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The New York Foreclosure Abuse Prevention Act (FAPA): Potential Impact on Real Estate Finance

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The New York Foreclosure Abuse Prevention Act (FAPA): Potential Impact on Real Estate Finance

On December 30, 2022, Governor Hochul signed the New York Foreclosure Abuse Prevention Act ("FAPA") into law, with immediate effect. FAPA not only applies to mortgage foreclosures sought in 2023 and beyond, it also applies retroactively to all mortgage foreclosure actions "in which a final judgment of foreclosure and sale has not been enforced" at the time FAPA was promulgated. In addition, while the context of the debate around FAPA prior to its adoption appeared to focus on homeowner and consumer protection, the language of the act is broad enough to encompass both residential and commercial mortgages. FAPA's coverage could therefore have a significant impact on the real estate financing landscape in New York.[1]

According to the New York Legislature, FAPA, which amended provisions of the Civil Practice Law and Rules Law ("CPLR"), the Real Property Actions and Proceedings Law ("RPAPL") and the General Obligations Law ("GOL"), was intended "to clarify the existing law and overturn those decisions that have strayed from legislative prescription and intent" within the context of the judicial foreclosure process.[2]

It is evident that FAPA was born out of the New York Legislature's vehement disagreement with the New York Court of Appeals' 2021 decision in *Freedom Mortgage Corp. v. Engel*. In *Engel*, the Court examined the interplay between the statute of limitations and the purported revocation of an election to accelerate a mortgage loan within the context of the judicial foreclosure process.

Notably, the Court confirmed the long-standing rule that an "affirmative act" was needed to revoke an election to accelerate debt. Such affirmative revocation is relevant to a statute of limitations analysis in the mortgage loan foreclosure context because it is the acceleration of the mortgage loan that enables the noteholder to foreclose on the underlying property; such acceleration is the act that triggers accrual for the six-year statute of limitations applicable to mortgage foreclosure actions.

Consistent with century old precedent, the *Engel* Court acknowledged that revoking the acceleration of debt places the parties in a pre-acceleration position, including for purposes of statute of limitations accrual. In other words, the revocation of an acceleration of debt would stop and reset the statute of limitations clock, which would accrue with a new six-year period if the debt were to be subsequently accelerated. Thus, a critical factor in discerning whether a mortgage foreclosure action commenced more than six years after a prior acceleration on debt was time-barred was "whether, and when, a noteholder revoked an election to accelerate."[3] More specifically, in assessing whether the statute of limitations had run, a court would consider whether the voluntary dismissal of the prior foreclosure constituted an "affirmative act" that revoked the acceleration and therefore stopped the accrual of the statute of limitations. According to the *Engel* Court, a noteholder's voluntary discontinuance of a foreclosure action sufficiently constituted an "affirmative act," and thereby reset the six-year statute of limitations. The Court held that its ruling was

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1 Assembly Bill A7737B, The New York State Senate, https://www.nysenate.gov/legislation/bills/2021/a7737/amendment/b. While applicable to all property types, we believe the impact is likely to be greater in the residential real estate market, given the longer average terms of residential mortgage loans and the bargaining power and sophistication of the average commercial borrower when compared with a homeowner. Nevertheless, market participants should be aware of the law and its impact on the foreclosure process.

2 *See* Senate Bill S5473D, The New York State Senate, https://www.nysenate.gov/legislation/bills/2021/S5473.

3 *See Freedom Mortgage Corp. v. Engel,* 37 N.Y.3d 1 (2021).

consistent with settled New York law and with New York's long-standing policy of ensuring that a statute of limitation provides certainty and clarity.

However, FAPA unsettles and overturns such precedent. Pursuant to FAPA, the threshold inquiry regarding when and whether a voluntary discontinuance of a foreclosure action effectuated a revocation of acceleration of a debt is no longer relevant because, irrespective of whether a foreclosure action triggers acceleration of the debt or whether a noteholder voluntarily discontinues the foreclosure action or otherwise revokes the acceleration, a de-acceleration of mortgage loan will not reset the six-year statute of limitations. Specifically, the addition of subsection (e) to CPLR § 3217 and amendments to GOL § 17-105 provide that a stipulation or voluntary discontinuance of a foreclosure action, in and of itself, is insufficient to reset the six-year statute of limitations period for mortgage foreclosure actions. The practical effect of FAPA is that once a noteholder elects to accelerate the mortgage loan, such noteholder (and any subsequent noteholder of such mortgage loan) may only commence a foreclosure action within the next succeeding six years, or be barred by the statute of limitations absent, as we explain below, an agreement to the contrary.

Let's look at an example. A borrower has missed a number of debt service payments on its mortgage loan. The noteholder accelerates the mortgage loan. The borrower and noteholder engage in workout discussions and establish a payment plan. This resolution takes twelve months to achieve. Five years pass. The borrower again misses a number of debt service payments. The mortgage loan was transferred and a new noteholder is the lender thereunder. The mortgage loan is once again accelerated. The borrower and the new noteholder engage in workout discussions for six months. No resolution is reached. The new noteholder commences a mortgage foreclosure action. The borrower raises the defense of the statute of limitations (as it has been more than six years since the first acceleration occurred) citing, among other things, FAPA. The new noteholder is unpleasantly surprised, and potentially left with very limited remedies – the right to foreclose not being one of them.

FAPA is likely to have the unintended consequence of deterring a mortgage noteholder from reaching a mutually agreeable solution to rectify a property owner's inability to make debt service payments. It is well-established that borrowers, especially residential borrowers, can benefit from de-acceleration of a debt. For example, as articulated by the New York Court of Appeals in *Engel*, de-acceleration of a debt can be advantageous for borrowers because it can reinstate their right to make regular monthly installment payments, rather than having to pay the entire outstanding balance due "in order to avoid losing their homes."[4] Moreover, such de-acceleration is also beneficial for both commercial and residential borrowers because it could provide them an opportunity to engage in workout programs with their respective noteholders.[5]

Historically, a noteholder has been able to use the acceleration of a mortgage loan (but not actually proceeded to foreclose or consummate a foreclosure) as a device to encourage borrowers to work out alternative payment plans because "foreclosure is simply a vehicle to collect a debt and postponement of the claim delays recovery."[6] Accordingly, to the detriment of borrowers, FAPA may actually encourage noteholders to accelerate the debt by way of foreclosure action and not look back.

In addition, the New York Legislature has emphasized that pursuant to GOL § 17-105, the circumstances in which parties may alter the statute of limitations in foreclosure actions is significantly limited, such limitations including an express written agreement to extend, to waive, or to not plead the statute of limitations as a defense. The practical

4 *Id.* at 6.

5 *See id.*

6 *Id.* at 8.

effect here is that the unilateral de-acceleration of mortgage loan by the noteholder is insufficient to alter the running of the statute of limitations.

Returning to our example above, if the initial workout had been memorialized with a mutually agreed, express, written agreement that provided for an extension or waiver of the statute of limitations, the foreclosure right would have been preserved. The noteholder at the time would have needed to use the workout concession as a bargaining chip to get the affirmative agreement from the borrower to so extend or waive. Additionally, the new noteholder would need to accept that a modification may have been done that would impact its ability to foreclose on the mortgage loan or, to avoid an unpleasant surprise, would have needed to diligence carefully the mortgage file, specifically asking for copies of any acceleration notices and agreements evidencing any workout or other resolution (and, although not currently market practice, particularly in the residential real estate context, as a matter of best practice, may request seller representations regarding the same as part of its acquisition of the mortgage loan). In light of the protections that FAPA provides borrowers, though, it may be difficult for a noteholder to convince a borrower to expressly waive its right to assert the statute of limitations as a defense given the materiality of the running of the statute of limitations.[7]

It is also important to note that FAPA applies not only to accelerations of debt from and after FAPA's effective date of January 1, 2023, but also to mortgage foreclosure actions pending as of January 1, 2023.

FAPA's Material Amendments

A short summary of each statute impacted by FAPA is set forth below:

- **RPAPL § 1301**: Subsection (3) was amended and a new subsection (4) was added.
  - The amendment to subsection (3) makes it a requirement to obtain court approval, while the foreclosure action is pending or after final judgment, before commencing another action to "recover any part of the mortgage debt" including, significantly, "an action to foreclose the mortgage."[8] Furthermore, the amendment now codifies such "de facto" discontinuances, whereby "the failure to procure such leave shall be a defense to such other action" and "in the event such other action is commenced without leave of the court, the former action shall be deemed discontinued upon the commencement of the other action. . ." Consequently, a noteholder will need to be careful in selecting the means by which they bring the borrower to the table to work out a repayment solution, as the election of one means of enforcement, without the leave of the court, may result in foreclosing other options.
  - New subsection (4) provides that if "an action to foreclose a mortgage or recover any part of the mortgage debt is adjudicated to be barred by the applicable statute of limitations, any other action seeking to foreclose the mortgage or recover any part of the same mortgage debt shall also be barred by the statute of limitations." (emphasis added). The practical effect of this new subsection will be to limit the use of foreclosure a tool for noteholders to the six year statute of limitations. Given one bite

7 *See* Senate Bill S5473D, The New York State Senate, https://www.nysenate.gov/legislation/bills/2021/S5473.

8 *Id.*

at the foreclosure apple, noteholders may not wish to look for other means to restructure a mortgage because once begun, other actions will be barred.

- **GOB § 17-105**: Both subsections (4) and (5) were amended.[9]
  - Subsection (4) now provides that "an acknowledgement, waiver, promise or agreement, express or implied in fact or in law, shall not, in form or effect, postpone, cancel, reset, toll, revive or otherwise extend the time limited for commencement of an action to foreclose a mortgage for any greater time or in any other manner than that provided in this section, unless it is made as provided in this section."
  - Subsection (5) provides that "this section does not change the requirements or the effect with respect to the accrual of a cause of action, nor the time limited for commencement of an action, based upon either: (a) a payment or part payment of the principal or interest secured by the mortgage, or (b) a stipulation made in an action or proceeding."
  - According to the New York Legislature, these changes are intended to set forth the "exclusive means by which parties are enabled to effectuate a waiver, postponement, cancellation, resetting, tolling, revival or extension of time limited by statute for commencement of an action or proceeding and interposition of a claim to foreclose a mortgage." (emphasis added).[10]
- **CPLR § 203**: Subsection (h) was added.
  - The new subsection (h) notes that once a cause of action has accrued, "no party may, in form or effect, unilaterally waive, postpone, cancel, toll, revive, or rest the accrual thereof, or otherwise purport to effect a unilateral extension of the limitations period . . . unless expressly prescribed by statute." (emphasis added).
  - Under this provision, notwithstanding language in the respective loan documents allowing a lender to "de-accelerate" the loan, such action will no longer effectuate a "de-accrual" for statute of limitation purposes.[11]
- **CPLR § 205-a**: CPLR § 205-a was added as an entirely new subsection.
  - This subsection outlines the conditions for making use of the "extension period" for refiling an action that was timely commenced and terminated for reason other than those found within Section 205. Specifically, the six-month extension period is only accorded to an "original plaintiff" or someone acting on behalf of the original plaintiff. Notably, the extension period is only available if the action is

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9 *See* Senate Bill S5473D, The New York State Senate, https://www.nysenate.gov/legislation/bills/2021/S5473. (noting how "Subdivisions (4) and (5) are amended to expressly overrule Engel by. . .") (emphasis added).

10 *See id.* Accordingly, these amendments effectively overrule one of the New York Court of Appeals' holding in *Freedom Mortgage Corp. v. Engel*, which provided that a stipulation of discontinuance of a foreclosure action constituted a revocation of such election, absent a contrary statement from the noteholder. What is less clear, however, is whether the agreement to discontinue the foreclosure action can reset the statute of limitations entirely, or merely provides the noteholder the opportunity to initiate a new foreclosure action within the original six year statute of limitations.

11 *See* Senate Bill S5473D, The New York State Senate, https://www.nysenate.gov/legislation/bills/2021/S5473.

terminated "in any other manner than by a voluntary discontinuance, a failure to obtain personal jurisdiction over the defendant, a dismissal of the complaint for any form of neglect. . . including those specified in . . . " CPLR § 3126(3), CPLR § 3215, CPLR § 3216 and CPLR § 3404, "for violation of any court rules or individual part rules, for failure to comply with any court scheduling orders, or by default due to nonappearance for conference or at a calendar call, or by failure to timely submit any order or judgment, or upon a final judgment upon the merits." [12]

- In the event a dismissal was based on neglect to prosecute, the amended section no longer requires a judge to set forth the specific conduct constituting neglect.[13] Additionally, the new section states that an original plaintiff cannot receive more than one six-month extension period and a successor in interest or assignee of that original plaintiff is not entitled to the six-month extension afforded under the section, unless pleading and proving it is acting on behalf of the original plaintiff.

- **CPLR § 205**: Subsection (c) was amended.
  - The amendment to subsection (c) explains that the "savings provision" within Section 205(a) does not apply to proceedings that are governed by Section 205-a.

- **CPLR § 213**: Subsection (4) was amended.
  - In the event the statute of limitations is raised as a defense, the amendment effectively renders a plaintiff estopped from asserting an instrument was not accelerated, unless a court expressly ruled "upon a timely interposed defense" the instrument was not accelerated.[14]

- **CPLR § 3217**: Subsection (e) was added.
  - Subsection (e), which "is expressly intended to overrule *Engel*," makes clear that another central holding in *Engel* is no longer good law, namely, that a voluntary discontinuance of a foreclosure action does not constitute a "de-accrual" for purposes of the statute of limitations. Specifically, the new subsection states that "the voluntary discontinuance. . . whether on motion, order, stipulation or by notice, shall not, in form or effect, waive postpone, cancel, toll, extend, revive or reset the limitations period to commence an action." [15]

Within the Securitization Context

Within the context of mortgage loan securitizations, it is important that entities acting as trustees are aware of the implications for mortgage loans secured by real property in New York due to the application of CPLR § 205-a. Specifically, regarding the six-month extension period for recommencing an action previously dismissed, CPLR §

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12 *See id.* (emphasis added).

13 *See id.*

14 Assembly Bill A7737B, The New York State Senate, https://www.nysenate.gov/legislation/bills/2021/a7737/amendment/b. Additionally, a defendant in an action seeking cancellation and discharge of record subject to RPAPL 1501(4) is estopped under the amendment and cannot assert the statute of limitations period did not expire because the instrument wasn't accelerated. *See id.*

15 *Id.*

205-a states that "a successor in interest or assignee of the original plaintiff shall not be permitted to commence the new action, unless pleading and proving that such assignee is acting on behalf of the original plaintiff."[16] By way of example, the New York Legislature discusses "Bank A" as the original trustee and "Bank B" as the successor trustee to Bank A. If Bank A timely commenced a foreclosure action on behalf of the respective "mortgage backed securitized loan trust," and that action was terminated for some reason not specified in CPLR § 205-a(a), Bank B can nevertheless act on behalf of the "original plaintiff" (Bank A), as long as an assignment of mortgage is recorded indicating such change.

Notably, however, if the "loan trust sold, assigned or otherwise transferred the mortgage loan to any other person or entity, related or not, outside the foregoing limited circumstances," then the transferee *would not* be accorded the extension under CPLR § 205-a. Accordingly, entities acting as trustees should be cognizant of this additional requirement to ensure, if needed, they are accorded the six-month extension period and are aware that an original plaintiff is only entitled to one six-month extension period.

What's Next?

Given the significant impact FAPA is expected to have on the New York mortgage industry, there is little doubt that FAPA's application will be subject to judicial scrutiny and constitutional challenges. Specifically, there is an argument that FAPA's retroactive application to such actions "in which a final judgment of foreclosure and sale has not been enforced" violates substantive due process under the Fourteenth Amendment of the U.S. Constitution. Indeed, earlier this month, U.S. Bank, as noteholder whose foreclosure was dismissed as untimely, challenged the constitutionality of FAPA.[17] New York's Appellate Division, Second Department issued an order directing the Attorney General of New York to either (i) inform the Court that it will not intervene in the pending appeal or (ii) file a brief in support of the constitutionality of FAPA.[18] There is also an argument that FAPA's general provisions run afoul of the U.S. Constitution's Contracts Clause, which states explicitly that "[n]o state shall pass any Law impairing the obligation of contracts."

As a practical matter, the application of FAPA has immediate and unintended consequences on distressed loans secured by real property in New York. Acceleration of a mortgage det has long been a tactical way that noteholders have gotten borrowers to the table to work out a plan to address the underlying distress. With the FAPA's implications, holders and servicers of both residential mortgages and commercial mortgages will have to carefully and strategically assess if, when and how to use the remedy of acceleration, with the understanding that such acceleration commences the ticking of the six-year statute of limitations clock. We are also curious to see the interplay between automatic acceleration provisions common in commercial mortgages (e.g. for bankruptcy of the borrower) and the application of FAPA.

For now, servicers and noteholders of mortgage loans should evaluate their loss mitigation, workout and foreclosure policies to ensure they are preserving their rights under New York law, including FAPA. Additionally, they should review their portfolios to identify mortgage loans that may now be subject to an acceleration as a result of the

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16 *See* Senate Bill S5473D, The New York State Senate, https://www.nysenate.gov/legislation/bills/2021/S5473.

17 *See U.S. Bank national Association, etc. v. Miguel Corcuera*, 2023 N.Y. 61406 (N.Y. App. Div. 2023).

18 On Friday, February 24, 2023, the New York Attorney General's office requested an extension of time to file its position.

statutory amendments and the current date that the related statute of limitations will run in order to affirmatively manage recovery on such mortgage loans.

Dechert continues to monitor new developments regarding FAPA and will provide further updates as legal challenges and other news continue to develop.

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