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Consumer Finance Practice
May 6, 2013

Limits on "Judicial Sympathy"

New York Appellate Division Limits Trial Court's Remedies Against Lenders for Failure to Negotiate in Good Faith

By: Casey B. Howard and Joseph N. Froehlich

The Second Department of New York's Appellate Division recently held that New York's CPLR 3408 did not authorize a trial court to force a lender to enter into a loan modification agreement to which they never agreed, as a remedy for that lender's failure to negotiate with borrowers in good faith during the mandatory foreclosure settlement conference. This decision, *Wells Fargo Bank, N.A. v. Meyers*, Index No. 34632/2009, 2013 NY Slip Op 03085 (2d Dep't May 1, 2013) is the second of two cases in which the Second Department has placed limitations on the trial courts' ability to sanction lenders for failure to negotiate with borrowers in good faith under CPLR 3408. In the prior case, *IndyMac Bank F.S.B. v. Yano-Horoski*, 78 A.D.3d 895 (2d Dep't 2010), the Second Department similarly held that the trial court was not authorized to cancel the subject mortgage and note as a remedy for the lender's purported bad faith negotiation.

In *Meyers*, the trial court held that Wells Fargo negotiated in bad faith with borrowers after having commenced a foreclosure action against borrowers just one day after borrowers accepted Wells Fargo's proposed trial modification. The trial court also held that Wells Fargo's refusal to grant borrowers' request for a permanent loan modification after borrowers completed two successful trial modification periods was further evidence of bad faith. *Meyers* at *3-*4. The trial court concluded that, under its equitable powers, it could compel Wells Fargo to accept the initial trial modification agreement as a permanent modification agreement with borrowers. *Meyers* at *4.

While the Second Department deferred to the trial court's finding that Wells Fargo had acted in bad faith and in contravention of CPLR 3408, it took issue with the lower court's prescribed remedy.

Assessing what the Second Department called "the entirely appropriate limitations of CPLR 3408" and the related 22 NYCRR 202.12-a(c)(4), the latter of which sets the procedure and rules for settlement conferences, the Appellate Division held that these rules "both provide courts with the authority to take some action where a party fails to satisfy its obligation to negotiate in good faith." In making this assessment, the Court highlighted a number of remedies that have been applied by courts in cases where lenders violate CPLR 3408, including: barring lenders from collecting interest, fees and expenses; imposing exemplary damages and monetary sanctions; and, dismissing the foreclosure action in its entirety. *Meyers* at *6-*7.

However, the Court concluded that converting an original trial modification agreement into a new binding agreement between the owner of the loan (in this case, Freddie Mac) and the borrowers "'was unauthorized and inappropriate'" and that "'stability of contract obligations must not be undermined by judicial sympathy.'" *Meyers* at *7, citing *Emigrant Mtge. Co., Inc. v. Fisher*, 90 A.D.3d 823, 824 (2d Dep't 2011). Ultimately, the Court held that trial court "may not rewrite the contract that the parties freely entered into—the loan and mortgage agreement—upon a finding that one of those parties failed to satisfy its obligation to negotiate in good faith pursuant to CPLR 3408[.]" *Meyers* at *7. The Court further found, on an alternate theory, that the trial court's sua sponte order amounted to a violation of Wells Fargo's due process rights because Wells Fargo was not given requisite notice before the trial court made such an order affecting its material rights under contract. *Meyers* at *7. The due process argument articulated in *Meyers* will be very useful for lenders responding to any potential sua sponte remedies based on a borrower's bad faith allegation—as does occur in the trial courts of the Second Department.

Thus, the *Meyers* decision beneficially provides a clarification and limitation on a trial court's remedies and powers available under CPLR 3408 and 22 NYCRR 202.12-a(c)(4). There is precious little appellate precedent addressing the scope of the courts' reach under these rules both because these rules have only been in place in their current form since 2009, and because such orders issued under the rules are infrequently appealed. Lenders should be mindful to bring this new decision to the attention of any New York State trial court that seeks to invent remedies against them for purported bad faith conduct.

For more information on the matters discussed in this *Locke Lord QuickStudy*, please contact the authors:

Casey B. Howard | 212-812-8342 | choward@lockelord.com

Joseph N. Froehlich | 212-812-8345 | jfroehlich@lockelord.com