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One Way Out: New York's One-Action Rule

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This article is a brief refresher on the basics of New York's one-action rule. Following an event of default, typical commercial real estate loan documents give the lender the right to pursue alternative remedies simultaneously, or in any order it chooses. For example, if a borrower is in default on a mortgage loan beyond any applicable notice and cure periods, the mortgage usually provides the lender the right to foreclose its mortgage while simultaneously suing on the note or, if applicable, a guaranty. However, every lender needs to be aware that some states have enacted so-called "one-action rules" which, in many circumstances, restrict a lender's right to simultaneously pursue multiple legal actions to recover the debt. We would note that one-action rules can vary greatly from state to state, and this article specifically focuses on New York's application of the rule.

In the State of New York, N.Y. Real Prop. Actions Law § 1301(3) states that "[w]hile the action is pending or after final judgment for the plaintiff therein, no other action shall be commenced or maintained to recover any part of the mortgage debt, without leave of the court in which the former action was brought." The result of this statute is that if a lender wants to exercise remedies to recover debt secured by a lien on Property located in the State of New York, then it must choose between pursuing an action at law to recover on the note (and, if applicable, any guaranty) or to pursue an action in equity to foreclose on the mortgage.[1] This restriction forces the lender to select its exercise of remedies carefully in order to maximize its recovery and avoid several potential pitfalls.

When choosing its remedies, one of the most obvious concerns for the lender is simply one of timing. Pursuant to § 1301(1), if a lender elects to enforce the note and/or guaranty and obtains a money judgment against the defendant, the lender must first exhaust its collection efforts on the judgment by executing against the defendant's property in the appropriate county, before it is permitted to foreclose on its mortgage.[2] This process could be time consuming, resulting in opportunity costs for the lender as well as the risk that the value or condition of the collateral deteriorates in the interim. For this reason, it is most common for lenders in New York to choose a foreclosure action over seeking a money judgment.

Pursuing a foreclosure in New York is not without its own potential pitfalls. In many cases, the winning bid in the foreclosure sale, whether by the lender as a credit bid or a third party, ends up being less than the lender's outstanding debt (including interest and costs). If the value of the property does not exceed the outstanding amount of the debt, the lender is going to be the most likely winner at the foreclosure sale, as there is unlikely to be a third party willing to match its credit bid. In such situations, the lender must apply with the court for a deficiency judgment in order to try to recover the difference between the sale price and the outstanding debt. Unfortunately for the lender, though, the deficiency judgment will not necessarily equal the difference between the sale price and its outstanding debt. Rather, the deficiency judgment will be equal to the difference between the outstanding debt and the greater of (a) the fair market value of the property, as determined by the court, and (b) the sale price of the property.[3] Notably, then, the court can find that the sale price was not representative of the true market value of the property, resulting in a deficiency judgment that is less than the difference between the sale price and the outstanding amount of the debt.[4] This rule was intentionally designed to protect mortgagors from lenders that might otherwise be incentivized to suppress the bidding at the foreclosure sale, purchase the property at a bargain price and then obtain the benefit of an exaggerated deficiency judgment.[5] Therefore, the rule applies regardless of whether the lender or a third party is the winning bidder at the foreclosure sale.[6]

Another concern for lenders in electing to pursue a foreclosure action in New York is that once a foreclosure action has been commenced, any claim on a guaranty can't be pursued until the foreclosure is completed, and the recovery thereunder will be limited to the amount of the deficiency judgment, which, as noted above, may not be sufficient to make the lender whole.[7] In contrast, if the lender were to sue on the guaranty instead of foreclosing, the lender would potentially be able to obtain a judgment against the guarantor for the full amount of the guaranteed obligations.[8]

Second, if a lender chooses to bring a foreclosure action, it must be careful to name any parties that are responsible for the debt, including any guarantors, in such foreclosure action or else they risk losing the ability to make a claim against such parties altogether.[9] This rule is codified in § 1371(1), which makes an obligor's liability for a deficiency judgment conditioned on the obligor being named as a defendant in the foreclosure suit.

Third, the lender must also make sure to apply for a deficiency judgment against all appropriate parties, including any guarantors. Pursuant to § 1371(3), if no motion for a deficiency judgment is made following a foreclosure sale, the proceeds of the sale (regardless of the amount) will be deemed to fully satisfy the mortgage debt, and the lender will have no further right to recover any deficiency in any action or proceeding. Furthermore, "when mortgage debt is deemed satisfied, so also is the liability of the guarantor of that debt."[10]

Between the one-action rule set forth in RPAPL §1301 and the limitations on deficiency judgments set forth in RPAPL §1371, lenders in New York that want to exercise remedies need to carefully consider their litigation strategy in order to maximize the efficiency and amount of their recovery.

[1] *Trustco Bank v. Pearl Mont Commons, L.L.C.*, 47 N.Y.S.3d 644, 649 (Sup. Ct. 2016) (quoting *Gizzi v. Hall*, 767 N.Y.S.2d 469, 471 (App. Div. 2003)) ("A foreclosure plaintiff 'may proceed at law to recover on the note or proceed in equity to foreclose on the mortgage, but must only elect one of these alternate remedies.'")

[2] *See Simms v. Soraci*, 675 N.Y.S.2d 295, 295 (App. Div. 1998).

[3] N.Y. Real Prop. Acts. Law § 1371(2) (Consol. 2021).

[4] *See id.*

[5] *Sanders v. Palmer*, 499 N.E.2d 1242, 1243-45 (N.Y. 1986).

[6] *Id.* at 1245.

[7] *Id.*; *Letchworth Realty, L.L.C. v. LLHC Realty, L.L.C.*, No. 6:15-CV-06680-FPG, 2020 U.S. Dist. LEXIS 163220, at *3 (W.D.N.Y. Sep. 6, 2020).

[8] Note that any such judgment would be unsecured and, as mentioned above, the lender would have to first execute against the judgment and be able to show that it was unable to satisfy the judgment, before being able to make a claim on its mortgage.

[9] *Sanders*, 68 N.Y.2d at 1245-46; *Letchworth*, 2020 U.S. Dist. LEXIS 163220, at *4-*5; *Merchs. Nat'l Bank v. Wagner*, 402 N.Y.S.2d 936, 939 (Sup. Ct. 1978).

[10] *Trustco v. Pearl Mont Commons*, 47 N.Y.S.3d 644, 650 (N.Y. Sup. Ct. 2016).