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New York Court of Appeals Resolves Divisions in the Acceleration and De-acceleration of Mortgage Loan Debt

The Court of Appeals has now provided clarity for all parties in actions relating to mortgage foreclosures in New York.

By Tracy DeWitt, Scott Parker and Ben Raindorf

On Feb. 18, 2021, in a joint opinion addressing four separate appeals, the New York Court of Appeals overturned a plethora of anti-lender decisions on the statute of limitations to foreclose.

Two of those appeals were cases where the trial court had found that a voluntary discontinuance de-accelerated the loan, only to have those decisions overturned by New York's Appellate Division, Second Department.

The third appeal sought to answer whether a notice of default containing the phrase "will accelerate" constituted an acceleration of the loan.

The fourth appeal involved whether a borrower could, on the one hand, successfully move to dismiss prior complaints based upon a pleading deficiency, while arguing years later that the complaints accelerated the loan.

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In all of these cases, the Court of Appeals found in favor of the lender, while being largely guided by the principle that "[t]his Court has emphasized the need for reliable and objective rules permitting consistent application of the statute of limitations to claims arising from commercial relationships."

'Will Accelerate' Notices of Default: 'Vargas v. Deutsche Bank Natl. Trust'. Pursuant to CPLR 213(4), mortgage foreclosures are governed by a six-year statute of limitations, which begins to run at the time the mortgagee accelerates the maturity date of the loan and demands immediate repayment of the entire outstanding debt after a mortgagor defaults. The Court of Appeals reiterated that the act of acceleration "should not be presumed or inferred; noteholders must unequivocally and overtly exercise an election to accelerate."

Up until Feb. 18, 2021, New York courts have been split on whether a notice of default referencing a future event could accelerate a loan. In *Deutsche Bank Natl. Trust Co. v. Royal Blue Holdings,* 148 A.D.3d 529 (1st Dept. 2017), the Appellate Division, First Department, held that a notice of default constituted an acceleration if it stated that the

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lender "will accelerate" the loan if the default was not cured. Other courts said that this type of notice of default referenced a future event that may or may not occur, and therefore did not constitute an acceleration.

In *Vargas v. Deutsche Bank Natl. Trust Co.*, the Court of Appeals held that a notice of default that did not reference an immediate acceleration merely constituted a warning of a possible, future discretionary acceleration—which is consistent with standard loan documents that provide acceleration is at the lender's discretion. The notice of default had stated that the lender "will accelerate [his] mortgage with the full amount remaining accelerated and becoming due and payable in full, and foreclosure proceedings will be initiated at that time", and further advised that "failure to cure your default may result in the foreclosure and sale of your property."

Based upon the notice of default, the borrower filed a quiet title action seeking to discharge the mortgage, arguing that the letter accelerated the debt and was sent more than six years prior to his filing of the complaint. The Court of Appeals rejected the borrower's argument, concluding that "an automatic acceleration upon expiration of the cure period, could be inconsistent with the terms of the parties' contract, which gave the noteholder an optional, discretionary right to accelerate upon a default … ." Further, the Court of Appeals observed that a notice that accelerated the loan would hinder pre-foreclosure negotiations: "[D]efault notices provide an opportunity for pre-acceleration negotiation—giving both parties the breathing room to discuss loan modification or otherwise devise a plan to help the borrower achieve

payment currency, without diminishing the noteholder's time to commence an action to foreclose on the real property, which should be a last resort."

Complaints Dismissed for Substantive Deficiencies Are Not Accelerations: 'Wells Fargo Bank v. Ferrato'. While the filing of a complaint may accelerate the loan, until Feb. 18, 2021, there remained a question as to whether a complaint that had been dismissed for failing to include a loan modification effectively accelerated the debt. In *Wells Fargo v. Ferrato*, the First Department held that two prior complaints acted as accelerations even though they were dismissed upon the borrower's argument that the complaint sought to foreclose the original note and mortgage, but failed to reference her loan modification. The Court of Appeals reversed and held that, "[u]nder these circumstances—where the deficiencies in the complaints were not merely technical or de minimis and rendered it unclear what debt was accelerated—the commencement of these actions did not validly accelerate the modified loan."

Presumably, any complaint dismissed for a substantive pleading defect does not act as an acceleration. And, there seems to be a colorable argument that a lender can raise this deficiency on its own, without the necessity of a court order identifying that deficiency.

Voluntary Discontinuance De-Accelerates the Debt: 'Freedom Mortgage Corporation v. Engel' and 'Ditech Financial v. Naidu'. On the opposite end of the spectrum, the appeals in *Freedom Mortgage Corporation v. Engel* and *Ditech Financial v. Naidu* addressed the issue of de-acceleration. As the Court of Appeals noted, "[d]etermining whether, and when, a noteholder revoked an election to accelerate can be critical to determining whether a foreclosure action commenced more than six years after acceleration is time-barred." The court reiterated that revocation requires "an affirmative act" by the noteholder within six years of the election to accelerate. The question before the court in *Engel* and *Naidu* was "whether a noteholder's voluntary motion or stipulation to discontinue a

mortgage foreclosure action, which does not expressly mention de-acceleration or a willingness to accept installment payments, constitutes a sufficiently 'affirmative act'."

To that end, the court was "persuaded that, when a bank effectuated an acceleration via the commencement of a foreclosure action, a voluntary discontinuance of that action—i.e., the withdrawal of the complaint—constitutes a revocation of that acceleration …. absent an express, contemporaneous statement to the contrary by the noteholder." Further, and critically, the borrower need not agree that the discontinuance is a de-acceleration: "[w]hether to exercise the contractual right to accelerate, and de-accelerate, remains[s] within the discretion of the [mortgagee]."

The court rejected prior holdings that required a probe of post-discontinuance conduct to determine whether the noteholder revoked the acceleration. Rather, as the court found, the act of de-acceleration should be determined at the time of the act itself, and "what occurred thereafter may shed some light on the parties' perception of the event but it cannot retroactively alter the character or efficacy of the prior act." A rule requiring post-hoc evaluation would not be consistent with the court's overarching goal of finality, certainty, and predictability: "Indeed, if the effect of a voluntary discontinuance of a mortgage foreclosure action depended solely on the significance of noteholders' actions taking place months (if not years) later, parties might not have clarity with respect to their post-discontinuance contractual obligations until the issue was adjudicated in a subsequent foreclosure action."

In an interesting footnote, the court stated that, "[t]o be sure, there may be cases in which the question of whether an acceleration was validly revoked involves an 'issue of fact,' such as where the operative facts surrounding a purported acceleration or revocation are disputed, and the court may be unable to decide whether the statute of limitations has run as a matter of law." Presumably, this footnote means that when the documents discontinuing the case are unclear, there may be an issue of fact. For instance, if the lender moves to discontinue and the borrower moves to dismiss on the merits, a court may need to parse out whether the subsequent order was a dismissal or a discontinuance. Reading this footnote in context with the opinion, the discontinuance on its own effectively de-accelerates the debt without the necessity of including revocation language therein, absent some fact in the effectuation of the discontinuance suggesting de-acceleration may not have occurred.

Motive for De-accelerating Is Irrelevant: 'Wells Fargo Bank v. Ferrato'. In reviewing *Ferrato*, the Court of Appeals went on to state that it "reject[s] the theory argued by Ferrato and reflected in several decisions (e.g., *Milone v. US Bank, N.A.*, 164 A.D.3d 145 (2d Dept. 2018)), that a lender should be barred from revoking acceleration if the motive of the revocation was to avoid the expiration of the statute of limitations on the accelerated debt."

This holding represents a sea change in another area: de-acceleration letters. The seminal decision by the Second Department in *Milone* held that a de-acceleration letter could not be used as a pretext to avoid the statute of limitations. *Ferrato* removes that subjective portion of the *Milone* test. Instead, courts are left with the test in *Kilpatrick v. Germania Life Ins. Co.*, 83 N.Y. 163 (1905), which states that a plaintiff can only be equitably estopped from revoking an acceleration if a borrower detrimentally relied on her reasonable belief that the statute of limitations had run, and thereafter changed her position on that belief. In reaching this conclusion, the Court of Appeals noted that "a noteholder has little incentive to repeatedly accelerate and then revoke its acceleration because foreclosure is simply a vehicle to collect a debt and postponement of the claim delays recovery."

In conclusion, the Court of Appeals has now provided clarity for all parties in actions relating to mortgage foreclosures in New York. While there will undoubtedly be ongoing litigation relating to the interpretation of certain provisions of the opinion, the court's bright line rules should help facilitate negotiation and reduce overall litigation costs.

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