Banks Behaving Badly: Remedies for Failing to Negotiate in Good Faith

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New York state courts have recently grappled with how to punish banks for failing to negotiate in "good faith" in residential mortgage foreclosure actions. Although the applicable statute and court rules[1] require that parties engage in "good faith" settlement negotiations, both are silent as to the specific remedies or sanctions that courts can, or should, impose upon lenders that do not abide by the rules.

This article discusses some recent lower and appellate court decisions in which judges have attempted to fill this void. In a nutshell, these recent decisions confirm that, while courts have broad discretion to award attorney fees and costs, reduce interest and/or principal on residential mortgages, or even stay foreclosure actions, courts cannot compel parties to settle or enter into mortgage modification agreements.

Background

CPLR 3408 was enacted in 2008, as part of omnibus legislation known as the "Subprime Residential Loan and Foreclosure Laws," which was intended to combat a dramatic increase in residential mortgage foreclosure actions that was overwhelming state courts in New York. This remedial statute was designed to preserve home ownership, and to mitigate the subprime credit crisis through mandatory settlement conferences during the initial stages of mortgage foreclosure actions.[2] In 2009, the statute was amended to include all residential mortgage foreclosure actions, and not just those involving so-called "subprime" or "high-cost" mortgages.[3]

A key provision of CPLR 3408(a), for purposes of this article, is its requirement that, in any "residential foreclosure action involving a home loan...the court shall hold a mandatory conference" within 60 days after proof of service is filed. The express purpose of this conference is to determine "whether the parties can reach a mutually agreeable resolution to help the defendant avoid losing his or her home, and evaluat[e] the potential for a resolution in which payment schedules or amounts may be modified or other workout options may be agreed to...."

CPLR 3408(f) further mandates that, during these conferences, "[b]oth the plaintiff and defendant shall negotiate in good faith to reach a mutually agreeable resolution, including a loan modification, if possible." To that end, Section 202.12-a(c)(4) of the Uniform Rules of Trial Courts places the onus upon courts to "ensure that each party fulfills its obligation to negotiate in good faith," and see to it that "conferences not be unduly delayed or subject to willful dilatory tactics...."

Recently, the court in Deutsche Bank Trust of Am. v. Davis[4] made it abundantly clear that, in light of CPLR 3408, parties to a residential foreclosure action are required not only to come to court in "good faith," but also "to *negotiate in good faith* toward creation of a mutually satisfactory agreement" (emphasis in original).

Although both the statute and the court rules mandate that parties negotiate in "good faith," as the First Department recently held in Wells Fargo Bank v. Van Dyke,[5] there is no requirement under CPLR 3408 that a lender must make a settlement proposal to a borrower. Moreover, both the statute and the court rules are silent not only as to the sort of "dilatory tactics" that courts should not countenance, but also the penalties that can, and should, be imposed upon parties that employ such tactics.

Dilatory Tactics

As conducting early and sometimes time-consuming settlement conferences (where lenders may need to produce bank officers from out of town) conflicts with lenders' desires to prosecute and conclude foreclosure cases as quickly as possible, it is not surprising that some lenders may attempt to delay, or avoid altogether, their statutory obligation to negotiate in "good faith" in order to move cases away from settlement conference parts to regular foreclosure parts.

To that end, courts have noted that some lenders have employed a wide array of "dilatory tactics," including: (a) delaying the filing of a request for a mandatory settlement conference; (b) sending counsel to settlement conferences unprepared and without settlement authority;[6] (c) delaying the appearance at such conferences of a representative of the bank who has full settlement authority; or (d) claiming that the borrower is not eligible, under CPLR 3408, for a settlement conference due to the borrower's alleged failure to meet the statute's "residency" requirement.

What Can the Courts Do?

As CPLR 3408 and the court rules do not set forth any specific penalties that courts can, or should, impose upon lenders that flout their statutory obligations, courts have had to improvise, and have devised, in the exercise of their broad equitable powers and jurisdiction,[7] various remedies and sanctions to punish banks that have behaved badly.

For instance, in *Wells Fargo, v. Lindo*,[8] in which the lender employed all of the tactics discussed above, Justice Peter Moulton found that the bank's former counsel had acted "frivolously," and, thus, violated 22 NYCRR §130-1.1(c)((3), by making a material misrepresentation to the court that unspecified Fannie Mae regulations supposedly prohibited the lender from accepting, in settlement, anything less than the full amount due on the mortgage loan. The authors' firm represented the borrower in this case.

The court also found that the lender's former counsel, the Steven J. Baum law firm, which has since disbanded,[9] had unjustifiably delayed filing a request for judicial intervention (an RJI) to request a mandatory settlement conference, and thereby prejudiced the borrower by increasing the accrued interest on the loan. Moulton's remedy was to award the borrower some of the legal fees incurred for several settlement conferences, and to reduce a portion of the interest on the loan, in order to compensate the borrower (at least partially) for her "damages," and to punish the lender for its former counsel's delays and its present counsel's conduct.

The court's decision in *Lindo* was consistent with other recent decisions in which lenders were found to have employed "dilatory tactics" to delay the resolution of residential foreclosure actions. Thus, in *Deutsche Bank Trust of Am. v. Davis*,[10] after the plaintiff's dilatory tactics and failure to negotiate in good faith required no less than 17 conferences, held over a period of nearly two years, to determine whether the borrower qualified for the HAMP mortgage modification program, the court not only stayed the foreclosure action until the lender was prepared to resume negotiating in "good faith," but also sanctioned plaintiff's counsel 50 percent of the interest due on the mortgage for the period of time attributable to plaintiff's unreasonable delay.

Likewise, in *Bank of America v. Lucido*,[11] the court imposed even more severe sanctions as a result of the "unconscionable, shocking and egregious conduct" of the plaintiff and its former counsel (again, the Baum law firm), which included plaintiff's failure to negotiate in "good faith." There, a total of 18 settlement conferences were held, and it was only upon the court's directive that the bank appeared by a representative (travelling from Fort Worth, Texas) "with a view toward some amicable resolution" of the action. However, the court noted that, in derogation of CPLR 3408(c), no person who appeared on behalf of the bank ever possessed the full settlement authority required by the statute.

Given the extreme delay, and the resultant accumulation of interest, other loan charges and legal fees, the *Lucido* court noted that it could not, and would not, "countenance a lack of good faith in the proceedings," and would not "permit equitable relief to lie in favor of one who so flagrantly demonstrated such obvious bad faith." Under that rationale, the court barred the lender from recovering any interest from the date of the default to the date of the order, and reduced the principal amount of the mortgage by an award of "exemplary damages," in the amount of $200,000. The court also prohibited the lender from seeking to foreclose upon the reduced amount of the mortgage, thereby relegating plaintiff to commencing a separate action at law to recover the reduced principal balance.

Not to be outdone, other courts have gone so far as to dismiss foreclosure actions,[12] and vacate a judgment of foreclosure and sale and cancel the note and mortgage,[13] although the "severe sanctions" imposed by the lower court, in the latter case, were subsequently found, on appeal, "not authorized by any statute or rule."[14]

While the Second Department has noted that a court's equitable powers may be "as broad as equity and justice require,"[15] there are limits as to how far courts can go in punishing banks. Thus, in *Wells Fargo Bank v. Meyers*, the Supreme Court had found that the lender had failed to negotiate in "good faith" during settlement conferences and, as a remedy, directed the lender to execute a final loan modification agreement based upon the terms of a trial loan modification proposal that had been offered to, and signed by, the borrowers before the foreclosure action was commenced. In fact, the borrowers had made all payments required under the trial loan modification.

The Second Department, even while it recognized the breadth of a court's equitable jurisdiction, reversed the lower court's "remedy" (but not its finding that the bank failed to negotiate in good faith), and held that imposing a modification agreement upon the parties was "unauthorized and inappropriate," as courts cannot bind parties to an agreement that they themselves did not agree upon. There, the Second Department reasoned that compelling the bank to accept the trial modification agreement would violate not only the Contract Clause of the U.S. Constitution (U.S. Const. Art. I, §10[1]), but also the bank's "due process" rights.

Conclusion

These recent decisions confirm that although courts have wide discretion in devising sanctions and remedies to punish banks for failing to negotiate in "good faith" (e.g., awarding legal fees and costs and reducing the interest and/or principal amount of the mortgage), courts cannot compel parties to actually reach a settlement by way of a mortgage modification agreement, or otherwise.

The Second Department in *Meyers* may have summed it up best when it stated that, "in the absence of further guidance from the Legislature or the chief administrator of the courts, the courts must prudently and carefully select among available and authorized remedies, tailoring their application to the circumstances of the case." Thus, absent legislative action, it is up to courts to determine, and mete out, appropriate punishments when banks behave badly.

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Endnotes:

1. See CPLR 3408 and Section 202.12-a of the Uniform Rules of Trial Court, which rules were enacted to "buttress and implement" the provision of CPLR 3408. See Bank of America v. Lucido, 35 Misc.3d 1211(A), 950 N.Y.S.2d 721 (Sup. Ct., Suffolk Co. 2012). Notably, as CPLR 3408 applies only to residential mortgages, neither the statute nor this article pertains to commercial mortgage foreclosure actions.

2. See Sponsor's Mem., Bill Jacket L. 2008, ch. 472.

3. CPLR 3408 is effective until Feb. 13, 2015. As of that date, the provision will apply only to residential foreclosure actions involving a "high-cost home loan" consummated between Jan. 1, 2003, and Sept. 1, 2008, or a "subprime or nontraditional home loan."

4. 32 Misc.3d 1210(A), 934 N.Y.S.2d 33, at *1 (Sup. Ct., Kings Co. 2011).

5. 101 A.D.3d 638, 638, 958 N.Y.S.2d 331, 332 (1st Dept. 2012).

6. CPLR 3408(c) requires that if plaintiff appears by counsel, "such counsel shall be fully authorized to dispose of the case." Likewise, pursuant to Section 202.12-a(c)(3) of the Uniform Rules of Trial Courts, counsel who appear at the settlement conferences "must be fully authorized to dispose of the case."

7. See *Jamaica Sav. Bank v. M.S. Investing*, 274 N.Y. 215 (1937).

8. 2013 NY Slip Op 30375(U) (Sup. Ct., N.Y. Co.) (Jan. 12, 2013).

9. Peter Lattman, "Foreclosure Firm Steven J. Baum to Close Down," N.Y. Times, Nov. 21, 2011, available at http://dealbook.nytimes.com/2011/11/21/foreclosure-firm-steven-j-baum-to-close-down/.

10. 32 Misc.3d 1210(A), 934 N.Y.S.2d 33, at *2 (Sup. Ct., Kings Co. 2011).

11. 35 Misc.3d 1211(A), 950 N.Y.S.2d 721 (Sup. Ct., Suffolk Co. 2012).

12. See *Wells Fargo Bank v. Hughes*, 27 Misc.3d 628, 897 N.Y.S.2d 605 (Sup. Ct., Erie Co. 2010).

13. See *IndyMac Bank v. Yano-Horoski*, 26 Misc.3d 717, 890 N.Y.S.2d 313 (Sup. Ct., Suffolk Co. 2009).

14. See *IndyMac Bank v. Yano-Horoski*, 78 A.D.3d 895, 912 N.Y.S.2d 239 (2d Dept. 2010).

15. —N.Y.S.2d—, 2013 WL 1811781, at *4 (2d Dept. 2013). See also *Mortgage Elec. Registration Sys. v. Horkan*, 68 A.D.3d 948, 890 N.Y.S.2d 326 (2d Dept. 2009); *Norstar Bank v. Morabito*, 201 A.D.2d 545, 607 N.Y.S.2d 426 (2d Dept. 1994).