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Cooperative Foreclosure: The Accidental Doctrine

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Although the lack of judicial supervision[1] of the foreclosure process for default upon cooperative apartment mortgages vastly simplifies the lives of lenders' counsel, under the latest changes in the foreclosure statutes, it creates a nightmare for the title industry insuring titles down the line from such a foreclosure.

In the closing days of 2009, the governor signed into law changes to the procedures in foreclosing on these mortgages. The process is now made more to resemble the procedure for foreclosing on one to four family houses and incorporates procedural features from the Home Equity Theft Prevention Act (HETPA). Numerous new features entered the procedures for co-op foreclosure, on their face clearly intended to create traps for the unwary foreclosing attorney, but more subtly creating traps for title insurers as well.

Clearly, the intent of the legislature was to give more time for this class of homeowners to rally the funds necessary to avoid losing their homes, but one has to assume the legislature did not actually intend to destabilize title, even if this is the inevitable effect. The legislature could have given the homeowners greater protection without such destabilizations of title if it had abolished the purely nonjudicial procedure, as it did for real property foreclosures, and replaced it with a requirement that such foreclosures require the filing of exact copies of all the notices and filings with the County Clerk and perhaps a simple order to show cause to schedule the sale.[2]

Simple Procedures

On its face, foreclosing on a co-op mortgage currently looks like a very simple procedure involving sending a couple of notices, taking an ad in a newspaper, and conducting an auction. Currently, courts are only involved to stop the procedure or, if the co-op was sold for less than the outstanding loan, for getting a deficiency judgment in favor of the lender for the shortage.

Generally speaking, cooperative apartments—consisting of shares of stock and a lease—are not real property, but are personal property. Their mortgage foreclosures thus come

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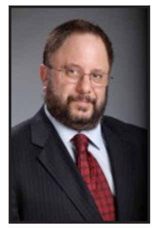

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under Article 9 of the UCC rather than Article 13 of the RPAPL.

In that regard, UCC Article 9 is relatively straightforward on its face. The applicable section is UCC §9-611, which requires that notification be sent to the mortgagor, any secondary obligor, and any other lienors of whom the mortgagee has notice a reasonably authenticated notice of the impending sale of the shares of stock. There are two notices required, the first 90 days prior to the disposition, containing HETPA-like warnings, and the second at least 10 days before the actual sale. However, the statute also requires that a lien search be run on the property between 20 and 30 days prior to the sending of the second notice.

Therefore, the prudent practitioner will first sit down with a calendar and schedule the sale and then count back ten days from that date to establish the date for the sending of the second notice, allowing an extra day or two for error. Then the practitioner will diary ordering a lien search 29 days before the date of the second notice, and finally will diary the 90-day notice to be given no later than 91 days before the previously established sale date.

Hidden Traps

However, literally hidden in RPAPL §1306 there is a provision that relates to foreclosure on cooperative loans in spite of the fact that they are not real property and not otherwise subject to Article 13 of the RPAPL. This provision requires that within three business days of the 90-day notice the mortgagor's attorney electronically file with the department of banking various data set forth in the statute and potentially more detailed in any regulations the banking department may at some future time issue.

While this same section specifies that the pleading of having done so is "a condition precedent" to the bringing of a foreclosure action, normally there is no "foreclosure action" in a cooperative foreclosure. However, if the practitioner has not made that electronic filing, it is clear that any court would sign an order to show cause to stop the sale of the property or, if it has already taken place, would reverse the sale. Therefore, a title company on a transaction subsequent to the sale, must search the banking department records to check for compliance.

As regards the ten-day notice, the statute does not require any particular form, but it does suggest one and the practitioner would be foolish not to accept the suggestion. It reads:

> **Notification of Disposition of Collateral**
> To: [Name of debtor, obligor, or other person to which the notification is sent]
> From: [Name, address, and telephone number of secured party]
> Name of Debtor(s): [Include only if debtor(s) are not an addressee]
> [For a public disposition:]
> We will sell [or lease or license, as applicable] the [describe collateral] [to the highest qualified bidder] in public as follows:
> Day and Date:
> Time:
> Place:
> [For a private disposition:]
>
> We will sell [or lease or license, as applicable] the [describe collateral] privately sometime after [day and date].
>
> You are entitled to an accounting of the unpaid indebtedness secured by the property that we intend to sell [or lease or license, as applicable] [for a charge of $]. You may request an accounting by calling us at [telephone number]

If, as is very rarely the case, the

cooperative mortgage or note contain requirements for notices or other procedures in addition to those under the statute, the foreclosing party would have to comply with these as well.

Where to Sell

Once the debtor has been served with the appropriate notices, all that is left is advertising the sale in the newspaper and conducting an auction. The law does not specify where the auction is to take place, although certain places have become traditional for the purposes, notably including the courthouse steps. In New York County, one of the most common sites for such an auction is the rotunda of the Supreme Courthouse at 60 Centre St. This has the advantage of being large and airy, but the decided disadvantage of being noisy and echoey. We have seen attempts to set aside sales at 60 Centre St. because of complaints of the inability to hear the auctioneer. One may therefore want to choose a somewhat less noisy venue for the purpose and might even consider renting for it a modest space in a hotel.

Similarities to HETPA

Under HETPA, in order to foreclose on an affected property, in addition to the traditional steps associated with foreclosure, the plaintiff must serve on the defendant a notice on contrasting colored paper, 271 words long. In the new co-op foreclosure statute, there is a notice, also on colored paper, 284 words long. About two-thirds of the co-op notice is identical to the HETPA notice and many of the changes are attributable to the undeniable differences between coops and more traditional forms of ownership.3

It can therefore be said with absolute certainty that the co-op foreclosure notice is, in fact, derived from the HETPA notice and, more importantly, is intended to perform the same function. This leads us to the doctrine that "Similar statutes enacted for the purpose of avoiding similar evils and affording similar remedies should have uniformity of application and of construction."4

Thus, in construing the effect of the co-op foreclosure notice requirements, we must look to the decisions discussing the HETPA notice requirements. Of these, the most important is the sole appellate decision to deal with the procedural requirements: First National Bank of Chicago v. Silver.5 Silver dealt with the failure of the plaintiff in the judicial foreclosure on a one family home failing to give the contrasting color notice HETPA mandates to accompany the summons and complaint in such an action. As above noted, there is no summons or complaint involved in a foreclosure on a cooperative apartment and no judicial procedure at all in the normal course of events. So, it becomes a question of interpretation as to how to apply the core holding of Silver:

> In this matter we are asked to determine an issue of first impression at the appellate level, that is, whether the failure to comply with notice requirements of the Home Equity Theft Prevention Act (Real Property Law §265-a; hereinafter HETPA) must be raised as an affirmative defense or whether it can be raised at any time during an action. We hold that it can be raised at any time.

As regards cooperative foreclosure, it is not an issue of first impression, but an issue of no impression yet. Yet, since the co-op notice and the HETPA notice are so closely related, it is necessary that they receive "uniformity of application and of construction," especially application.

Silver never really explained what it meant by "at any time," but strongly suggested that "any time" meant any time prior to entry of judgment. In co-op foreclosure, were we to interpret "any time" to mean any time prior to entry of judgment, we would come up with a meaning of "forever" unless and until either the foreclosing party seeks a deficiency judgment or the foreclosed upon party seeks an injunction against the foreclosure. However, if one regards the foreclosure without the proper notice to be a breach of the contract by the lender to hold on to the security, then there would be the normal CPLR 213(2) six year statute of limitations for breach of contract.6

Danger to Title

However, there is a feature of the co-op foreclosure notice that is vastly more invidious to the stability of titles rendered in a co-op foreclosure: It is not filed with the County Clerk and would, unlike HETPA notices, not normally be found with the land records in question. RPAPL §1306's requirement that the foreclosing party file with the State Banking Department "the name, address, last known telephone number of the borrower, and the amount claimed as due and owing on the mortgage, and such other information as will enable the superintendent to ascertain the type of loan at issue" does not require that a copy of the notice be filed with the Banking Department.

Indeed, it would be physically impossible to do so as the statute calls for electronic filing and while such could, with the clever use of a pdf file, indicate that the foreclosing party had complied with the font size and paper color requirements, it would not be the kind of hands on physical proof that a paper filing at the County Clerk would accord. Thus, there is no amount of research that could disclose to a title company whether or not the foreclosing party really did comply with the statute. The title company would have no choice but to except such compliance from coverage and the purchaser either at the foreclosure itself or further down the chain of title would have to do so at its own risk.

It is clear that the intent of the Legislature in the 2009 amendments to the foreclosure statutes were for the very specific purpose of making the procedure more complicated for foreclosers, with the specific aim of creating technical traps to avoid the foreclosure. One can debate whether this is in the final analysis pro-consumer or anti-consumer. However, it is also clear that the unintended consequence of this legislation is to destabilize the title of those who purchase their apartment down the chain of title from one of these foreclosure sales.

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Endnotes:
1. Or as many practitioners call it, "judicial review."
2. Not only would this have stabilized cooperative apartment titles, but it would have been a neat revenue measure for the State.
3. The two notices appear at www.alblawfirm.com/CoopForeclosureNotice.pdf with the co-op notice as a redline of the HETPA notice.
4. Matthews v. Matthews, 240 NY 28 (1925).
5. 2010 NY Slip Op 02511.
6. However, the general equity statute of limitations CPLR 213(1), also six years, would seem inappropriate, as it applies to assertion of a cause of action, not assertion of an equitable defense.