu of foreclosure.9

For other cases, however, the case is merely a matter of "start over and get it right." This was the case in Stern-Obstfeld v. Bank of America,10 where the court dealt with the provisions for foreclosing on cooperatives analogous to the provisions for dealing with foreclosing on a house. Where the court found that the proper notices had not been served, it stayed further proceedings until such notices would be properly served. Had it been a house foreclosure, clearly the court would have dismissed the complaint, but since the foreclosure was non-judicial in nature, all the court could do was issue the stay. This could only delay the proceeding, not halt it.

## Relay Race Batons

In a case best understood only against the background of just how mortgages are passed around in this country, Deutsche Bank v. McRae,11 refused to allow the foreclosure proceeding to go forward because the underlying note of the mortgage was not in possession of the plaintiff at the time of the commencement of the suit. To the same effect is Deutsche Bank v. Eisenberg.12 This has become an extremely common basis of defense to foreclosures because, especially during the heyday of sub-prime loans, banks originated mortgages with the purpose of selling them as rapidly as possible. With such rapidity came sloppiness in office practice and the notes did not actually follow the mortgages.

Further, with so many banks failing when the whole house of cards came crashing down, the underlying notes simply went out of existence. In essence, the home owner became foreclosure proof. McRae merely typifies this process. Since, in fact, the mortgage was passed around like the baton in a relay race and the original baton holder is now out of existence, it is literally impossible to cure this deficiency. The mortgage is essentially useless except to cloud title.

## Strict Adherence

Trustco Bank v. Alexander,13 found adherence to the special notice requirements under procedural HETPA to be something that could be dispensed with under appropriate circumstances.

However, cases such as WMC Mortg. Corp. v. Thompson,14 presaging Silver and Weisblum, explicitly reject that kind of reasoning. Rather than finding the HETPA special notices a mere technicality that could be dispensed with, these cases found such procedures absolutely essential to the foreclosure, regardless of the sophistication of the defendant.

Butler Capital Corporation v. Cannistra, supra, specifies some of the requirements the plaintiff must obey in order to make an HETPA compliant foreclosure proceeding. The proof required includes an attorney affirmation as to the color of the paper used for the statutory notice. To similar effect is Countrywide Home Loans Inc. v. Taylor.15

## Prudent Practice

It appears obvious that the initial filing with the courts, although not requiring that contrasting paper color, should nonetheless have it so that the attorney can truthfully state that his or her office always uses that paper for those notices. It would also seem wise for the plaintiff's attorney to make a videographic record of the assembly of the papers with the notice correct as to form, content, and printing and of the service of them. The case law records process server affidavits specifying the various colors of the papers served.

## Conclusion

Finally, Weisblum gathers nearly all these themes together. This case is important for two substantive holdings: that the plaintiff has the burden of proving strict adherence to each and every element of the procedures, regardless of any showing of non-prejudice; and that the plaintiff must be in possession of both the mortgage and note at the time of commencement of the proceeding or be able to show fully authorized assignments of both such documents for each step when the documents changed hands.

For an enormous number of mortgages issued during the housing bubble, this will be an impossible burden to meet. No matter what, the plaintiff in Weisblum will never be able to foreclose, but it shares that fate with many other financial institutions.

The overall trend in these cases is obvious. Courts are simply bending over backwards to give the borrowers as much insulation as possible from a foreclosure going to judgment and sale. Of course, there can be little doubt that this does serious damage to the banking industry, an industry hardly as invulnerable as was commonly believed.

For the foreclosure practitioner, therefore, the lesson is simple. First check whether there is any chance to bring the foreclosure proceeding at all. There is little point to wasting the client's money on a sure failure. Then there must be punctilious observance of each and every little technicality in the procedures and there must be overwhelming demonstrable proof of that level of observance. The days of a foreclosure action being something that could be cranked out by a paralegal with only the lightest attorney supervision are gone.

**Adam Leitman Bailey** is the founding partner and **Dov Treiman** is a partner of Adam Leitman Bailey, PC.

Endnotes:

1. 2011 NY Slip Op 04184.
2. Added L.2006, c. 308, §4, eff. Feb. 1, 2007. Amended L.2007, c. 154, §13, eff. July 3, 2007; L.2008, c. 472, §1, eff. Aug. 5, 2008; L.2009, c. 507, §1, eff. Jan. 14, 2010; L.2010, c. 358, §1, eff. Sept. 12, 2010).
3. 73 A.D.3d 162, 899 N.Y.S.2d 256 (2d Dept. 2010).
4. We reflect the intent of the Legislature without necessarily agreeing that there is anything objectionable about the loans in question.
5. 7782-2008, NYLJ, 1202473595162, at *1 (Sup. Suffolk, Decided Sept. 21, 2010).
6. 25 Misc.3d 460, 886 N.Y.S.2d 317.
7. 09-10577, NYLJ, 1202471042402, at *1 (Sup. Suffolk, Decided Aug. 11, 2010).
8. 26 Misc.3d 598, 891 N.Y.S.2d 238 (Sup. Suffolk 2009).
9. Although debate in the field has raged whether such deeds are exempt from HETPA's other prohibitions, on May 10, 2011 the State Banking Department issued an opinion letter

that deeds in lieu of foreclosure are exempt from HETPA. Whether the courts will agree with the Banking Department cannot be predicted. The authors wish to thank Mike Berey, Esq. of First American Title Insurance Co. for his assistance in delivering this opinion letter.

10. 30 Misc.3d 901, 915 N.Y.S.2d 456 (Sup. NY 2011).

11. 27 Misc.3d 247, 894 N.Y.S.2d 720 (Sup. Alleghany 2010).

12. 24 Misc.3d 1205(A), 890 N.Y.S.2d 368 (Sup. Suffolk 2009).

13. 23 Misc.3d 1129(A), 886 N.Y.S.2d 69 (Sup. Saratoga 2009).

14. 24 Misc.3d 738, 877 N.Y.S.2d 885 (Sup. Kings 2009).

15. 17 Misc.3d 595, 843 N.Y.S.2d 495 (Sup. Suffolk 2007).