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Financial Services Litigation Update

Second Department Leaves Open the Door to a Third Party Interposing the Statute of Limitations as a Defense to Foreclosure Creating Potential Peril for Lenders

By Morgan R. McCord

On August 4, 2021, the Appellate Division, Second Department notably avoided ruling on the open question of whether a third party that is not in privity with a borrower may interpose the statute of limitations as a defense to foreclosure. Had the Appellate Division addressed this important question, it could have clarified an unsettled area of the law and aided settlement in foreclosure cases. Instead, in avoiding the question, the Second Department, perhaps inadvertently, has made it more perilous for foreclosing lenders to settle cases with statute of limitations issues. Because of the Appellate Division's decisions, lenders must be more cautious of junior lienholders and note holders when considering settlement. Lenders that fail to exercise vigilance may find their mortgages unenforceable.

The facts in *Emigrant Bank v. McDonald*, 2021 NY Slip Op 04594, are straightforward. The plaintiff commenced a foreclosure action in May 2014 against, among others, the two borrowers under the mortgage note and a subordinate note holder. One of the borrowers defaulted in appearing in the action and the other answered the complaint interposing several defenses, but not the statute of limitations. The subordinate note holder answered the complaint interposing, among other defenses, the statute of limitations. Subsequently, the plaintiff moved for summary judgment. The subordinate note holder opposed the motion and cross-moved for summary judgment on statute of limitations grounds. The lower court granted plaintiff's motion and denied the cross-motion. Judgment of foreclosure and sale was later issued in plaintiff's favor. The subordinate note holder appealed.

The Second Department began its analysis by discussing the law relative to the statute of limitations in foreclosure, noting, at the outset, that the statute of limitations is "generally viewed as a personal defense, which is waived if not affirmatively pled." Next, the court recited the well-settled law that a mortgage foreclosure action is subject to a six-year statute of limitations period. The Appellate Division explained that the limitations period begins to run on the entire debt, at the plaintiff's election, upon the filing of a foreclosure complaint. The court further observed that a plaintiff could revoke its election to accelerate the mortgage debt by taking an overt action such as voluntarily discontinuing the foreclosure action within the six-year limitations period.

In applying the law to the facts, the Second Department found, under the assumption, without deciding, that the subordinate note hold could interpose a statute of limitations defense, that the plaintiff affirmatively revoked its election to accelerate the mortgage debt by discontinuing the prior action within six-years of its commencement. In further support of its holding, the Appellate Division noted that the plaintiff demonstrated, prima facie, that it revoked its election to accelerate the mortgage debt by submitting, among other things, a loan modification agreement between the borrowers and the plaintiff that was entered into within six-years of the commencement of the prior action. Based on these findings, the Second Department affirmed the lower court.

Although the Appellate Division's decision appears to be a win for the mortgage servicing industry on its face, upon closer inspection, the reality is much different. In leaving open the possibility that a third party may interpose a statute of limitations defense to a foreclosure action, the Second Department, perhaps inadvertently, has made settlement

more problematic. Because of the Appellate Division's decision, lenders must be more vigilant of junior lienholders and subordinate note holders when settling cases with statute of limitations issues.

Failure to exercise such caution may be perilous. For example, a lender may enter into a tolling agreement with a borrower during settlement negotiations. The tolling agreement would bind the borrower, but likely not a junior lienholder and/or subordinate note holder. Under these circumstances, permitting a third party that is not in privity with the borrower to interpose a statute of limitations defense would lead to inequitable and unjust results. Indeed, it could result in the mortgage being rendered unenforceable. Until the Appellate Division addresses this issue, we recommend that lenders exercise extreme caution when evaluating settlement in cases with statute of limitations issues.

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