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CHAPTER 14

Defaults; Acceleration; Consequences

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§ 14.01 Overview of Defaults, Acceleration, and Consequences

If a commercial mortgage loan begins to suffer distress, at some point the borrower may stop making payments or may otherwise violate the loan documents. If and when that happens, the lender may begin to take a more confrontational and less cooperative approach toward its borrower. This chapter examines some of the issues that arise early in the process of enforcing a set of New York commercial mortgage loan documents.

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Unlike most of the chapters in this book, which focus on the loan closing process rather than loan enforcement, this chapter discusses legal issues that arise once the loan gets into trouble — but only based on the recognition that a lender might improve its position after default by including appropriate language in the loan documents at the time of the original closing. This chapter focuses on those opportunities.

As an early step in any troubled real estate loan, the lender may choose to give the borrower a notice of default—if the lender has not waived the right to do so. Those issues are examined first.

The discussion then turns to the question of whether a lender can enforce a mortgage based on a nonmonetary default, and actions the lender might want to take in drafting the mortgage to increase its leverage and flexibility later.

The lender's legal fees are a topic close to counsel's heart. This chapter includes a brief description of some of the issues they can create in preparing a mortgage.

This chapter closes with a discussion of late charges and interest.

§ 14.02 Oral Waiver of Right to Accelerate

[1] Affirmative Defense

In New York, a court can determine that a lender orally waived its right to accelerate and foreclose. A waiver of this type gives the borrower a valid affirmative defense to foreclosure, unless the lender has withdrawn the waiver with reasonable notice to the borrower.[1]

In one noteworthy case, *Nassau Trust Co. v. Montrose Concrete Products Corp.,* the loan documents allowed the lender to accelerate the loan if the borrower failed to make any required payment within 30 days after the due date.[2] When the borrower failed to comply with a written extension plan and continued to miss payments, the lender declared a default and started a foreclosure action.[3] As an affirmative defense, the borrower claimed that, in face-to-face meetings and a telephone conversation, the lender had stated that the lender would waive the

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[1] *See* Nassau Trust Co. v. Montrose Concrete Prods. Corp., 56 N.Y.2d 175, 451 N.Y.S.2d 663, 664, 436 N.E.2d 1265 (1982) (permitting borrower's affirmative defense of waiver and reversing summary judgment of foreclosure), *motion to appeal denied,* 57 N.Y.2d 674 (1982).

[2] *See* Nassau Trust Co. v. Montrose Concrete Prods. Corp., 56 N.Y.2d 175, 451 N.Y.S.2d 663, 665, 436 N.E.2d 1265 (1982). A 30-day cure period for monetary defaults is already more generous than the typical monetary cure period in modern loan documents.

[3] *See* Nassau Trust Co. v. Montrose Concrete Prods. Corp., 56 N.Y.2d 175, 451 N.Y.S.2d 663, 665, 436 N.E.2d 1265 (1982).

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default until the borrower concluded a pending sale of the mortgaged property.[4]

The Appellate Division struck this affirmative defense. It reasoned that any oral waiver was invalid for lack of consideration.[5] Although § 5-1103 of the General Obligations Law[6] dispensed with any need for consideration if there exists a writing signed by the party to be charged, in this case no such writing existed.[7] Thus, the court entered summary judgment on the issue of foreclosure.[8]

On appeal, the New York Court of Appeals held that the Appellate Division should not have struck the borrower's affirmative defense of waiver.[9] The Court of Appeals concluded that the Appellate Division had taken an overly narrow view of the New York law of waiver. To the contrary, a binding waiver "requires no more than the voluntary and intentional abandonment of a known right which, but for the waiver, would have been enforceable."[10]

The Court of Appeals said a lender could withdraw a waiver of this type only by giving the borrower notice of withdrawal and a reasonable time after notice within which to perform.[11] Based on this analysis, the case could no longer be decided as a matter of law, and the grant of summary judgment of foreclosure was reversed.[12]

[2] Practical Advice

In practice, the *Nassau Trust Co.* case discussed above teaches that no matter

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[4] *See* Nassau Trust Co. v. Montrose Concrete Prods. Corp., 56 N.Y.2d 175, 451 N.Y.S.2d 663, 665–666, 436 N.E.2d 1265 (1982).

[5] *See* Nassau Trust Co. v. Montrose Concrete Prods. Corp., 75 A.D.2d 866, 428 N.Y.S.2d 40, 42 (App. Div. 1980).

[6] That section provides: "An agreement, promise, or undertaking to change or modify, or to discharge in whole or in part, any . . . mortgage or other security interest in personal or real property, shall not be invalid because of the absence of consideration, provided that the agreement, promise or undertaking changing, modifying, or discharging such . . . mortgage or security interest, shall be in writing and signed by the party against whom it is sought to enforce the change, modification or discharge, or by his agent." N.Y. Gen. Oblig. Law § 5-1103.

[7] *See* Nassau Trust Co., 451 N.Y.S.2d at 666.

[8] *See* Nassau Trust Co. v. Montrose Concrete Prods. Corp., 75 A.D.2d 866, 428 N.Y.S.2d 40, 42 (App. Div. 1980).

[9] *See* Nassau Trust Co., 451 N.Y.S.2d at 664–665.

[10] *See* Nassau Trust Co. v. Montrose Concrete Prods. Corp., 56 N.Y.2d 175, 451 N.Y.S.2d 663, 668, 436 N.E.2d 1265 (1982).

[11] *See* Nassau Trust Co. v. Montrose Concrete Prods. Corp., 56 N.Y.2d 175, 451 N.Y.S.2d 663, 668, 436 N.E.2d 1265 (1982).

[12] *See* Nassau Trust Co. v. Montrose Concrete Prods. Corp., 56 N.Y.2d 175, 451 N.Y.S.2d 663, 669, 436 N.E.2d 1265 (1982).

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what the documents say, if the lender has informally waived the borrower's default or led the borrower to believe the lender will forbear, the lender should not change its mind without giving the borrower clear notice to that effect and a reasonable period in which to perform. While this rule sounds no different from a statement of standard operating procedure for any institutional lender, it does underscore how important it is for a lender and its counsel to identify and clearly revoke any waivers before starting a foreclosure action.[13]

Not every case applying New York law has followed the borrower-friendly approach to lender waivers suggested by *Nassau Trust Co.* In *Security Pacific Mortgage & Real Estate Services, Inc., v. Canadian Land Company of America*,[14] for example, the court acknowledged the rule of *Nassau Trust Co.*, but said it only applied to waivers of past defaults. After reviewing the mortgagee's alleged oral waiver, the court concluded: "The statement attributed to [the mortgagee] could not possibly be construed to waive the right to foreclose on further *future* defaults."[15] So the court allowed the mortgagee to foreclose quickly for subsequent defaults, notwithstanding any previous waivers.

The risk that a court will decide a lender has "waived" a default also underscores the need for a lender to obtain a pre-workout agreement[16] before initiating any discussions at all with a borrower in default. Absent such an agreement, routine discussions will be misconstrued and misremembered, creating theories of waiver that might defeat a motion for summary judgment.

The foregoing by no means constitutes a complete discussion of New York law on waiver. It is intended only to identify and describe an important case in this area that has placed lenders and their lawyers in a chronic state of concern and perhaps panic.

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[13] *But see* § 14.03, *below,* implying that any such revocation should be issued by the lender and not its counsel.

[14] 690 F. Supp. 1214 (S.D.N.Y. 1988) (applying New York law).

[15] Security Pacific Mortgage & Real Estate Services, Inc., v. Canadian Land Company of America, 690 F. Supp. 1214, 1219 (S.D.N.Y. 1988) (applying New York law).

[16] For sample documents and a more extensive discussion of this topic, *see* Steven D. Bloom, *Pre-Workout Agreement,* 442 Practising L. Inst.: Com. Real Est. Fin. 991 (May-June 1999). These agreements will, among other things, remind the borrower that a waiver will not be effective unless in writing. Of course, the original loan documents already said the same thing. Maybe the anti-waiver language needs to appear in several documents. Maybe the anti-waiver language means more once the borrower has defaulted. Maybe loan documents and pre-workout agreements should obligate the borrower to notify the lender in writing as soon as the borrower believes the lender has made an enforceable waiver, with the waiver automatically being rescinded unless the lender countersigns it within a short period.

[3] Mortgage Language

As a matter of loan documentation, lenders might consider responding to the *Nassau Trust Co.* case by trying to beef up their anti-waiver language along the lines suggested in § 14.04[2], *below.* A lender might also want the loan documents to address exactly what happens if the lender has temporarily waived a default but commences a foreclosure action without giving notice that the temporary waiver has been withdrawn. A lender might, for example, want to say that the commencement of the foreclosure automatically constitutes notice that any temporary waiver has been withdrawn. Of course, to fall within the rule of *Nassau Trust Co.,* the lender would then need to allow the borrower some reasonable period within which to cure the default—a concept that might obfuscate the foreclosure action itself and introduce complexity at a time when a lender would prefer to keep everything as simple and straightforward as possible.

As a wiser and simpler course of action, the lender should probably just revoke the waiver through a separate formal notice to the borrower, give the borrower a reasonable time to cure the default, and then wait for the cure period to expire before commencing a foreclosure action. In other words, lenders should live with *Nassau Trust Co.*, as it is not all that burdensome a case.

§ 14.03 Notices of Default and of Termination; Attitude of New York Courts

[1] Notice by Attorneys: Judicial Hostility

New York courts have sometimes been hostile to attorneys who purport to give notices on behalf of their clients. Although a notable Court of Appeals case on this issue involved termination of a lease,[1] the same issues could arise if an attorney were to give notices of default under a mortgage. This case also provides a useful paradigm for New York law on the enforcement of leases and, by extension, the enforcement of mortgage loan documents.

In *Siegel v. Kentucky Fried Chicken,*[2] a landlord commenced a summary proceeding to recover possession of leased commercial premises. As a predicate to start the eviction, a notice of default and a notice of termination had been given by the landlord's attorney, rather than by the landlord itself.

The lease in *Siegel* contained four provisions that referred to "Landlord or Landlord's agent," but the language in the lease regarding defaults and remedies

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[1] *See* Siegel v. Kentucky Fried Chicken, 67 N.Y.2d 792, 501 N.Y.S.2d 317, 492 N.E.2d 390 (1986).

[2] Siegel v. Kentucky Fried Chicken, 67 N.Y.2d 792, 501 N.Y.S.2d 317, 492 N.E.2d 390 (1986).

spoke only of "the Landlord serving a written five (5) days' notice upon Tenant" and the "Landlord [serving] a written three (3) days' notice of cancellation."[3] The lease defined "Landlord" as "only the owner, or mortgagee in possession, for the time being."[4]

By the time the lease went into default, the landlord was represented by a new attorney—not the attorney who had originally negotiated the lease and whose name appeared in the lease in another context. The landlord's new attorney signed the notice of default and notice of termination on behalf of the landlord. The New York Court of Appeals concluded that these notices were ineffective and the tenant "was entitled to ignore them as not in compliance with the lease provisions concerning notice."[5]

A New York court would very likely reach the same result if a lender's attorney issued a notice of default (or any other notice) to the borrower for its lender client, particularly if the borrower had never dealt with that particular attorney before on the lender's behalf (though the "logic" of decision in this case hardly hinges on whether the attorney was known or not known as the other party's attorney).[6]

[2] Lessons of *Siegel* Case

The *Siegel* case teaches New York mortgage lenders (and their landlord borrowers) some important lessons about the intensity with which New York courts may try to protect tenants (and, by analogy, borrowers) from any possible "forfeiture." In *Siegel,* the courts could easily have ruled for the landlord based on

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[3] Siegel v. Kentucky Fried Chicken, 67 N.Y.2d 792, 501 N.Y.S.2d 317, 318, 492 N.E.2d 390 (1986).

[4] Siegel v. Kentucky Fried Chicken, 67 N.Y.2d 792, 501 N.Y.S.2d 317, 318, 492 N.E.2d 390 (1986).

[5] *See* Siegel v. Kentucky Fried Chicken, 67 N.Y.2d 792, 501 N.Y.S.2d 317, 318, 492 N.E.2d 390 (1986).

[6] Any attorney who considers giving such a notice to any natural person, such as a guarantor, should also consider the effect of the federal Fair Debt Collection Practices Act ("FDCPA"), which federalizes the law of consumer (but not commercial) debt collection. The FDCPA is administered by the Federal Trade Commission and carries small civil penalties for each violation. *See generally* 15 U.S.C. § § 1692–1692(o). Multiple violations can attract class actions and larger penalties. *See* Romea v. Heiberger & Assocs., 163 F.3d 111 (2d Cir. 1998) (applying FDCPA to landlord's attorney when issuing three-day notice to pay rent or quit premises as required under New York landlord-tenant law). Other authority suggests that perhaps Congress did not really intend to rewrite landlord-tenant procedure from coast to coast when it passed the FDCPA. *See* Barstow Road Owners, Inc. v. Billing, 179 Misc. 2d 958, 687 N.Y.S.2d 845, 850 (D.C. Nassau Cty. 1998); Wilson Han Ass'n Inc. v. Arthur, N.Y.L.J., July 6, 1999, at 29, col. 4 (App. Term 2d and 11th Dist. 1999) (mem.); Travieso v. Gutman, No. 94 CV 5756 (JBW), 1995 U.S. Dist. LEXIS 17804 (E.D.N.Y. 1995).

some combination or all of the following arguments:[7]

- *Sufficient Authority.* The attorney was in fact authorized to give notice on behalf of the landlord, and asserted his authority in the notice, and that suffices. This is what attorneys do.[8]
- *Request for Proof of Authority.* If the tenant, when it received the notice of default from an unknown attorney, was in fact truly confused and concerned about whether the attorney was authorized to act for the landlord (or thought the attorney might just be having some fun), the tenant could have requested proof of authority, but did not. It was too late to raise the issue after the fact.[9]
- *Common Sense.* If an attorney purports to act for a landlord, common sense says it is highly likely that the attorney is in fact so authorized, and is not some charlatan interloper who is sending notices of default just to cause confusion or because he or she has nothing better to do. A tenant should proceed accordingly or seek clarification quickly.
- *Authority Irrelevant.* If the tenant was in fact in default, then it did not matter whether the party sending the notice of default was in fact authorized to do so. The tenant should simply either cure its default or assume it will soon lose its lease. Why should the tenant escape its obligations and the consequences of nonperformance merely because of peculiar circumstances that possibly cast doubt on whether certain notices were authorized or not? Regardless of who sent it, did the notice achieve its fundamental purpose of giving the tenant an opportunity to cure? If the tenant chose not to take advantage of that cure period, why should the court system set back the clock? The tenant received everything it was supposed to receive as a result of the requirement for notice and opportunity to cure.

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[7] While these arguments sound attractive and appealing, the author's knowledge of the facts of the case relies solely on the reported decisions. Other facts not reported may preclude or negate some of these otherwise attractive and appealing arguments.

[8] A lower court's dissent pointed out: "Under settled principles, an action taken by an attorney is presumed to have been taken by and at the instance of the client [citations omitted]. That presumption cannot be overcome by the 'mere suggestion' of the attorney for the adversary that such authority is lacking." Siegel v. Kentucky Fried Chicken, 108 A.D.2d 218, 488 N.Y.S.2d 744, 750 (App. Div. 1985) (Titone, J., dissenting), *aff'd,* 67 N.Y.2d 792, 501 N.Y.S.2d 317, 492 N.E.2d 390 (1986). The dissent also suggested some of the other arguments made in the text. The author believes, of course, that the dissent has the better of the arguments.

[9] A less tenant-oriented approach might have tried to use the doctrine of "laches" to conclude that the tenant bore the burden of requesting proof of authority in a timely manner, and that because the tenant failed to do so the tenant cannot raise the issue later in the proceedings. Maybe New York tenants raising defenses to lease termination actions are exempt from the doctrine of "laches."

- *Relative Burdens.* A tenant might suffer some confusion as a result of a notice of this type, but the burden to a tenant of dealing with that confusion is far less than the burden to a landlord if the notice were retroactively ruled invalid, which ultimately happened here. This type of ruling forces the landlord to start over from the beginning.
- *Plenty of Opportunity to Cure.* The years of litigation in this case amply cured whatever uncertainty might have existed in the original notice. If the tenant was in fact going to cure its default, the tenant had plenty of time in which to do so. (This statement assumes, of course, that the landlord remained willing or obligated to accept such cure.)

The Court of Appeals endorsed none of these arguments. Instead, it applied the language of the lease literally. The lease said certain notices were to come from "Landlord." The landlord's current lawyer was not "Landlord." Therefore, the tenant was "entitled to ignore" notices given by the landlord's current lawyer.[10]

The courts imposed on the tenant no burden whatsoever. The courts did not say that the tenant should have asked the landlord to clarify a notice that might arguably be confusing if the tenant concocted doubts about the authority of the sender. The courts did not point out that in the modern business world, if one is confused by a communication that appears to be serious, it is customary to seek clarification rather than remain silent. Instead, the Court of Appeals simply concluded that the initial notices were invalid and hence so was everything else that followed.

This case and others like it teach an extremely important lesson to any landlord or lender doing business in New York: The landlord or lender must comply strictly with the documents and applicable law when enforcing its rights and remedies. The landlord or lender may cut no corners. The tenant or borrower bears no responsibility to seek clarification of any notices that might be uncertain or dubious. Instead, the tenant or borrower can use those notices as the basis to invalidate an entire proceeding. Any misstep, or possible misstep, will be punished, potentially several years later.[11]

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[10] *See* Siegel v. Kentucky Fried Chicken, 67 N.Y.2d 792, 501 N.Y.S.2d 317, 318, 492 N.E.2d 390 (1986).

[11] In the context of lease enforcement proceedings, a landlord might think that one could solve any "authority" problems by granting the landlord's attorney a power of attorney to act for the landlord. But the landlord would be wrong. At least one case says that a landlord's attorney-in-fact lacks authority to commence a summary eviction proceeding, because the statute authorizes only (in relevant part) the "landlord" to commence such a proceeding. 1550 Broadway Assocs. v. El-Pine Drinks, Inc., 96 Misc. 2d 707, 409 N.Y.S.2d 584 (N.Y.C. Civ. Ct. 1978) (applying N.Y. Real Prop. Acts. Law § 721(1)). This is another example of the same formalism that drove the *Siegel* case and drives so much else in New York landlord-tenant and foreclosure litigation.

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[3] Better (Longer) Documents

Lenders, as well as parties to other New York transactions, now sometimes try to solve the *Siegel v. Kentucky Fried Chicken* problem by adding language to their documents to provide expressly that attorneys have the power to give notices on behalf of their clients. This is yet another example of the familiar process by which one bad case triggers a new paragraph of boilerplate in thousands of subsequent transactions. In each such case, a court reaches a particular result because the documents either did not contain certain language, did not make a particular point clearly or extensively enough, or did not say the same thing enough times in enough different ways. Attorneys who pay attention to these details then perpetrate new language that would have prevented that particular "bad result" in that particular case.

From that point onward until the end of time, the new language will appear in future documents, each of which will be a little bit longer as a result. Moreover, in most cases, such as in the case of notices given by attorneys, the party adversely affected by this language will not object to it during negotiations. Instead, that party will regard it as self-evident—a routine step in implementing the parties' business intentions.

In cases in which protective language of this type would have been utterly noncontroversial and routine had it appeared in the original document, the author would argue that the courts should try a little harder to infer it, after the fact, as being part of what the parties must have intended. Of course, other people (including the author) might in other contexts say that at some point any such inference enters the realm of creating a new contract for the parties rather than merely interpreting the contract they made.

One of the lower courts in the *Siegel* case said that the tenant was "contractually entitled" to notice from "Landlord."[12] Did the tenant really negotiate a "contractual entitlement" to notice from the landlord rather than the landlord's lawyer? Was this indeed a negotiated contract right and entitlement? In the real world, is there any chance at all that during lease negotiations the tenant asserted that notices must come only from the landlord, because the tenant wanted contractual protection against the risk of receiving notices from the landlord's lawyer? Or was the language in the lease merely a general expression of the parties' normal and typical intention that the tenant would be entitled to notice of default?

If the draft lease had stated that notices of default could be given by the landlord's lawyer instead of the landlord, would the tenant have batted an eye? In the real world, would the tenant have fought for a contractual entitlement to notices from the landlord? Would the tenant have walked out of the lease

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[12] 108 A.D.2d 218, 488 N.Y.S.2d 744, 746 (App. Div. 1985).

negotiations or even traded a concession on this issue for a benefit on some other issue? Surely not.

For a court to decide after the fact that the landlord must now adhere literally to strict requirements on who may actually give notices (without regard to intuitively obvious and practical propositions about the roles that attorneys play for their clients) is to exalt form and technicality over substance. While this may achieve a desired result in a particular case, it does so at the expense of many dead trees over the short, medium, and long run.[13]

[4] Sample Language: Notices by Attorneys

Lenders' counsel should remember *Siegel v. Kentucky Fried Chicken* when preparing loan documents for use with New York borrowers. As a result, unless counsel chooses to ignore this case, the following language should appear in loan documents, as well as leases, contracts, and all other legal documents:

Notices by Attorneys. Any attorney who at the time in question represents any party to this Mortgage or any other Loan Document may give any notice(s) under this Mortgage or such other Loan Document on behalf of such party. Any such notice(s) shall be fully effective as if given by the party that engaged such attorney.

This language, if used, might also need to appear in the note or loan agreement. One could limit the language to apply only to an attorney initially named in the document as counsel to the party giving notice, or identified by that party as replacement counsel. In the alternative, one could allow the notice recipient to demand proof of the attorney's authority, with the effectiveness of the notice tolled pending delivery of proof.

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[13] *See also* Joshua Stein, *Cures for the (Sometimes) Needless Complexity of Real Estate Documents,* Real Est. Rev., Fall 1995, at 63 (discussing, among other things, the process by which "bad" cases drive the endless expansion of "as is" clauses in purchase and sale transactions). The author collects cases of this type. Readers are invited to submit further examples of cases in which: (1) an intuitive reading of a document would have produced a particular interpretation and outcome, and neither party would have objected to such interpretation and outcome when the documents were being negotiated; (2) the court rejected that interpretation because the document did not go far enough in saying that the parties really intended that particular intuitively obvious interpretation and outcome; and (3) as a result, in all future cases lawyers should add another sentence or two, or maybe another paragraph, to make it really clear that the document should be interpreted in the commonsense, intuitive way referred to in clause "1." For one example of such a case, *see* Marine Mgmt., Inc. v. Seco Mgmt., Inc., 176 A.D.2d 252, 574 N.Y.S.2d 207 (App. Div. 1991), discussed in § 14.07[2], *below.* As another example, consider Sons of Thunder, Inc. v. Borden, Inc., 148 N.J. 396, 690 A.2d 575 (1997), which has been interpreted, perhaps correctly, as meaning that a bare discretionary termination right is not really discretionary—or, to put it another way, that the lawyers should have added a few paragraphs to the discretionary termination right to make it very clear that it is really and truly discretionary. *See* Joshua Stein, *When Is a Termination Right Not Really a Termination Right?,* The Innkeeper (ABA) (Oct. 1999).

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Both of these concepts, although reasonable, probably introduce more complexity and future pitfalls than they justify. They mostly just prove that if smart lawyers think hard enough, they can always come up with a new issue to raise, a new exception that should apply, or a new procedure to create. In many cases, these procedures sound great in legal documents. They can, however, be very problematic for anyone who must administer the procedures and live with them in the real world. It may sound perfectly easy and legitimate to expect someone to send notice of who their new attorney is, but in the real world they will rarely remember. Such procedures are ultimately often embarrassing for the counsel who created them.

§ 14.04 Nonmonetary Defaults

[1] Accepted Wisdom Versus Occasional Cases

Real estate professionals, in New York and elsewhere, tend to assume that a commercial mortgage lender cannot foreclose for nonmonetary defaults, such as the borrower's failure to maintain the property, failure to obtain the lender's consent when the loan documents require it, and other defaults that do not arise from failure to pay money.

Some New York cases indicate that under certain circumstances this may be incorrect, *i.e.,* a lender can in fact foreclose for nonmonetary defaults. It is not necessarily easy, though. The following discussion considers this issue and suggests possible language to use in loan documents to improve the lender's odds.

In a 1987 case, *Laber v. Minassian,*[1] the court let the lender foreclose when the borrower demolished the buildings on the mortgaged premises, even though the demolition increased the value of the property and brought the value of the property above the mortgage balance. In *Borack v. Do Good Realty Co.,*[2] the court let a lender foreclose because the borrower had destroyed a building on the property without the lender's consent.

From a practical perspective, however, New York courts seem to allow lenders to foreclose for nonmonetary defaults only under very narrow circumstances, as more fully described below. Lenders that understand the law in this area, and want to be able to enforce the nonmonetary covenants in their documents, may be able to increase their chances of doing so by adding certain language to their loan documents, and taking into account some of the principles that underlie the cases in this area.

Before the courts decided *Laber* and *Borack,* the question of whether a lender

[1] 134 Misc. 2d 543, 511 N.Y.S.2d 516 (1987).

[2] N.Y.L.J., Sep. 15, 1993, at 25, col. 5 (N.Y. Sup. Ct.).

could ever foreclose for a nonmonetary default was an open one. A few cases spoke to the issue, but each failed to give a definitive answer. In *Brayton v. Pappas,*[3] for example, the lender's foreclosure action failed, not because the court held or implied that acceleration for a nonmonetary default was generally unenforceable, but merely because the court decided the clause the mortgagee relied on was inadequate. The mortgage agreement simply did not allow for acceleration in the event of demolition.

Another inadequate answer to this question was provided in *Bodwitch v. Allen,*[4] where the premises had to be demolished because of a municipal order issued to cure a safety hazard. In this case, the court determined that the acceleration clause as written did not support foreclosure.

At least one leading commentator believes *Laber* and *Borack* helped clarify the ambiguity that previously surrounded this issue.[5] In *Laber,* the borrower demolished an obsolete gas station on the property. By doing so, the borrower actually increased the value of the property by sparing any future owner the cost of demolishing the gas station. An appraisal suggested that the highest and best use for the property was as retail or office space. The mortgage stated, however:

> the whole of said principal sum and interest shall become due at the option of the mortgagee . . . after the actual or threatened alteration, demolition or removal of any building on the premises without the written consent of the mortgagee.[6]

Based on this covenant alone, the *Laber* court allowed the lender to foreclose, even though the value of the property after demolition exceeded the mortgage balance. The *Laber* court distinguished several cases that the borrower relied on for the proposition that destruction of a building was an insufficient basis for the lender to foreclose.

For example, in *Loughery v. Catalano,*[7] the court blocked foreclosure even though the borrower had altered the premises without the lender's consent. The *Loughery* court said a lender could not foreclose if the borrower's alterations to a building, even in violation of the mortgage, were: (1) minor; (2) more in the nature of repair; (3) necessary to preserve the building; (4) not altering its character; or (5) beneficial.

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[3] 52 A.D.2d 187, 383 N.Y.S.2d 723 (4th Dep't 1976).

[4] 91 A.D.2d 1177, 459 N.Y.S.2d 148 (4th Dep't 1983).

[5] *See* Bruce J. Bergman, Bergman on New York Mortgage Foreclosures, § 4.14[4] (LexisNexis Matthew Bender) (arguing that *Laber* and *Borack* mean that demolition without consent is clearly a mortgage breach sufficient to support foreclosure).

[6] Laber v. Minassian, 134 Misc. 2d 543, 511 N.Y.S.2d 516, 518 (1987). The quoted language tracks the case, which omitted several ellipses. The language itself is fairly common and standard in commercial mortgages.

[7] 117 Misc. 393, 191 N.Y.S. 436 (1921).

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In *Laber,* the borrower also relied on *Rockaway Park Series Corp. v. Hollis Automotive Corp.*[8] Here, the lender tried to foreclose based on the existence of municipal violations. The court denied foreclosure on grounds of estoppel and laches.[9] The *Laber* court, however, said these considerations did not apply in that case. The *Laber* court also distinguished the facts of that case from those in *Loughery* and found that none of the five factors mentioned in *Loughery* was present.

The *Laber* court reasoned that, although foreclosure is an equitable action, the borrower was bound by the terms of the contract, including the acceleration clause triggered by destruction of the building. The court also reasoned that it did not want to set a precedent that would let a borrower destroy buildings on the mortgaged property without the lender's consent merely because a court determined that such destruction would increase the value of the property.[10]

In *Borack,* the borrower tried to enjoin the lender's foreclosure action. In rejecting the borrower's motion for an injunction, the *Borack* court concluded that the borrower's demolition of a building on the property was "an obvious breach of the mortgage," sufficient to support a foreclosure proceeding.[11] Thus, *Laber* and *Borack* support the view that demolition of a building in violation of the mortgage can support foreclosure.

This may all be true. A closer look at the case law reveals, however, that judges will go out of their way to prevent foreclosures for nonmonetary defaults. In *Loughery,* the court rejected foreclosure because the court believed the alterations were minor. Thus, even though the borrower's alterations to the building were unambiguously a default under the express terms of the mortgage, the court decided that allowing the lender to foreclose would be unconscionable.[12]

In the *Rockaway* case described above, the lender suffered the same fate when it tried to accelerate after the borrower violated its covenant to comply with law.[13] The court blocked the lender because the lender had not acted against the

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[8] 206 Misc. 955, 135 N.Y.S.2d 588 (1954).

[9] "Estoppel" and "laches" are two defenses that borrowers often assert. "Estoppel" means the lender did or did not do something, the borrower "relied on" whatever the lender did or didn't do, the borrower incurred prejudice because of such reliance, and therefore the lender should not be allowed to change its mind. "Laches" is similar, except that the lender's inaction consisted of waiting a long time to assert its rights, while knowing that the borrower was relying on the lender's inaction. Estoppel and laches are very elastic and discretionary. Courts often use them to do justice, *i.e.,* reach whatever result they want to reach.

[10] Laber v. Minassian, 134 Misc. 2d 543, 511 N.Y.S.2d 516 (1987).

[11] N.Y.L.J., Sep. 15, 1993, at 25, col. 5 (N.Y. Sup. Ct.).

[12] 117 Misc. 393, 191 N.Y.S. 436, 439 (1921).

[13] 206 Misc. 955, 135 N.Y.S.2d 588, 589 (1954).

borrower for several years even though the lender knew that the borrower was in default. The lender further damaged its case by accepting payments of principal and interest with that knowledge.[14] *Rockaway* appears to stand for the principle that a lender must initiate a foreclosure action soon after learning of the nonmonetary default or it may waive the right to do so. Accepting payment from a borrower in nonmonetary default may make it impossible to foreclose.

Thus, although *Laber* and *Borack* do stand for the general principle that demolition of a building in violation of the mortgage, and perhaps more generally some other substantial nonmonetary default, sustains foreclosure, that general principle probably applies only in limited circumstances. If a lender wants to foreclose for a nonmonetary default, it should probably do so as soon as it learns of the default. If the lender waits to accelerate or foreclose, it runs the risk that a sympathetic judge will identify some rationale to decide that such an action is unconscionable or has been waived. If the lender waits too long, or accepts payments in the interim, then the outcome may well be the same as in *Rockaway*.

On the other hand, if the facts demonstrate chronic defaults by the borrower, foot-dragging on a wide variety of loan covenants, mechanics' liens, nonpayment of taxes, or other similar facts, the court may weigh these circumstances in the lender's side of the scale and more likely allow foreclosure than otherwise, particularly if the lender acts quickly.

Unfortunately for lenders, although a mortgage might by its terms (and New York law does in theory) allow foreclosure for a nonmonetary default, the cases teach that one cannot read the mortgage documents, apply them to the borrower's behavior, and thereby know with any confidence whether it is possible to foreclose for a nonmonetary default. Regardless of what the parties negotiated within the four corners of the document, ultimately it is the judge who will decide whether a given nonmonetary default, and all the circumstances that surround it, give the lender sufficient basis to foreclose. The answer will often be "no," but it could be "yes" in some cases.

[2] Sample Language: Nonmonetary Defaults; No Waiver

A lender that wants to increase the likelihood of succeeding on this question might want to include language like the following in the mortgage documents, to respond to common fact patterns that later produce borrower-friendly results:

Nonmonetary Defaults; No Waiver. Borrower acknowledges that Lender shall have the right to exercise any of its rights and remedies under the Loan Documents at any time for any default that has continued beyond applicable cure periods, whether such default is monetary or nonmonetary. For any default, Lender's right to exercise

[14] 206 Misc. 955, 135 N.Y.S.2d 588, 590 (1954).

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its rights and remedies for such default shall continue unless and until Borrower has cured such default. If Lender accepts any payment(s) under the Loan Documents with knowledge of any default, then such acceptance of payment(s) shall not be deemed a waiver of such default. Lender may accept any payment(s) and thereafter enforce its rights and remedies on account of any default(s) that existed before or at the time of such payment(s). [Even though Lender shall not be subject to any claims of waiver under any circumstances, if at any time any act or omission of Lender would or could nevertheless (in contravention of the intentions of the parties) constitute Lender's waiver of any of Borrower's obligations or any of Lender's rights or remedies, then Borrower agrees to give Lender written notice of any such waiver (a "Waiver Notice") within five business days after such waiver occurred. Any Waiver Notice shall specify the subject matter and basis of the alleged waiver. If Lender does not confirm the alleged waiver in writing within five business days after receipt of a Waiver Notice, then such alleged waiver shall be deemed to have been cancelled and rescinded by agreement of the parties. If Borrower fails to give a timely Waiver Notice regarding any alleged waiver by Lender, then Borrower shall be estopped from asserting such waiver. This does not limit the provisions of the Loan Documents that bar the defense of waiver, as against Lender's exercise of any rights or remedies under the Loan Documents, under any circumstances, in the absence of Lender's written confirmation of such waiver.]

Some of the preceding language may be rather creative, such as the bracketed language that requires Borrower to notify Lender if Borrower believes a waiver has occurred. Moreover, it is difficult to square a requirement for notice of waiver with the proposition that there cannot be a waiver under any circumstances. Still, the suggested language may provide a reasonable way to deal with this problem in the real world (where courts may stretch to find a waiver regardless of what the documents say), and should do no harm.

The language suggested above addresses the common fact pattern in which the borrower argues waiver or the like because of a lender's failure to act quickly and decisively in response to a nonmonetary default.

[3] Intermediate Remedies for Intermediate Defaults

Another reason lenders and their counsel are skeptical about the enforceability of nonmonetary defaults is that they fear a court may regard a particular nonmonetary default as being immaterial, or at least not sufficiently material to justify accelerating the loan and foreclosing under the mortgage. This is particularly true when the default might arise from the borrower's failure to comply with a financial, but not directly monetary, covenant, such as a covenant to maintain a particular debt service coverage ratio. Although these covenants are intended to give the lender an "early warning mechanism" so the lender can act decisively in the early stages of a problem (before the problem becomes a disaster), borrowers can and do argue that any particular nonmonetary covenants should not be taken seriously (the lender should have no remedies until the loan

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actually goes into a more "serious" form of default). Judges sometimes agree. Based on that reality, lenders need to be strategic about how they structure their remedies for any nonmonetary default.

For nonmonetary defaults of any kind, lenders should consider building into their loan documents a mechanism that gives the lender "intermediate" remedies—something short of accelerating the loan or calling an Event of Default, but nevertheless meaningful—if any nonmonetary default occurs.

For example, if the nonmonetary default consists of failure to repair, the lender might insist on having the right to identify any necessary repairs and then to give the borrower 30 days to make the repairs. After that period (or perhaps even when the period begins), the loan documents would require the borrower to deposit with the lender a cash reserve sufficient to pay for the repairs. If the borrower failed to make the cash deposit, the nonmonetary default would thereby become a monetary default, thus presenting a much straighter path toward accelerating the loan and foreclosing.

Similarly, if the borrower violates a debt service coverage ratio, instead of accelerating the loan the lender might ask for the right to require a partial amortization payment sufficient to bring the loan back into compliance with the required ratio. If the borrower did not make the payment, then the lender could declare the borrower to have committed a monetary default.

If a mortgage lender obtains rights and remedies of the types just described, these rights and remedies should go a long way toward achieving enforceability for nonmonetary defaults. These rights and remedies achieve that result by establishing a logical link between the default and the acceleration, giving the borrower a reasonable and clear opportunity to prevent acceleration by solving whatever problem would have otherwise constituted a default. Such an approach probably increases the likelihood that a court would allow a lender to foreclose if the borrower ultimately did nothing to solve the particular problem.

§ 14.05 Lender's Legal Fees

[1] Inclusion in Mortgage

A leading commentator on New York mortgage foreclosures has suggested that if the lender wants the mortgage to secure reimbursement of the lender's legal fees, then the obligation to reimburse legal fees must be written in the mortgage itself, not merely in the promissory note.[1] The rationale is that "mortgage

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[1] Bergman, Bergman on New York Mortgage Foreclosures, § 1.08 ns.3–4 (LexisNexis Matthew Bender) (citing only *dictum* in City of Utica v. Gold Medal Packing Corp., 54 Misc. 2d 721, 283 N.Y.S.2d 603, 606 (Sup. Ct. Special Term 1967)).

notes—as opposed to the mortgage itself—are usually not recorded. Thus, junior lienors would not have notice that legal costs superior to their own debt exist."[2] The lender would then be subject to the usual rule, barring recovery of its attorneys' fees.[3]

Under this rationale, should not the lender also be punished for failing to record the interest rate, payment schedule, prepayment restrictions, "exit fees," and maturity date of the loan—provisions that are at least as important as reimbursement of the lender's attorneys' fees, but rarely recorded? It is not the practice in New York to record promissory notes or loan agreements, yet junior lien holders are thought to be bound by the interest rate, payment schedule, prepayment restrictions, "exit fees," and maturity date, and all other obligations set forth in those unrecorded documents. Why should junior lien claimants not be bound by a provision that requires the borrower to reimburse the lender's attorney's fees? Is it not just as "intuitively obvious" that a note will contain an "attorneys' fees" clause as that it will contain an interest rate and a maturity date? The argument fails completely in the typical case in which the only holder of a junior interest is the borrower (as opposed to a third-party junior lien holder, who can claim she is a "victim" of material nondisclosure because she relied on the public record and assumed the mortgage did not secure an obligation to reimburse attorneys' fees, and she would not have done business with the mortgagor if the public record had disclosed the true facts).

Regardless of the merits of this discussion, a lender can avoid the entire issue quite easily, by including in the mortgage the borrower's obligation to reimburse the lender's attorneys' fees—in foreclosure litigation, in bankruptcy litigation, in administering the loan, if the borrower requests any consents from the lender, and in any actions or proceedings otherwise relating to the mortgage. If the same counsel that prepared the mortgage without an attorneys' fees clause is later called on to enforce its handiwork, that counsel may have an interesting conversation indeed with its client.

Printed forms of New York mortgage often require the borrower to reimburse the lender's attorneys' fees, but then, somewhat counterintuitively, expressly exclude the lender's attorneys' fees in "an action to foreclose this mortgage or to collect the debt secured thereby" —the one occasion when the lender would seem most likely to incur attorneys' fees that the lender might think should be

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[2] Bergman on New York Mortgage Foreclosures, § 1.08 at n.3 (LexisNexis Matthew Bender).

[3] *See* Chase Manhattan Bank v. Each Individual Underwritten Bound to Lloyd's Policy No. 790/004A89, 258 A.D.2d 1, 690 N.Y.S.2d 570 (1999) (New York adheres to the American Rule against fee shifting unless authorized by agreement between parties, statute, or court rules). *See also* Hunt v. Sharp, 85 N.Y.2d 883, 884, 626 N.Y.S.2d 57, 649 N.E.2d 1201 (1995).

reimbursed.[4] Some other printed forms merely require the borrower to reimburse the lender's legal fees if the lender is made a party to a legal action relating to the mortgaged property (not if the lender commences any such legal action). In addition, if the note says the borrower must pay the lender's attorneys' fees "in case any installment under this Note is not paid when due," then according to one New York court, this language will not allow the lender to collect its attorneys' fees in a foreclosure action.[5]

Those are just some examples of how the reluctance of the New York courts to enforce attorneys' fees clauses makes it easy for lender's counsel to create future unpleasant surprises for the lender (and the lender's counsel). Any attorneys' fees clause should be broadly enough worded to cover all possible attorneys' fees for which the lender expects to be reimbursed. It should also state that the mortgage secures the borrower's obligation to reimburse attorneys' fees. (The documents probably already state that the mortgage secures all the borrower's obligations. But for some reason this is not enough. The documents need to say the mortgage also secures the obligation to pay attorneys' fees. Should the same statement appear for every other borrower obligation under the loan documents?)

[2] Sample Language: Mortgagee's Attorneys' Fees

For an example of strong language regarding mortgagee's attorneys' fees, consider the following:[6]

Mortgagee's Attorneys' Fees. If Mortgagee engages counsel to collect the Loan or any part of it, to exercise any of Mortgagee's rights and remedies under this Mortgage (including prosecution of a judicial or nonjudicial foreclosure action) or under any other Loan Document or under applicable law, to represent Mortgagee in any Insolvency Proceeding relating to Mortgagor or the Mortgaged Property, to defend Mortgagee or prosecute Mortgagee's rights in any action or proceeding relating to the Mortgaged Property or to protect Mortgagee's interest in the Mortgaged Property or the lien of this Mortgage, to defend Mortgagee in any action or claim against Mortgagee asserted by Mortgagor or any partner(s), member(s), or other principal(s) of Mortgagor, to represent Mortgagee in any action to interpret or adjudicate the terms of this Mortgage, to advise Mortgagee regarding any default by Mortgagor under this Mortgage or any other Loan Document or regarding the interpretation of this Mortgage or any other Loan Document, to assist Mortgagee in administering or closing the Loan or in processing any request for any consent or other action, or as

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[4] *See, e.g.*, City of Utica v. Gold Medal Packing Corp., 54 Misc. 2d 721, 283 N.Y.S.2d 603, 607 n. 2 (Sup. Ct. Special Term 1967).

[5] Lipton v. Specter, 96 A.D.2d 549, 465 N.Y.S.2d 59 (App. Div. 1983).

[6] *See also* Bergman, Bergman on New York Mortgage Foreclosures, Chapter 26 (LexisNexis Matthew Bender) (quoting from and analyzing attorneys' fees clauses that were enforced, and others that were not, by the courts in foreclosure actions).

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the result of any Default or Event of Default or otherwise in connection with this Mortgage, any other Loan Document, the Mortgaged Property, or the Loan, whether or not Mortgagee succeeds in obtaining any relief or remedy that Mortgagee seeks, then Mortgagor shall on demand reimburse all costs and expenses, including reasonable legal costs, that Mortgagee incurs in connection with the foregoing. Mortgagee's reasonable legal costs shall include reasonable attorneys' fees, fees of paralegals and law clerks, costs of document preparation, filing or application fees, fees of process servers and private investigators, disbursements, costs of electronic legal research, other charges, court costs, and any and all other reasonable charges (including charges for other personnel in addition to those listed) that Mortgagee incurs in connection with the receipt of legal services or any other activities of the type described in this paragraph. This Mortgage and all the other Security Documents shall secure Mortgagor's obligation to reimburse all such reasonable legal costs and other expenses of Mortgagee. Mortgagee shall be entitled to include in computation of the amount due under this Mortgage any such reasonable legal costs and other expenses of Mortgagee not previously reimbursed by Mortgagor, subject in all cases however to any applicable limitation on the amount this Mortgage secures. Any sums that this paragraph requires Mortgagor to pay shall bear interest at the Default Rate, both before and after entry of judgment, until actually paid in full in cash. For purposes of this paragraph, if Mortgagee uses the services of persons who are employees of Mortgagee, then Mortgagee shall be deemed to have incurred reimbursable costs equal to the arm's-length fees that Mortgagee would have incurred by engaging comparable nonemployees of approximately equivalent levels of seniority and experience, as reasonably calculated and determined by Mortgagee. Without limiting Mortgagor's obligations under this Mortgage to promptly make any payment that this paragraph requires, Mortgagor hereby authorizes and instructs Mortgagee to debit the Loan (by increasing the principal amount of the Loan, subject however to any limitations on such principal amount as provided for in this Mortgage), to the extent of any payment that this paragraph requires Mortgagor to make, but Mortgagor fails to make within five Business Days after Mortgagee's request.

The preceding language is quite "full" and "extensive." Another word might be overkill—much more language than a lender really needs in order to achieve an adequate attorneys' fees clause and an adequate set of documents. This language is offered only as a starting point for consideration and possible deletions. This sample language addresses only attorneys' fees and some related expenses. The attorneys' fees clause should appear in the recorded mortgage, as suggested above, and would also typically appear in the unrecorded note or loan agreement. In many generic mortgages, the attorneys' fees clause will already be almost as broad as suggested here, so it might not require further improvement.

§ 14.06 Late Charges on Acceleration

When a commercial mortgage requires the borrower to pay a late charge, New York courts will typically enforce that requirement. If, however, a lender tries to

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impose a late charge on the balloon payment due on maturity, the courts hesitate to allow it. In several cases, courts have interpreted customary "late charge" provisions in mortgages as applying only to late payment of regular monthly installments, rather than the balance due on maturity.[1] The courts did not rule out the latter type of late charge. They have simply interpreted standard late charge language as not providing for it.[2]

If a lender wants to be able to impose a late charge on the entire loan when the borrower fails to pay it on maturity, then the loan papers should provide for it unequivocally. All it takes is an express statement that a borrower must pay a late charge if the borrower fails to pay the balance of the loan when due on the maturity date. Of course, borrower and its counsel may have other ideas.

§ 14.07 Interest After Acceleration and After Judgment

[1] General Rule

As a general proposition of New York law, once a lender accelerates a loan, the loan bears interest at the "legal" or "judgment" rate—nine percent per annum[1]—even if the loan documents generally call for payment of a higher rate.[2] This rule of law is merely a pitfall for the unwary. Lender's counsel can prevent the problem merely by adding language to the note to say that the contractual

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[1] *See, e.g.*, Green Point Sav. Bank v. Varana, 236 A.D.2d 443, 653 N.Y.S.2d 656, 657 (App. Div. 1997) ("at least in the absence of a provision providing otherwise, which is not present in the mortgage documents involved here, late charges for nonpayment of installments claimed to be due *after* acceleration cannot be collected"); Centerbank v. D'Assaro, 158 Misc. 2d 92, 600 N.Y.S.2d 1015, 1017 (Sup. Ct. Special Term 1993) (late charge applies to "any installment of principal and/or interest" not paid when due, but this does not include nonpayment on maturity); Trustco Bank N.Y. v. 37 Clark Street, Inc., 157 Misc. 2d 843, 599 N.Y.S.2d 404 (Sup. Ct 1993) (same result, relying on language in mortgage reciting that late charges were assessed "for the purpose of defraying the expense incident to handling delinquent payment").

[2] In each of these cases, the "late charge" language in question was fairly typical of New York mortgages. Therefore, any lender that uses a "typical" New York mortgage may find itself unable to impose a late charge if the borrower fails to pay on maturity.

[1] N.Y. C.P.L.R. 5004. In today's interest rate environment, nine percent interest is not necessarily a bad result for a lender.

[2] *See, e.g.*, Chipetine v. McEvoy, 238 A.D.2d 536, 657 N.Y.S.2d 88, 89 (App. Div. 1997) ("Inasmuch as the note did not provide that interest was to be paid at a specified rate until the principal was fully paid, the court should have [applied an] interest rate of 9% after . . . the date of the defendant's default."); Sindelar v. Fritzsch, 167 A.D.2d 812, 563 N.Y.S.2d 374 (N.Y. App. Div. 1990) (holding because "the note made no specific provision for the rate of interest to be charged following maturity," interest rate should have dropped to the judgment rate on maturity). *See also* N.Y. U.C.C. § 3-122(4) ("Unless an instrument provides otherwise," interest runs at the judgment rate from the date of demand for payment).

"default rate" continues to apply after the lender accelerates the loan, or after the loan has otherwise matured. If clearly expressed, such a provision will be enforced by the courts, at least until entry of judgment.[3]

[2] Interest After Judgment

Even the cases that allow a lender to charge contractual default rate interest after default say that once the lender obtains a judgment, the interest rate on the judgment drops to the "legal" or "judgment" rate. What if the loan documents expressly said that any judgment shall bear interest at the default rate under the loan documents, or that the borrower's obligations continue to bear interest at that default rate even after judgment? Would the courts enforce it? Does a lender lose anything by trying?

A 1991 case suggests, but does not hold, that if a lender were to include strong enough language in its loan documents, the lender might be able to collect default rate interest even after obtaining a judgment on the note. In that case, *Marine Management, Inc. v. Seco Management, Inc.,*[4] the mortgage required the borrower to pay interest at the highest rate permitted by law (which the parties agreed was 25 percent per annum) from the date of default until "the date of the actual receipt of payment . . . by the holder of this mortgage."[5]

As a matter of commonsense interpretation of English words, obtaining a judgment is not the same thing as being paid. Hence, one might intuitively think that the quoted language would have allowed the lender to collect default rate interest (at 25 percent per annum) until the "actual receipt of payment," *i.e.,*

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[3] *See, e.g.*, European Am. Bank v. Peddlers Pond Holding Corp., 185 A.D.2d 805, 586 N.Y.S.2d 637, 637–638 (App. Div. 1992); Astoria Fed. Sav. & Loan Ass'n v. Rambalakos, 49 A.D.2d 715, 372 N.Y.S.2d 689, 690 (App. Div. 1975) (where note required payment of contract rate "until the principal is fully paid," this rate would govern "after maturity and before judgment"); Citibank, N.A. v. Liebowitz, 110 A.D.2d 615, 487 N.Y.S.2d 368, 369 ("the parties agreed that the interest rate of 153/4% per annum is to apply after default, and until the principal has been paid"; accordingly such rate governs until "the contract is merged in a judgment"); Stein v. Am. Mortgage Banking, Ltd., 216 A.D.2d 458, 628 N.Y.S.2d 162, 164 (App. Div. 1995) (enforcing rate after maturity of two percent per month, as provided for in the mortgage documents). If the court decides the mortgagee has inordinately delayed the foreclosure litigation, though, the court might still cut off the accrual of interest at some point. *See, e.g.,* Yagamo Acquisitions, LLC v. Baco Dev. 102 Street Inc., 278 A.D.2d 134, 718 N.Y.S.2d 325, 326 (App. Div. 1st Dept. 2000) (allowing only one year of interest after seven years had elapsed from summary judgment to entry of judgment of foreclosure and sale; "unconscionable to hold defendants responsible for plaintiff's lengthy delay"; no recognition of the pure time value of money regardless of fault and no indication of whether defendants had made any effort to expedite the proceeding to protect themselves from accrual of interest).

[4] 176 A.D.2d 252, 574 N.Y.S.2d 207 (App. Div. 1991).

[5] 176 A.D.2d 252, 574 N.Y.S.2d 207, 208 (App. Div. 1991).

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payment of the judgment rather than mere entry of the judgment, as contemplated by the mortgage. One would be wrong.

According to the majority decision in this case, even though the borrower agreed to pay 25 percent interest until "the date of the actual receipt of payment . . . by the holder of this mortgage":

> [T]here is nothing in the language of the mortgage [that] would suggest that the defendant intended to bind itself to paying a 25% interest rate following the entry of the judgment. . . . [A]lthough the mortgage does provide that in the event of a default the higher rate of 25% would become applicable, the mortgage is completely silent as to whether such a rate would continue ad infinitum despite the ultimate merger of the contract into the judgment. The mortgage provisions must be read in light of the above-established legal principles [stating that judgments bear interest at the legal rate rather than the contract rate], and if it was the intent of the parties to depart from those principles, they should have stated it clearly and unequivocally.[6]

One might have thought that the parties did state such intention "clearly and unequivocally" by saying that the lender could collect default interest until "the date of the actual receipt of payment," but this was apparently not clear enough.[7]

Two of the five Justices of the Appellate Division panel hearing the case dissented, and would have allowed the lender to continue to recover interest at 25 percent per annum until the judgment was paid.[8]

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[6] 176 A.D.2d 252, 574 N.Y.S.2d 207, 209 (App. Div. 1991). ("In conclusion, in the absence of a clear, unambiguous, and unequivocal expression that [borrower] agreed to pay the highest interest rate allowed by law, namely, 25%, until the judgment was satisfied, we decline to depart from precedent establishing the statutory rate of interest of 9% as the proper rate to be applied to the judgment.").

[7] The following colloquy from *Through the Looking Glass* may help explain the court's interpretation of the words "actual receipt of payment":

"When *I* use a word," Humpty Dumpty said in rather a scornful tone, "it means just what I choose it to mean—neither more nor less."

"The question is," said Alice, "whether you *can* make words mean so many different things."

"The question is," said Humpty Dumpty, "which is to be master—that's all."

Lewis Carroll, Through the Looking Glass, Chapter 6, at 57 (Dover Publications edition, 1999; originally published 1872). This work is in the public domain and may be downloaded from www.gutenberg.org/etext/12.

As another possible explanation, N.Y. CPLR 5004 may represent a debtor protection measure that a debtor may not waive. The court expressed no such rationale.

[8] Marine Mgt., Inc. v. Seco Mgt., Inc., 574 N.Y.S.2d at 207, 210–211 (App. Div. 1991) ("the parties clearly intended that the specified contract rate should survive the entry of judgment and continue until payment of the principal debt was actually received by the holder of the mortgage . . . we conclude that the [lender] was entitled to the benefit of the bargained-for 25% interest rate

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[3] Sample Language: Interest After Default

The *Marine Management* case leaves open the possibility that if a lender uses strong enough special language in the loan documents, the lender should be able, at least in theory, to collect the contractual "default interest rate" after acceleration and even after entry of judgment.[9] The following language may be strong enough to assure that the lender can collect "default" interest both after acceleration and entry of a judgment (although a lender may want to go a step further and impose the "default" rate as soon as any default occurs even before the loan has been accelerated):

Interest After Default. If Mortgagor fails to pay all or any part of the Loan[10] when due on maturity or its earlier acceleration, then the Loan, to the extent unpaid, shall bear interest at the Default Rate both before and after acceleration and maturity, and both before and after entry of judgment. Any judgment (including a judgment under New York Real Property Actions and Proceedings Law Article 13 or 14) in favor of Mortgagee on account of the Loan shall by its terms bear interest at the Default Rate until such judgment has been paid in full in cash, notwithstanding the provisions of New York Civil Practice Law and Rules 5004, which the parties expressly intend to override and supersede, so that any judgment shall bear interest at the Default Rate and not at the judgment rate. Lender's right to recover interest at the Default Rate shall not be superseded by, or merged into, the issuance of a judgment. At all times after occurrence of any default under the Loan, the parties expressly intend to impose interest on Mortgagor's obligations (before and after reduced to judgment) at the Default Rate both after acceleration and after judgment, until the judgment has been satisfied and paid in full and in cash.

The preceding language should appear both in the mortgage and the note or the loan agreement.

In view of cases like *Marine Management, Inc. v. Seco Management, Inc.,* however, one can never be sure that any words in a loan document will be interpreted to mean what one would expect them to mean.[11] Hence, even if a

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on the principal amount . . . to the date that principal amount was paid.") (Ritter, J., and Rosenblatt, J., dissenting in part). In the author's opinion, the dissent has the better argument.

[9] If this is actually true, then every New York contract should include similar language so that every potential judgment creditor holding a judgment on a contract can recover a default rate of interest on the judgment, rather than the statutory judgment rate. Would this not make the judgment rate a meaningless concept in the arena of judgments on contract claims? Would that be a great loss? Does the statutory judgment rate reflect a nonwaivable policy decision by the legislature? Of course, the statement in text assumes that a court would not find some other way to disregard whatever great new "magic language" (such as the language suggested in this section) a lender might add to the documents to try to recover default interest until the judgment has actually been paid.

[10] The loan documents should define the "Loan" broadly to include principal, interest, protective advances, and all other sums payable under the loan documents.

[11] This is why lawyers should write documents even more clearly than they intuitively might

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lender tries to continue to charge interest at the default rate after obtaining a judgment, such a provision may be unenforceable. It may conceivably lead borrower's counsel to raise an exception in its opinion of counsel as to "enforceability."

Along similar lines, lender's counsel should focus on the interest rate imposed on protective advances made by the lender, such as advances to pay insurance premiums. Unless addressed in the mortgage, such advances may bear interest at only the legal or judgment rate.[12]

"need" to be written, and why many lawyers feel the need to make the same point repeatedly.

[12] *See* Bergman, Bergman on New York Mortgage Foreclosures, at § 1.11[2] (LexisNexis Matthew Bender).