

LOWENSTEIN SANDLER NEWSLETTER REAL ESTATE

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Appellate Division Holds That a Real Estate Contract Can Be Formed by E-Mail Correspondence

On October 5, 2010, the New York State Supreme Court Appellate Division, First Department, expanded the application of New York's Statute of Frauds, ruling that a real estate contract could be formed through e-mail correspondence. In the case of *Naldi v. Grunderg*, 908 N.Y.S.2d 639, 2010 NY Slip Op 07079 (App Div, 1st Dept 2010), the respective brokers of the buyer and seller discussed via e-mail the terms of the sale of property in New York City, including an offer and counteroffer. Although the proposed terms acknowledged there was no due diligence period, both brokers' e-mails mentioned a right of first refusal in the event the seller received a legitimate better offer during the next 30 days. Partly relying on the parties' prior correspondence, including e-mails from the seller's broker that contained a higher counteroffer and stated that there was to be no due diligence, the buyer started its due diligence without a signed contract and sued to enforce

the right of first refusal when the seller attempted to make a deal with a third party.

In reviewing whether this right of first refusal was a valid real estate contract, the Court in *Naldi* had to determine whether the e-mails by the parties' representatives could create an enforceable real estate contract that complied with the Statute of Frauds (New York General Obligations Law §5-703). The Appellate Division held that e-mail correspondence could satisfy the Statute of Frauds requirement for real estate contracts, noting that the Court had previously held that e-mails could satisfy the Statute of Frauds in other writing contexts like stipulations, modifications to agreements, etc. Moreover, the Court reasoned that the Statute of Frauds accepted other electronic forms of communication, such as e-mails and facsimiles, as writings with regard to certain complex financial agreements, and with e-mails ever present in business and personal affairs, there is no distinction between an e-mail creating a real estate contract and one creating a financial agreement.

The Appellate Division decided that

the Statute of Frauds was flexible enough to permit forming a real estate contract through e-mail correspondence. Under the facts of the case before it, the *Naldi* Court held that a contract was not formed, because the parties never agreed on a price because the seller's broker counter-offered \$52 million and buyer's broker submitted a draft contract with its original offer of \$50 million.

Nevertheless, real estate professionals, including brokers, listing agents and attorneys, should be aware of the serious implications this case may have regarding the method of negotiating real estate agreements in New York, especially term sheets and leases. The risk is that what parties believe to be casual preliminary correspondence could accidentally create a binding agreement if the parties aren't careful in their e-mail communications. In light of the *Naldi* decision, we are advising clients that all preliminary correspondence, e-mail or otherwise, should always include a disclaimer that the parties have not reached an agreement until all parties sign a negotiated contract.

Massachusetts Court Sets Aside Foreclosures – Will This Decision Impact Foreclosures in New York and New Jersey?

The Massachusetts Supreme Judicial Court's decision in *U.S. Bank National Association v. Ibanez*, No. SJC-10694, 2011 Westlaw 38071 (Mass. January 7, 2011) has caused a firestorm in the world of residential and commercial mortgage-backed securities. In this consolidated case, the Court invalidated two residential foreclosure sales because the Court found that U.S. Bank National Association ("U.S. Bank") and Wells Fargo & Company ("Well Fargo" and together with U.S. Bank, the "Trustees") could not show that they were the holders of the subject mortgages at the commencement of foreclosure proceedings. The Court held that without proof of a proper assignment prior to the commencement of foreclosure proceedings, the Trustees for the REMIC trusts purporting to hold the mortgages could not rely upon assignments after the fact to cure the deficiency.

Massachusetts allows nonjudicial foreclosure of mortgages by exercise of the statutory power of sale. Because a mortgage holder may foreclose without immediate judicial oversight, under Massachusetts law the terms of the power of sale in the applicable mortgage must be strictly followed. "If [the mortgage holder] fails to do so, there is no valid execution of the power, and the sale is wholly void."¹ The statutory power of sale can be exercised by the mortgagee or his executors, administrators, successors or assigns.² Under the plain language of the statute, the Trustees only had the

authority to exercise the power of sale if they could establish that they were the assignees of the subject mortgages at the time of the notice of sale and the subsequent foreclosure sale.³

To support their claim to be the holders of the mortgages at the time of the notice of sale, the Trustees proffered, among other documents, mortgage assignments executed in connection with the establishment of the REMIC trusts by the prior holder of the mortgages "in blank" (i.e., without specifying to whom the mortgages were to be assigned). The Court quickly rejected the assignments in blank as invalid, stating that "a mortgage that does not name the assignee conveys nothing and is void; [Massachusetts does] not regard an assignment of land in blank as giving legal title in land to the bearer of the assignment."⁴

Although each of the Trustees purported to hold its mortgage through a series of assignments, neither could establish that it was the holder of record of its respective mortgage. The Trustees asserted ownership of the mortgages pursuant to the terms of their securitization documents.⁵ The Court rejected the securitization documents as insufficient evidence that the Trustees were present holders of the subject mortgages. While an assignment of mortgage need not be in recordable form at the time of the notice of sale or subsequent foreclosure sale, the Court specifically noted the following:

Where a pool of mortgages is assigned to a securitized trust, the executed agreement that assigns the pool of mortgages, with a schedule of the pooled mortgage loans that clearly and specifically identifies the

mortgage at issues as among those assigned may suffice to establish the trustee as the mortgage holder.⁶

Because the Court found that the Trustees failed to establish that they held the mortgages at the time of the notice of sale, the Court held that they did not have the authority to foreclose under the power of sale.

The *Ibanez* decision reinforces the fundamental requirement that a trustee of a REMIC trust must obtain a valid assignment of all mortgages and underlying loan documents in the pool prior to commencing foreclosure proceedings or exercising a power of sale against a particular defaulted mortgage loan. The availability of non-judicial foreclosure in Massachusetts allowed conditions to arise in which the Trustees were not the present holders of the mortgage, rendering the foreclosure sales invalid. However, in states requiring judicial oversight of foreclosure, such as New York⁷ and New Jersey, the *Ibanez* decision merely confirms standard foreclosure practices.

In New York and New Jersey, judicial oversight of mortgage foreclosure requires that the foreclosing lender submit for the court's review the loan documents, including all written assignments of mortgage. Under New Jersey law, a mortgage assignment must be in writing⁸ and may be recorded in the county recording office, although the failure to record an assignment of mortgage does not affect the validity of the assignment.⁹ If the plaintiff is not the original mortgagee, the name of the original mortgagee and a recital of all assignments in the chain of title must be included in the foreclosure complaint.¹⁰ In order to obtain a judgment in foreclosure, the plaintiff

must produce the original or a certified true copy of the mortgage, evidence of indebtedness, assignments, and any other original document upon which the claim is based.¹¹

Under New York law, an assignment of mortgage need not be in writing but may be accomplished by delivery of the mortgage with the intention of assigning same. The assignment must be complete at the time a foreclosure action is initiated and the assignment to the foreclosing plaintiff is recited in the complaint.¹² Where a written assignment is executed subsequent to the initiation of the foreclosure action, and there is no proof of earlier file

delivery, the action will be dismissed.

¹³ It should be noted, however, that prior to the execution of a foreclosure deed to the purchaser at the foreclosure sale, any written assignment of the mortgage must be filed with the clerk or, if same is in recordable form, the assignment must be recorded in the county where the property is located.¹⁴

While the *Ibanez* decision has caused a firestorm in some residential and commercial securitization circles, the case merely confirms the standard practice that a foreclosing mortgage holder must have its documentation in place prior to commencing foreclosure proceedings. While

assembly of such documentation may prove to be a challenge to trustees of REMIC trusts that were created under more lax underwriting and record-keeping practices, it should have no significant impact on foreclosure practices in New York and New Jersey, which have always mandated that a foreclosing plaintiff establish that it is the holder of the applicable mortgage.

Please contact any member of Lowenstein Sandler's Real Estate Practice Group with questions regarding the topics discussed in this newsletter.

¹ *Ibanez*, 2011 Westlaw 38071 at *11, quoting *Moore v. Dick*, 187 Mass. 207, 211 (1905).

² G.L. c.183 §21.

³ G.L. c.244 §14. Because only a present holder of the mortgage is entitled to foreclose on the mortgaged property, the failure to identify the holder of the mortgage in the notice of sale may render the notice defective and the foreclosure sale void.

⁴ *Ibanez*, 2011 Westlaw 38071 at *14. Massachusetts follows the "title theory" of mortgages; i.e., the granting of a mortgage vests title to property in the mortgagee while the underlying debt remains unpaid.

⁵ U.S. Bank submitted a private placement memorandum (PPM) that described the mortgaged pools and summarized the provisions of the trust agreement. Although the PPM specified that each loan to be assigned would be identified in a schedule appearing as an exhibit to the trust agreement, U.S. Bank did not provide any schedule identifying the subject loan as being among the mortgages that were assigned. Wells Fargo submitted a pooling and servicing agreement ("PSA") that referenced a mortgage loan schedule but did not contain said loan schedule, and the only schedule provided by Wells Fargo did not identify the subject mortgage.

⁶ *Ibanez*, 2011 Westlaw 38071 at *13.

⁷ Article 14 of the Real Property Actions and Proceedings Law allowing power of sale was repealed on July 1, 2009, by virtue of its natural end without renewal, although it still applies to any nonjudicial foreclosure for which a notice of pendency was filed on or before July 1, 2009.

⁸ N.J.S. 46:9-9.

⁹ An assignment is effective as long as it identifies the assignee, the assignor and the property. N.J.S. 25:1-13(a).

¹⁰ Rule 4: 64-1.

¹¹ Rule 4: 64-2.

¹² See *Bergman on New York Mortgage Foreclosures* §16.05[1b].

¹³ In the event of an assignment during the pendency of an action, wisdom suggests the substitution of the new mortgage holder as the plaintiff in the foreclosure action. See *Bergman on New York Mortgage Foreclosures* §23.46.

¹⁴ RPAPL §1353(2).

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