

Finding Power of Sale Provision For Non-Judicial Foreclosure

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AS MOST ASTUTE lenders counsel and foreclosure practitioners in New York are aware, Article 14 of the Real Property Actions and Proceedings Law (RPAPL) was substantially overhauled in 1998 to allow for non-judicial foreclosure of certain commercial mortgages¹. Although New York had on its books for years the old Article 14 of the RPAPL entitled "Foreclosure of Mortgage by Advertisement," it was virtually unused by foreclosure practitioners because of its dubious constitutional validity.

These amendments to Article 14 have been hailed by the mortgage lending community as a substantial improvement over the extremely cumbersome and time-consuming process of a judicial foreclosure under RPAPL Article 13. One of the requirements of the new non-judicial foreclosure is that the mortgage to be foreclosed must contain a "power of sale" provision².

Although it may *appear* that many mortgages do not contain such a provision, appearances can be deceiving. In fact, a close analysis of the issue will reveal that most mortgages do, in fact, contain the requisite provision.

Nonjudicial Mortgage Foreclosure – Advantages

Having a power of sale provision in the mortgage (and therefore being able to conduct a non-judicial foreclosure) is quite significant. Indeed, the Senate bill that was signed into law

¹ 1998 N.Y. Laws Ch. 231

² RPAPL § 1401(1) states, in pertinent part: "A mortgage . . . containing a provision that, upon a default of the mortgage, or the note, bond or other obligation secured thereby, the mortgagee shall have the right to sell the mortgaged property, may be foreclosed in the manner prescribed in this article for a non-judicial proceeding for foreclosure by power of sale . . ."

recognized the significance of the non-judicial proceeding by offering the following justification in support of the passage of the bill:

The most common procedure for foreclosure of a mortgage in New York State is set forth in Article 13 of the Real Property Actions and Proceedings Law. That Article requires judicial action and intervention at many stages of the proceedings, even when the proceeding is uncontested. A referee must be appointed, the referees report must be approved, and a judgment of foreclosure and sale must be signed and entered. Due to the substantial caseload carried by judges in New York State, the various states of judicial review can delay such proceedings, even an uncontested one, to a year or two in duration. Mortgage lending, for both construction and foreclosures, is vital to the States real estate industry. That lending, in turn, is under-written based on the borrowers ability to repay the debt and the creditors ability to obtain prompt, full repayment in the event of a default. This bill provides a prompt, economical foreclosure remedy, which will encourage lenders to invest in New York State real estate.³

A judicial foreclosure under Article 13 is especially frustrating to lenders when it is uncontested and nevertheless takes a year to a year and a half (or more) due to congestion in the courts and the numerous stages that the foreclosure must go through. Furthermore, while a judicial foreclosure is winding its way through the courts, the real estate collateral is typically deteriorating due to lack of maintenance and upkeep, interest is accruing on the mortgage debt (usually at a higher "default rate") and the lender is frequently making advances to protect its security for items such as taxes and insurance.

This scenario benefits no one. From the lenders perspective, the value of the collateral is decreasing and the size of the indebtedness is increasing, thereby also increasing the amount of deficiency and perhaps the amount of the loss the lender will suffer. From the borrowers perspective, either the equity cushion is being eroded or the deficiency for which the borrower and any guarantors will be liable is increasing. The holder of a second mortgage or other subordinate lien is similarly prejudiced by the ongoing erosion of the equity cushion and the increase of the indebtedness, because it results in less, or, frequently, nothing available to pay

³ Memorandum in Support of Senate Bill Number S 588D

those liens in a surplus money proceeding.

From the foregoing, it is clear that a speedier nonjudicial foreclosure process is a preferable method for Lenders to realize on their collateral and should be utilized whenever possible. As a result, most Lenders, in response to the new Article 14, have amended loan documents to include a specific “power of sale” provision. Indeed, as stated earlier, the presence of “power of sale” provision in the mortgage is explicitly required for the mortgagee to utilize the nonjudicial foreclosure process set forth in Article 14.⁴

The New Article 14 – Statutory Requirements and Exclusions

Although this article is not intended to be an exhaustive discussion of Article 14, it should be noted at this point that there are numerous exclusions from, and requirements for, utilizing the non-judicial foreclosure process under Article 14⁵. For example, it cannot be used to foreclose a mortgage on:

- (a) a residential building containing less than six dwelling units;
- (b) a residential condominium unit;
- (c) a residential building owned by a cooperative apartment corporation; or
- (d) a residential building located within a city of one million or more people containing at least 65 percent residential tenancies⁶.

⁴ Supra Note 2

⁵ For a comprehensive discussion of the various requirements of Article 14, see Fries, "Amendment to RPAPL Article 14 Allows Nonjudicial Foreclosure of Commercial Mortgages," New York State Bar Journal, December 1998.

⁶ RPAPL 1401.

Furthermore, in order to take advantage of the non-judicial foreclosure process, (a) a default must have occurred and the indebtedness must be accelerated by written notice to the mortgagor, (b) there must have been no action to recover the debt or to foreclose the mortgage under Article 13, (c) the mortgage must have been duly recorded and (d) the first notice of sale must be published within the time in which a judicial action to foreclose the mortgage could be commenced.⁷

In addition, there are methods by which the mortgagor can invoke judicial intervention once the non-judicial process has been commenced. For mortgages executed prior to July 1, 1998, the mortgagor needs only to deliver a written notice to the mortgagee demanding a judicial foreclosure.⁸ The notice must be delivered within 40 days of the mortgagor's receipt of the Notice of Intention to Foreclose required by RPAPL 1402(1).⁹

For mortgages executed on or after July 1, 1998, a mortgagor may seek judicial intervention by way of order to show cause, supported by affidavits containing specified substantive allegations set forth in the statute¹⁰. Notably, one of the allegations which will require judicial intervention is "that the mortgage ... sought to be foreclosed does not contain a provision permitting the foreclosure thereof by power of sale or other non-judicial means."¹¹ Thus, if a power of sale provision is not included in a mortgage, a non-judicial foreclosure will not be able to proceed under Article 14.

⁷ Id.

⁸ RPAPL § 1421(1)

⁹ Id.

¹⁰ RPAPL 1421(2).

¹¹ RPAPL 1421(2)(b)(1).

Real Property Law § 254 – The Key to Finding the Power of Sale

As most foreclosure practitioners are aware, mortgages are often prepared by attorneys who are not necessarily attuned to the intricacies of foreclosure practice. This is especially true in private mortgage transactions and in transactions where a purchase money mortgage is taken back by the seller. In such transactions it is fairly common for the parties to utilize a "standard form mortgage," such as an NYBTU or a Blumberg form. While such mortgages frequently cover the basics, they are often lacking in many respects.

For example, foreclosure plaintiffs are often unpleasantly surprised to learn (after the mortgage has gone into default and foreclosure counsel has been retained) that their "standard form mortgage" does not include a provision allowing for the recovery of legal fees in a foreclosure action. Likewise, it appears, at first blush, that such "standard form mortgages" do not contain a power of sale provision which will allow the mortgage holders to take advantage of the expedited non-judicial foreclosure process when those mortgages go into default.

Upon closer scrutiny, however, the power of sale provision can usually be found. The key to finding it, surprisingly, lies in 254 of the Real Property Law.

Section 254 sets forth a statutory construction of a number of clauses typically found in real estate mortgages. Significantly, 254(3) states, in pertinent part, as follows:

3. *Covenant to pay indebtedness. In default of payment, mortgagee to have power to sell.* A covenant "that the mortgagor will pay the indebtedness, as hereinbefore provided," must be construed as meaning that the mortgagor ... covenant[s] and agree[s] to pay to the mortgagee, ... the principal sum of money secured by said mortgage, and also the interest thereon as provided by said mortgage. And if default shall be made in the payment of the principal sum or the interest that may grow due thereon, or of any part thereof, or in case of any other default, that then and from thenceforth it shall be lawful for the mortgagee, ... ***to enter into and upon all and singular the premises granted, or intended so to be, and to sell and dispose of the same, and all benefit and equity of redemption of the said mortgagor, his heirs, executors, administrators, successors or assigns therein, at public auction, according to the act in such case made and provided, and as the attorney of the mortgagor for that purpose duly authorized, constituted and appointed, to make and deliver to the purchaser or purchasers thereof a good and***

sufficient deed or deeds of conveyance for the same in fee simple,... which sale so to be made shall forever be a perpetual bar both in law and equity against the mortgagor, his heirs, successors and assigns, and against all other persons claiming or to claim the premises, or any part thereof by, from or under him, them or any of them.

Real Property Law 254(3) (emphasis added). The foregoing language is classic "power of sale" language, which makes clear that a non-judicial foreclosure under Article 14 can be utilized as long as the mortgage sought to be foreclosed contains a covenant by the mortgagor to "pay the indebtedness as hereinbefore provided." Stated another way, any mortgage that contains a covenant by the mortgagor to "pay the indebtedness as hereinbefore provided"¹² by definition contains a power of sale provision.

It is significant to note that Real Property Law § 254(3) states that a mortgage with such a covenant **must be** construed in this fashion. The courts of New York have consistently held that the use of the statutory language in mortgages must be given the interpretation defined in the statute.

For example, the Court of Appeals, in construing the meaning of the acceleration clause in the statutory form mortgage¹³, has stated that, "having chosen the statutory form, [the parties] are bound by the statutory construction given that form..." Albertina Realty, Co., v. Rosbro Realty Corp., 258 N.Y. 472 (1932). Likewise, in Leakey v. Schwing, 150 Misc 150 (County Ct.,

¹² A review of a variety of "standard form mortgages" and extension agreements or extension and consolidation agreements reveals that a covenant by the mortgagor to "pay the indebtedness as hereinbefore provided" can be found in the vast majority, if not all such forms. For example, the requisite covenant can be found in the following commonly utilized forms: the Statutory Form Mortgage set forth in Real Property Law 258 (Statutory Form M) (also known as Blumberg Form P682); the Statutory Form Bond and Mortgage set forth in Real Property Law 258 (Statutory form MN) (also known as Blumberg Form M86); NYBTU Mortgage Form 8014 (Blumberg Form A283); NYBTU Mortgage (Subordinate) Form 8015 (Blumberg Form A367); NYBTU Consolidation and Extension Agreement Form 8026 (Blumberg Form 388); NYBTU Extension Agreement Form 8025 (Blumberg Form A286). The foregoing list is not intended to be exhaustive.

¹³ See, Real Property Law § 258, Schedule M

Jefferson County 1934), the court followed the rationale of *Albertina* and stated:

There can be no question as to what construction shall be placed upon an acceleration clause which conforms to the precise wording of the statute the Legislature has construed the meaning of the Statutory form and the Court of Appeals has definitely settled any uncertainty relative thereto. ***Such legislative construction prevents the courts from construing the instrument according to the apparent intent of the parties.***

Leakey at 153 (emphasis added). Thus, the law is clear in New York that statutorily defined covenants and clauses must be strictly construed in accordance with their defined meanings. Therefore, there should be no room for any judicial discretion in the interpretation of a "covenant to pay the indebtedness as heretofore provided." Real Property Law § 254 mandates that the "power of sale" be read into such a covenant.

Given the fact that the old Article 14 "Foreclosure By Advertisement" procedure has been virtually unused for decades, it is not surprising that no recent cases have addressed the power of sale provision set forth in Real Property Law 254(3). However, the issue was specifically considered in *Home Owners Loan Corporation v. Houst, 168 Misc 948 (County Ct. Westchester County 1938)*.

In *Houst*, the mortgagee conducted a foreclosure by advertisement, under Article 17 of the Real Property Law (the predecessor statute to old Article 14). The mortgagor opposed a final order in the proceeding on the ground that the mortgage foreclosed did not contain a power of sale. The court framed the issue as follows:

Clearly, the mortgage in question does not contain any words or phrases which in and of themselves directly express a power to sell. It does, however, contain the statutory covenant "that the mortgagor will pay the indebtedness as hereinbefore provided." [Mortgagee] contends that his covenant is construed by statute (Real Prop. Law § 254, subd.3) to include and to constitute a power of sale. [Mortgagor] ... contends to the contrary. The interpretation of the statute is before the court. The question to be determined is: Does the covenant "that the mortgagor will pay the indebtedness, as hereinbefore provided", carry with it and constitute a power of sale?

Houst at 947. The court concluded that

... the covenant in question does create and constitute a statutory power to sell ... The Legislature in enacting this abbreviated covenant intended it to be construed as meaning that upon default in payment, the mortgagee had a power of sale, and also intended that when used, the abbreviated covenant should be deemed to express such a power, with the same force and effect as if more elaborate and precise words had been used.

Id. At 948-49. The rationale in Houst is as applicable today as it was over 60 years ago.

Even if the mortgage lacks both an express power of sale provision and the exact language set forth in 254(3), there is still hope for the utilization of the non-judicial foreclosure process. The opening paragraph of Real Property Law § 254 states that "... the following or *similar clauses or covenants* must be construed as follows:..." The section then goes on to recite the various covenants (including the "covenant to pay the indebtedness as hereinbefore provided") and the statutory definition of each such covenant.

Thus, any clause in which the mortgagor agrees to pay the indebtedness secured by that mortgage should receive the interpretation mandated by § 254(3), since it would be *similar to* a covenant to "pay the indebtedness as hereinbefore provided." It is this authors belief that there are few, if any, form mortgages in which the mortgagor does not, in some fashion, agree to pay the mortgage debt.

Finally, some commonly used mortgage forms contain clauses which state, in substance, the following: "Mortgagee shall have all the rights set forth in § 254 of the New York Real Property Law in addition to Mortgagees rights set forth in this Note and Mortgage, even if the rights are different from each other."¹⁴ Clearly, any mortgage which contains the foregoing or similar language should be deemed to have the power of sale provision set forth in 254(3). Therefore, such a mortgage has a requisite power of sale provision for purposes of Article 14.

¹⁴ Blumberg Form M667

Conclusion

Foreclosure practitioners should not quickly conclude that a given mortgage lacks the requisite power of sale provision needed to take advantage of the non-judicial foreclosure remedy provided by Article 14 of the RPAPL. A careful reading of the mortgage to be foreclosed, coupled with knowledge of the Real Property Laws statutory construction provisions, will usually result in a power of sale being read into the mortgage.

The foreclosure practitioner who is able to take advantage of the speedier non-judicial process will provide a substantial benefit to his or her client. Indeed, utilizing the non-judicial process may make the difference between a mortgage holder being made whole and suffering a loss, when a mortgage has gone into default and must be foreclosed.