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Can Courts Force Lenders To Negotiate Loan Modifications?

In the midst of the existing economic recession and the recent collapse in the credit market, courts have seen an avalanche of newly filed mortgage foreclosure actions with respect to both residential and commercial properties. One of the ways that courts, both in New York and elsewhere, have managed the volume of recently filed foreclosures is through settlement conferences where, ideally, the lender and the property owner work together to reach a mutually acceptable modification or short pay-off of the existing property loan. Such conferences can aid property owners in reaching agreements that permit them to keep their property in addition to aiding courts in managing their swelling dockets.

In many instances, however, it has become apparent that lenders and their counsel have entered such settlement conferences without any intention of negotiating with the property owners in good faith. Thus, a question that has arisen is: to what extent can a court interject itself into settlement discussions and force a plaintiff in a mortgage foreclosure action to act in good faith in negotiating a loan modification?

It is well-established in New York that parties to a litigation can be required to attend settlement conferences or court-ordered mediation, and that the parties and their attorneys can be sanctioned for failure to appear at such conferences. Indeed, as recently amended,

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CPLR 3408 mandates that a settlement conference be held in all residential foreclosure actions "for the purpose of holding settlement discussions pertaining to the relative rights and obligations of the parties under the mortgage loan documents, including, but not limited to determining whether the parties can reach a mutually agreeable resolution to help the defendant avoid losing his or her home, and evaluating the potential for a resolution in which payment schedules or amounts may be modified or other workout options may be agreed to, and for whatever other purposes the court deems appropriate."

The rule goes on to provide that "[b]oth the plaintiff and the defendant shall negotiate in good faith to reach a mutually agreeable resolution, including a loan modification, if possible."

Few would challenge the validity of CPLR 3408, or a court's authority to direct that the parties to a litigation participate in a settlement conference or mediation. In exercising their authority to conduct settlement or mediation conferences, however, judges must keep in mind the long-held and basic tenant of law that litigants have a right to litigate their claims, and that courts are not permitted to deprive litigants of that right by coercing a settlement.

Indeed, it is well-established that, while "it is the duty of [a judge] to encourage talk of settlement" and that a judge "can be of immeasurable help in acting as a catalyst in bringing the parties together to a fair settlement," that "in intervening to promote a fair settlement, undue pressure or coercive measures should not be applied by the [judge] on either attorney."[1]

Thus, a question that courts have recently had to wrestle with is, what can a judge do if a party attends a CPLR 3408 settlement conference, or a settlement conference or mediation session otherwise ordered by the court, but refuses to negotiate in good faith to reach a loan modification or other settlement? In order to effectively advocate for their clients, attorneys for lenders and property owners alike should take note of certain recent decisions that have addressed this issue.

Vacating the Mortgage

In *Indymac Bank F.S.B. v. Yano-Horoski*,[2] Justice Jeffrey A. Spinner, sitting in the Residential Mortgage Foreclosure Conference Part of Supreme Court, Suffolk County, upon finding that lender/plaintiff and its counsel had not participated in a settlement conference in good faith, imposed the extraordinary sanction of vacating the mortgage that was the subject of the foreclosure proceeding and cancelling the underlying indebtedness and note.[3]

In reaching this result, the court relied upon the fact that "an action claiming foreclosure of a mortgage

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is one sounding in equity" and noted that "[a]t the conference, it was celeritously made clear to the Court that Plaintiff had no good faith intention whatsoever of resolving this matter in any manner other than a complete and forcible devolution of title from Defendant." The court went on to note that "each and every proposal by Defendant, no matter how reasonable, was soundly rebuffed by Plaintiff," and to opine that "a loan modification would result in a proverbial 'win-win' for all parties involved." Thus, the court held that the plaintiff/lender's refusal to engage in good faith negotiations of a loan modification with the defendant/property owner warranted the imposed sanctions.[4]

It should be recognized that the reasoning of the *Yano-Horoski* decision would find natural applicability to situations other than CPLR 3408 conferences, such as instances where mortgages are pooled and securitized. In such instances, borrowers commonly face a complete stonewall in attempts to negotiate loan modifications with the various servicers and other parties that claim interest in the securitized mortgage.

Exemplary Damages

Similarly, in *Emigrant Mortgage Co. Inc. v. Corcione*,[5] another even more recent decision by Justice Spinner, the court sanctioned a lender/plaintiff finding that "it is patently clear to this Court that Plaintiff has failed to act in good faith" with respect to the CPLR 3408 settlement conference.[6] Unlike in *Yano-Horoski*, in *Corcione*, the lender/plaintiff did offer a "Loan Modification Agreement" to the defendant and produced a copy of the same at the settlement conference.

In its decision imposing sanctions, the court noted that the loan modification agreement proposed by the plaintiff contained some "deplorable particulars" and found that "Plaintiff's position appears to be facially unreasonable." Among the provisions in the proposed loan modification agreement that the court found to be "deplorable" were requirements for the borrower to waive any claim, counterclaim or right to set-off against the lender, and if the borrower were to file a petition in Bankruptcy, that it consent to relief from the Bankruptcy Code's automatic stay to permit the lender/plaintiff to enforce its rights and remedies.

The court held that the proposed loan modification agreement "as a whole is unacceptable for all purposes." As in *Yano-Horoski*, the court in *Corcione* imposed what can only be described as an extraordinary sanction. In *Corcione*, in addition to directing that the lender/plaintiff be barred from collecting interest from the date of default as well as attorney's fees, costs, expenses and advances, the court imposed exemplary damages in the sum of $100,000.

Also as in *Yano-Horoski*, it is easy to see how the reasoning of the court in *Corcione* could apply to situations other than CPLR 3408 conferences. For example, it is common with respect to commercial loans and mortgages for lenders to refuse to even discuss a potential loan modification with a borrower unless the borrower agrees to sign a pre-negotiation letter. Such pre-negotiation letters usually contain the same type of "deplorable particulars" that the proposed loan modification agreement in *Corcione* contained, i.e., a waiver by borrower of all claims, counterclaims or right to set-off against the lender. Under *Corcione* it is clear, at least in the context of settlement conferences or mediation overseen by a court, that such refusal to negotiate without preconditions by lenders will not be countenanced.

Bankruptcy Court Decision

Also worthy of note is the recent decision from the U.S. Bankruptcy Court for the Southern District of New York in *In re A.T. Reynolds & Sons Inc*.[7] There, the court sanctioned a secured creditor for failing to engage in good faith negotiations at a court ordered mediation. The secured creditor, Wells Fargo Bank, N.A., complied with the court's mediation order to the extent of physically attending the mediation. However, the court found that Wells Fargo entered the mediation with a predetermined "no-pay" position.

In imposing sanctions on Wells Fargo, the court held that "a party's mere attendance at a mediation, without participation beyond insisting that it won't settle, is [in]sufficient for compliance with the court's order directing the parties to engage in mediation." In reaching its decision, the court noted that "[w]hile it goes without saying that a court may not order parties to settle, this Court has authority to order the parties to participate in the process of mediation, which entails discussion and risk analysis."

Conclusion

While the above-discussed cases have not yet been the subject of appellate review and ruling, practitioners should take note of the trend that is developing in such decisional law. It is possible that, on appeal, appellate courts will find that these are discrete instances of judges overreaching in their role in bringing parties together in settlement.

However, at least these courts have found that it is necessary, in order for mandatory settlement conferences and mediation to be meaningful, for courts to have the authority, under penalty of sanctions, to require that the parties not merely attend such settlement conferences and mediation sessions, but act reasonably and in good faith in attempting to reach settlement.

1. *Wolff v. Laverne Inc.*, 17 A.D.2d 213, 233 N.Y.S.2d 555 (1st Dept. 1962).
2. *Indymac Bank v. Yano-Horoski,* 26 Misc.3d 717, 890 N.Y.S.2d 313 (Sup. Ct. Suffolk Co. 2009), NYLJ, Nov. 24, 2009.
3. 2005-17926 (Sup. Ct. Suffolk Co. Dec. 1, 2009).
4. The trial court's decision in *Yano-Horoski* is currently under appeal.
5. *Emigrant Mortgage Co. Inc. v. Corcione*, 900 N.Y.S.2d 608 (Sup. Ct. Suffolk Co. 2010), NYLJ April 21, 2010.
6. 2009-28917 (Sup. Ct. Suffolk Co. April 16, 2010).
7. 424 B.R. 76 (Bankr. S.D.N.Y. Feb. 5, 2010).