NY 'Intentional Violation' Ruling May Delay Foreclosure Cases

By **Christopher Gorman** (August 16, 2021)

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It is rare indeed for a court to tell a lender, directly or indirectly, that the lender is precluded entirely from enforcing its loan documents and collecting the monies that the lender claims to be owed from a borrower.

In recent years, that situation has arisen most frequently in the context of successful statute of limitations defenses raised by borrowers in foreclosure actions.

A recent decision by a New York state appeals court, however, reached just that result, and potentially opened up lenders to costly and time-consuming discovery in a certain subset of residential mortgage foreclosure cases where borrowers plead defenses founded upon the lender's allegedly intentional violations of the New York Banking Law.

On July 28, in VFS Lending JV II LLC v. Krasinski, the Supreme Court of the State of New York, Appellate Division, held, in somewhat cryptic fashion, that the lender's intentional violations of a series of Banking Law provisions voided the subject loan.[1]

While the implications of Krasinski remain to be determined, lenders in foreclosure cases involving loans covered by certain provisions of the state's banking law should expect to see Krasinski cited as a basis to request discovery from the lenders, and in opposition to summary judgment motions filed by lenders, for years to come.

Relevant Provisions of the Banking Law in Krasinski

Specifically, Banking Law Section 6-l imposes certain limitations upon and prohibits certain practices engaged in by lenders for what are defined by the statute as "high-cost home loans."

A home loan qualifies as high-cost if, among other things, the total points and fees charged exceed 5% of the total loan amount and the total loan amount is $50,000 or more.[2]

The relevant provisions of the Banking Law prohibit lenders on a high-cost home loan from engaging in a variety of activities, including, among other things:

- Consolidating more than two periodic payments owing under the loan documents and having them "paid in advance from the loan proceeds provided to the borrower";

- Engaging in loan flipping, which is described as "making a home loan to a borrower that refinances an existing home loan when the new loan does not have a tangible net benefit to the borrower considering all of the circumstances";

- Making the loan "without due regard to repayment ability" on the part of the borrower; and

- Failing to provide certain required notices; and charging financing points and fees, as defined in the statute, "in an amount that exceeds three percent of the principal amount of the loan."[3]

Banking Law Section 6-l(10) provides, in pertinent part, that a "home loan agreement shall be rendered void" where the court finds "an intentional violation by the lender of this section, or regulation thereunder."

In addition, the statute states that, where there is an intentional violation by the lender:

> [T]he lender shall have no right to collect, receive or retain any principal, interest, or other charges whatsoever with respect to the loan, and the borrower may recover any payments made under the agreement.

New York's Real Property Actions and Proceedings Law Section 1302 requires the complaint in any foreclosure action "relating to a high-cost home loan or a subprime home loan" to "contain an affirmative allegation that at the time the proceeding is commenced, the plaintiff ... has complied with ... section six-l or six-m of the banking law."

The statute further provides, in pertinent part:

> It shall be a defense to an action to foreclose a mortgage for a high-cost home loan or subprime home loan that the terms of the home loan or the actions of the lender violate any provision of section six-l or six-m of the banking law.

The Krasinski Decision

Krasinski involved a residential mortgage foreclosure action in which the defendants, Olga Krasinski and David Krasinski Jr., asserted counterclaims alleging violations of Banking Law Sections 6-l and 6-m.

The defendants filed a motion for summary judgment on the counterclaims, and the lender cross-moved to dismiss the counterclaims.

The trial court granted the defendants' motion and denied the plaintiff's cross-motion, concluding that the defendants were entitled to a judgment declaring the loan to be void and to an award of damages in an amount to be determined upon a hearing.

The plaintiff appealed, and the appeals court affirmed the lower court's order.

In so doing, the Appellate Division found the plaintiff's "contention that the Supreme Court lacked authority under Banking Law § 6-l to void the subject loan" to be without merit.

The court found that:

> [T]he defendants established, prima facie, that certain violations of Banking Law § 6-l, which appear on the face of the loan documents, were intentional, and the plaintiff failed to raise a triable issue of fact in opposition.

Of particular significance, the court held that:

> [C]ontrary to the plaintiff's contention, the court also had authority under Banking Law § 6-m to void the loan, as Banking Law § 6-m(11) authorizes "injunctive, declaratory and such other equitable relief" as the court deems appropriate.

Analysis

Krasinski makes clear that there are significant implications for a lender found to have intentionally violated the aforementioned provisions of the Banking Law.

A voided loan is the most serious of litigation consequences for lenders, who are left holding the bag in those situations, without any recourse against the borrower.

Making the situation even worse for lenders is the statutory language authorizing forfeiture by the lender to the borrower of the monies paid by the borrower under the loan, as well as the extremely broad language in the statutory scheme authorizing courts to impose equitable relief where an intentional violation of the Banking Law is found to have been committed.

Krasinski, therefore, provides justification to the lower courts to avail themselves of any and all of these remedies where an intentional violation of the state's banking law is found to have occurred.

As serious as these consequences for lenders are, however, Krasinski likely has even broader practical implications in terms of the pace at which lenders can try to move forward the mortgage foreclosure litigation process.

The issue or question of a party's intent, of course, is based upon one's state of mind. As a result, issues pertaining to a party's intent, or lack thereof, are generally held to be fact-intensive.

The issue of a party's intent can only be determined in almost all instances through discovery — including document discovery and depositions — aimed at uncovering documents and information pertaining to the party's state of mind during the relevant time period.

Moreover, issues of intent are often not amenable to resolution on a motion for summary judgment either, thereby requiring a trial, something that lenders seek to avoid in the context of mortgage foreclosure litigation.

Indeed, most lenders prefer to see mortgage foreclosure cases that are litigated on the merits disposed of as soon as possible based upon prediscovery summary judgment motions filed immediately after the pleadings in the case are closed.

At a minimum, Krasinski suggests that borrowers are entitled to discovery when they plead affirmative defenses and counterclaims founded upon allegedly intentional violations by the lender of the aforementioned provisions of the Banking Law.

A borrower faced with a prediscovery summary judgment motion from a lender in a foreclosure action where such defenses or counterclaims have been pled is undoubtedly going to rely upon Krasinski to claim that the borrower was deprived of the opportunity to mount a defense without discovery into the question of whether the lender engaged in intentional violations of the Banking Law.

And, given the breadth of the reasoning contained in the Krasinski decision, it seems a court would be hard-pressed to reject such arguments by borrowers in foreclosure actions that fall within the ambit of these provisions of the Banking Law.

Krasinski, therefore, may provide a road map to borrowers in residential foreclosure cases involving loans covered by the aforementioned Banking Law statutory scheme to delay the litigation process, which is frequently the goal of borrowers defending foreclosure cases.

Whether such defenses founded upon the Banking Law statutes and Krasinski will ultimately be successful in any given case is likely not all that relevant, as the increased cost and time for lenders to prosecute foreclosure cases in the face of these defenses and counterclaims may prove too burdensome in many cases and, thus, force lenders to reach early resolutions with borrowers.

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[1] 2021 NY Slip Op 04572, --- A.D.3d ----, --- N.Y.S.3d --- (2d Dep't July 28, 2021).

[2] See Banking Law § 6–l[1][g][ii].

[3] See generally Banking Law § 6–l.