

# Loan Servicer And Its Officers Protected In A Recent Case

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Loan servicers and their employees worry that they may become the targets of multi-million dollar lawsuits simply because they serviced a loan that becomes the subject of heated litigation. A recent case may allay such concerns. This case provides loan servicers with the protection of prior judgments won by the lender/principal in lender liability litigation. It also vindicates the right of the loan servicer to encourage the lender to initiate litigation upon a borrower's default.

In this case, the loan servicer had been retained by the FDIC (acting as receiver for a failed bank) to service the loan after the borrower defaulted. The borrower ignored the loan servicer's default notices. The loan servicer then made a written recommendation that the FDIC commence a foreclosure action, and the borrower filed for bankruptcy protection. Ultimately, the borrower lost its property, a leasehold interest in a 538,000 square foot building in lower Manhattan, which was sold at auction by the bankruptcy court.

In a prior federal court action, the borrower had asserted various lender liability claims against the FDIC based upon the conduct of the loan servicer, including the claim that the FDIC – through the loan servicer – acted in bad faith when it commenced the foreclosure action. Despite losing the first action, the borrower initiated a new lawsuit against the loan servicer and several of its officers. The borrower accused the defendants of various acts of wrongdoing – including wrongful acceleration of a \$20.3 million mortgage loan, submission of false information to the lender, refusal to negotiate in good faith, and the alleged destruction of documents designed to hide their bad deeds.

The defendants moved for summary judgment, arguing that the borrower's claims were barred under the res judicata doctrine, which provides that a final judgment on the merits precludes the parties or their privies from re-litigating issues that were or could have been raised in that action. The district court and the Second Circuit Court of Appeals agreed, finding that this lawsuit was based on the same operative facts and allegations as the first action, and that the parties would have expected that all of the borrower's claims would have been brought in the first action. That the borrower alleged new theories to support its claims did not

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change the result.

Res judicata protected the loan servicer and its employees, the agents of the FDIC, because their disputed acts were in discharge of their duties to the FDIC, even if the borrower's unsubstantiated allegations that the loan servicer acted irregularly or with disregard to the FDIC's instructions had been true. In addition, there was no evidence that the loan servicer acted outside the scope of its authority. The FDIC provided an affidavit confirming that it had authorized the loan servicer to commence the foreclosure action rather than grant the borrower the concessions it sought.

The borrower contended that its second round of claims was based on new evidence that it discovered only after its first lawsuit was dismissed. But, the allegedly new evidence was available – and even produced – in the prior action. Next, the borrower argued that the loan servicer had destroyed documents essential to prove its case. But the borrower failed to show that relevant documents were missing.

The borrower also attempted to assert against the loan servicer a claim for what it called "unspecified tort," based on a 1990 New York appellate court decision, which indicated that certain allegations could be sustainable as a tort claim even if they do not fall precisely within a recognized category of tort, but are sufficiently analogous to one. The courts held that there is no catchall cause of action for unspecified tort, and that the borrower's allegations were not analogous to any recognized tort that the borrower could prove. Significantly, the court held that there is no cause of action against a loan servicer for encouraging a lender to enforce its rights under a mortgage after the borrower has defaulted.

Similarly, the borrower's claim that the loan servicer should be liable for submitting false statements to the FDIC, when it recommended commencement of the foreclosure action, was also rejected. The borrower failed to prove that any specific written statement in the loan servicer's written recommendation caused it actual damages because it was indisputable that the borrower had defaulted in meeting its payment obligations under the mortgage before the loan servicer began administering the loan.

This case provides important illustrations concerning various tactics, claims and allegations that a litigious borrower can make. It demonstrates that a judgment in favor of a lender will preclude a subsequent lawsuit against the loan servicer if the servicer's challenged acts are not concealed, relate to the same operative facts as the first lawsuit and to the performance of its duties to the lender.

The case also highlights the importance of careful preservation of documents related to servicing of loans, including reports from the servicer to the lender, so that the servicer is not vulnerable to attacks that it discarded documents that would allegedly establish a claim in favor of the borrower.