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BANKING ALERT

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In Stinging Rebuke to Financial Institutions and Title Companies, NJ Supreme Court Favors Law Firm's Effort to Collect Unpaid Legal Bills

In a case closely-watched by New Jersey Banks and the Title Industry – and plainly important to both – the New Jersey Supreme Court granted lien priority to a law firm (Riker Danzig) and advanced its attempt to collect on a $3 million unpaid fee. The New Jersey Bankers Association and the New Jersey Land Title Association both were granted leave to appear as *amici* on the appeal and argued before the Supreme Court. The Court rejected the appellants' and Bankers' arguments and, instead, ruled that the law firm's later-filed mortgage for the trial counsel fees that had, according to the Supreme Court, "ballooned to over $3 million" could prime the secured lender's first mortgage. Now the details:

In *Rosenthal v. Vanessa Benun*, 2016 WL 39119107 (N.J. Jul. 21, 2016), the critical facts were not in dispute. Plaintiff Rosenthal & Rosenthal ("Plaintiff") entered into two factoring agreements with several corporate entities owned and operated by defendants Vanessa and Jack Benun. Among other things, after execution of the first factoring agreement, a mortgage was executed by Ms. Benun to secure the obligations of her companies under the first factoring agreement. The mortgage was thereafter recorded. Ms. Benun also gave a personal guaranty for the obligations of the companies under the first factoring agreement. The mortgage documents also included a "dragnet" clause, which secured any future obligations made under the first factoring agreement, and an anti-subordination clause, which precluded the defendants from further mortgaging or encumbering the property. Thereafter, a second factoring agreement was executed, which also provided for discretionary capital advances to the defendants. A mortgage on the same property previously provided as security for the first factoring agreement was executed as part of the second factoring agreement. The same dragnet and anti-subordination clauses in the first mortgage were contained in the second mortgage.

After execution and recordation of Plaintiff's mortgages, Riker Danzig, a law firm performing legal services on behalf of the defendants, obtained a third mortgage on the same real property to secure over $1.67 million in unpaid legal fees owed by the defendants (the "Riker Mortgage"). As

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the Supreme Court noted, after the recordation of that mortgage, Riker Danzig's legal fees "ballooned to over $3 million." Plaintiff conceded that, after receiving actual notice of the Riker Mortgage, it continued to make millions in dollars of advances to the defendants. Ultimately, a foreclosure complaint was filed by Plaintiff seeking to collect over $4 million in unpaid obligations. Riker Danzig filed an answer to the foreclosure complaint, disputing the priority of Plaintiff's mortgages. On cross-motions for summary judgment, the trial court found in favor of Plaintiff, finding both that the dragnet clauses were fully enforceable and that Riker Danzig was aware of the prior mortgages and the anti-subordination clauses and could not argue that its mortgage should take priority. On appeal, the Appellate Division reversed, relying on the common law rules of priority as stated in New Jersey case law dating back to 1864.

The Supreme Court permitted the New Jersey Bankers Association and the New Jersey Land Title Association to participate in the appeal. On appeal, the Bankers argued against Riker Danzig's position and asserted that a first mortgage securing future advances should be treated as though the discretionary advanced amounts were funded at the time the mortgage was executed so that lenders could continue to provide capital to its business clients in an expedient fashion.

The Supreme Court agreed with the Appellate Division, finding that the advances made by Plaintiff were "discretionary advances" subject to the common law rule that any advances provided to a borrower after actual notice of an intervening mortgage would be subordinate to the intervening mortgage. In so doing, the Supreme Court recognized that several states have departed from this common law rule by way of amendment to the statutory scheme governing mortgages. While the Court noted that the Bankers Association and the Title Industry "advanced persuasive reasons for departing from the common law rule…any plea to fundamentally alter the rule [would be] best addressed to the Legislature."

New Jersey Trial Court Finds Foreclosure Action Barred by Six-Year Statute of Limitations

Addressing an issue of first impression, a trial court in *Anim Investment v. Shaloub*, BER-F-30508-15 (Ch. Div. Jun. 30, 2016), found that an assignee of a mortgage was barred from foreclosing on the secured property under N.J.S.A. 2A:50-56.1(a). According to the foreclosure complaint, defendants George and Kathleen Shaloub (the "Shaloubs") borrowed $178,000 from Mina Investment Company in 1990. The Shaloubs subsequently defaulted on their first payment that year. After obtaining the loan by assignment, Anim Investment filed a foreclosure action in August 2015. While the parties initially agreed that the 20-year statute of limitations should be applied to the action, the parties disputed whether the default date should be the date of the first missed payment, November 1990, or the maturity date, October 1995. In finding that the foreclosure action was time-barred, the trial court rejected the parties' agreement that the 20-year statute of limitations applied, instead citing to N.J.S.A. 2A:50-56.1(a), as recently amended by the Legislature in 2009 to codify the decision in *Security National Partners v. Mahler*, 336 N.J. Super. 101 (App. Div. 2000), which provides for a six-year statute of limitations running from the maturity date of the note.

The trial court found that there was nothing in the legislative history or in the statute that limited subsection (a) of the statute to claims for damages, *i.e.*, enforcement of the note obligation, as opposed to foreclosure actions against the secured property. The trial court also rejected the plaintiff's argument that the six-year statute of limitations set forth in subsection (a) was consistent with N.J.S.A. 12A:3-118(a) of the UCC, which provides for a six-year statute of limitations to proceed on a claim under a note, evidencing the Legislature's intent that subsection (a) only applied to causes of action for damages on a note. The trial court stated that this argument ran contrary to the Appellate Division's decision in *Security National Partners*, which expressly held that an action for foreclosure and for seeking damages arising from the underlying note pursuant to the UCC were uniquely different. The trial court also rejected

the contention that its holding effectively read out of N.J.S.A. 2A:50-56.1 the other two statutes of limitation governing foreclosure actions as also set forth in the statute.

New Jersey District Court Denies Motion to Dismiss Complaint Against Bank Alleging Violations of RESPA and State Law Tort Claims

In *Edyta v. Bank of America, N.A.*, 2016 WL 3545521 (D.N.J. June 28, 2016), the District Court of New Jersey denied defendant Bank of America's ("BoA") motion to dismiss a residential mortgagor's complaint alleging, among other things, violations of Real Estate Settlement Procedures Act ("RESPA") and the New Jersey Consumer Fraud Act.

According to plaintiff's complaint, on or about March 1, 2012, plaintiff defaulted under her residential mortgage with BoA. BoA subsequently offered plaintiff a loan modification, which Plaintiff rejected claiming that the payments were too high. BoA subsequently denied the loan modification. After the BOA's denial of the modification, plaintiff claimed she submitted a full loan modification package for review by BoA, which BoA again denied. After the second denial, plaintiff requested a reconsideration of the loan modification and sent BoA a series of documents and information concerning a loan modification, which she claimed were being sent at the request of BoA.

On or about January 17, 2015, plaintiff was informed that her property was scheduled for a foreclosure sale on February 27, 2015. Plaintiff claimed that, up until this point, BoA had never rejected or denied her requests in any form but was instead "continuing to review her situation." Despite the pending sale, plaintiff continued to provide BoA with additional documentation, purportedly at the request of BoA. Prior to the scheduled sale, the law firm representing BoA in the foreclosure advised plaintiff that the sale had been postponed until March 27, 2015. Plaintiff continued to send BoA documentation regarding the loan modification after having been advised of the postponement. On or about April 3, 2015, BoA denied plaintiff's loan modification request, but, on or about May 14, 2015, BoA informed plaintiff that she could reapply for a loan modification. Plaintiff claimed that after having received notice that she could reapply, she prepared another loan modification package. Plaintiff further claimed that neither BoA nor its attorneys notified plaintiff of a new foreclosure sale date.

On or about May 18, 2015, plaintiff submitted another loan modification package to BoA, and on or about May 20, 2015 and May 28, 2015, BoA requested additional documentation, which plaintiff provided. On or about May 28, 2015, BoA's counsel advised plaintiff that the sale of her property was scheduled for June 5, 2015. Still, plaintiff continued to provide documents requested by BoA through June 2, 2015. On June 5, 2015, BoA sold plaintiff's home. However, on June 16, 2015, BoA sent plaintiff a letter stating that it was still in the process of reviewing her loan for a loan modification and subsequently sent plaintiff additional correspondence requesting more documentation for its supposed review.

Plaintiff thereafter filed suit asserting causes of action for violations of RESPA and the New Jersey Consumer Fraud Act, negligence, unjust enrichment and fraud. BoA moved to dismiss, arguing that plaintiff's claims under RESPA were barred on the grounds that (1) plaintiff's loan modification submissions were incomplete and (2) even if they were complete, they were untimely submitted.

The court found BoA's arguments unpersuasive, and declined to dismiss plaintiff's RESPA claim. Under RESPA's "Regulation X," 12 C.F.R. §1024.41, a loan servicer cannot refer a mortgage for foreclosure proceedings under certain circumstances where a borrower submits a complete loss mitigation application. The court declined to infer from BoA's requests for additional documentation that plaintiff submitted an incomplete application. Instead, the appropriate inference from plaintiff's allegations was that her application was under active review. The court reserved adjudicating BoA's motion to dismiss plaintiff's state law claims.

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