Liability for Refusing to Deliver an Assignment of Mortgage?

Paul Rubin

A New York court's recent decision may impact real estate lenders.

It generally has been understood that, under New York law, a lender need not deliver an assignment of mortgage upon payoff of its loan unless the loan documents specify otherwise. Instead, a lender may give the borrower only a certificate of discharge. Thus, in a recent case, when a loan servicer insisted that a borrower pay a fee upon prepayment in return for a mortgage assignment, and even extracted from the borrower a release in connection with imposition of that fee, the servicer was surely confident that it was fully insulated from any liability concerning collection of that fee. In a surprising decision, however, a New York state court denied the loan servicer's motion for summary judgment to dismiss claims brought by the unhappy borrower and its affiliate.

Factual Background

Two affiliated Manhattan commercial property owners sought to prepay their mortgages through separate refinancings. Both loans were administered by the same loan servicer acting for a trustee that held the loan for the benefit of holders of mortgage pass through certificates. The first borrower wanted the assignment to avoid payment of over $1.8 million in mortgage recording taxes. The loan servicer demanded and obtained from the borrower a fee equal to one percent of the outstanding principal balance of the loan and a release of any claims related to that fee in return for the assignment. Thereafter, the second borrower requested an assignment in connection with its loan prepayment. The loan servicer denied that request, and the borrower was forced to pay a mortgage recording tax upon prepayment. The borrowers then sued the servicer, asserting 17 different claims, and the lender moved for summary judgment to dismiss them all.

Paul Rubin is a partner at Herrick, Feinstein LLP. He concentrates his practice in bankruptcy and restructuring, insolvency and creditors' rights, and related litigation. Mr. Rubin may be reached at prubin@herrick.com.

The Holding

The court rejected most but, to the servicer's dismay, not all of the borrowers' claims. The first borrower alleged that the servicer had falsely represented that it was demanding a release to induce the trustee to provide an assignment and that it was acting within the authority granted to it by the trustee. The court held that this borrower should be allowed the opportunity to prove its claim that the servicer procured the release through fraud. Despite the loan servicer's production of a power of attorney stating that the borrower could rely upon the servicer's authority to act for the trustee, and even though the trustee did not repudiate the servicer's acts, the court nevertheless held that the trustee's role regarding the requested assignment and release was sufficiently unclear. Accordingly, the first borrower would be permitted to try to establish that, in signing the release, it reasonably relied on the servicer's allegedly false representations.

The court then determined that the servicer might be liable to both borrowers for breach of their loan agreements. The borrowers asserted that commercial mortgages in New York are rarely satisfied upon prepayment, and that original lenders customarily assign them to the new lenders in return for payment of costs for preparation of the assignment and reasonable attorney's fees. The servicer denied this is the common practice, and produced documents governing several other loans it services that specifically require delivery of an assignment upon prepayment. But the court held that the borrowers would be allowed to present evidence to support what they claim is the custom and usage applicable to their loan agreements upon prepayment.

Additionally, the court held that the servicer could also be liable for breach of the covenant of good faith and fair dealing inherent in every contract under New York law. The borrowers alleged that, by charging the one percent fee for one loan and refusing to grant the assignment for the other, the loan servicer effectively deprived them of the full benefits of the provisions in their agreements that permitted them to prepay the loans. In this regard, the court noted that the servicer had provided no evidence as to why it decided to charge a fee, how the fee was calculated, whether it was acting pursuant to guidelines provided to it by the trustee, or what position the trustee took regarding the servicer's demand for the fee.

Concluding Observations

In light of this decision, both loan servicers and mortgagees are cautioned when deciding whether to provide mortgage assignments and what to charge for them. The threshold question is whether the loan documents require the delivery of an assignment. Assuming there is none, loan servicers must be capable of providing evidence that, in charging a fee, they are acting within express directives provided by the owner of the loan. They must also be sure that their conduct is consistent with applicable local practice regarding whether and to what extent a fee may be charged for an assignment. In addition, servicers and mortgagees must ascertain that, when insisting upon a fee or refusing to provide an assignment, they are not causing economic pain that effectively deprives their borrowers from enjoying their contractual right to prepayment.