

NY Debt Collection Ruling's Narrow Application For Lenders

By **Christopher Gorman** (September 24, 2021)

Those in the business of acquiring distressed real estate assets have more than enough concerns in making investments based solely upon market-driven and certain legal factors, including the time it takes to prosecute foreclosure actions through to completion.

The New York Supreme Court Appellate Division addressed one such legal concern in a recent decision, *Citibank NA v. Yanling Wu*.^[1]

The court concluded that the plaintiff in that particular case, a lender who acquired a distressed real estate asset following an alleged default by the borrowers in making payment, was not required to be licensed as a debt collection agency pursuant to the New York Administrative Code, Section 20-490, in order to be able to prosecute a mortgage foreclosure action.



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But the court's holding in *Yanling Wu* cannot be read too expansively to apply to every lender in every foreclosure case.

Indeed, arguably, the court's analysis in *Yanling Wu* may require certain lenders — particularly those who regularly engage in the business of acquiring defaulted notes and mortgages secured by residential real property — to respond to discovery pertaining to their business practices and rebut defenses founded upon Section 20-490 on a case-by-case basis.

The Yanling Wu Decision

The case concerned Citibank NA, who had acquired the subject note after the defendants, Yanling Wu, had allegedly defaulted in making payment. In 2016, Citibank then commenced an action against the defendants to foreclose the mortgage. The plaintiff did not seek a deficiency judgment in the action.

The defendants served an answer in which they asserted as an affirmative defense, among others, that the plaintiff failed to allege that it had obtained a license to act as a debt collection agency pursuant to Section 20-490.

Section 20-490 makes it unlawful "for any person to act as a debt collection agency without first having obtained a license." A debt collection agency is defined as:

a person engaged in business the principal purpose of which is to regularly collect or attempt to collect debts owed or due or asserted to be owed or due to another and shall also include a buyer of delinquent debt who seeks to collect such debt either directly or through the services of another by, including but not limited to, initiating or using legal processes or other means to collect or attempt to collect such debt.

Debt means "any obligation or alleged obligation of a consumer to pay money arising out of a transaction in which the money, property, insurance, or services which are the subject of the transaction are primarily for personal, family, or household purposes."

The plaintiff moved for summary judgment on the complaint. The defendants cross-moved

to dismiss the complaint for failure to allege that the plaintiff had obtained the aforementioned license. The defendants contended that the foreclosing plaintiff in the case met the foregoing definition of debt collection agency and, thus, was required to obtain and plead that it obtained the license.

In response to the branch of the cross-motion seeking dismissal, the plaintiff argued that it was not required to be licensed as a debt collection agency under the administrative code.

The court disagreed with the defendants, concluding that the plaintiff was not required to be licensed pursuant to Section 20-490 under the facts of the case in order to prosecute the mortgage foreclosure action.

Specifically, the court concluded that Real Property Actions and Proceedings Law, Article 13, creates a distinction between an action to recover part of the mortgage debt and an action to foreclose, and thus "[a]n action to foreclose a mortgage is not an action to recover the mortgage debt from the mortgagor personally, but to collect it out of the land by enforcing the lien of the mortgage."

According to the court, therefore, the foreclosure action is an action to enforce a security interest in real property, and not an action to collect money directly from a debtor, thereby removing the plaintiff in the foreclosure action from the operative definitions of the statute that could make Section 20-490 applicable.

And while agreeing that the definition of debt collection agency contained in Section 20-489 also includes "a buyer of delinquent debt who seeks to collect such debt," which would have technically covered the plaintiff in the case, the court nonetheless found that the statutory definition of debt collection agency was not satisfied.

Specifically, while acknowledging that the plaintiff acquired the promissory note after the defendants were allegedly in default, the court found the language of Section 20-489(a) to be:

ambiguous in the sense that it is unclear whether the requirement that the "principal purpose" of the business be the collection of debt is intended to apply to the entire, expanded definition of "debt collection agency," or only to the first part of the definition pertaining to the collection of debts owed to another.

Thus, the court found that, "[t]o the extent the 'principal purpose' requirement also applies to the expanded definition of 'a buyer of delinquent debt who seeks to collect such debt,'" the defendants did not show, or even attempt to argue, that it is the principal purpose of Citibank to acquire delinquent debt, thereby bringing the plaintiff outside of the statutory definition.

The court also concluded that also concluded that, in any event, pursuing a judicial foreclosure action was not conduct so "shocking to the conscience of ordinary people" that the subject Administrative Code provisions were enacted to address.

As such, the court concluded, particularly in light of the state statutory scheme intended to protect homeowners in residential foreclosure, that:

[T]he City Council did not intend to include a plaintiff pursuing a judicial foreclosure action such as this one within the definition of "debt collection agency" set forth in the Administrative Code.

Analysis

While it is not up to debate that the court concluded in Yanling Wu that Citibank was not required to be licensed as a debt collection agency with respect to its prosecution of this foreclosure action, the decision in Yanling Wu leaves open the question of whether the failure to meet the licensure requirements of Section 20-489 could ever constitute a defense to a foreclosure action.

For instance, of particular significance to the decision in Yanling Wu was the fact that the plaintiff in that case did not seek a deficiency judgment against the borrowers in the action. In other words, in Yanling Wu, the lender was not seeking to hold the defendants personally liable for any portion of the debt, but only seeking recourse for the alleged default under the loan documents against its security, i.e., the real property.

If, however, the lender in a foreclosure action was pursuing a deficiency judgment against the borrowers by seeking to hold them personally liable for the indebtedness, it could certainly be argued that the statute's definition of debt was satisfied based upon the lender's efforts to enforce an "obligation or alleged obligation of a consumer to pay money arising out of a transaction" separate and apart from a claim made by the lender with respect to the real property securing the debt.

Moreover, and perhaps even more significantly, the court concluded in Yanling Wu that Citibank did not qualify as a debt collection agency because the defendants did not even argue, nonetheless attempt to show, that it was the principal purpose of Citibank to buy and collect delinquent debt.

This is likely the correct determination with respect to a bank or entity like Citibank — i.e., Citibank does many things other than buying and collecting delinquent debt, so it would appear to not satisfy the principal purpose statutory definition. This analysis, however, may not necessarily be germane to other, smaller private lending outfits that regularly trade in distressed debt secured by real estate.

For instance, there are many smaller private lenders whose sole business is to acquire and collect upon delinquent mortgage debts through use of the court system. Yanling Wu leaves open the possibility that such lenders may be required to comply with the licensing requirements of Section 20-489 in order to maintain a foreclosure action.

The decision in Yanling Wu also leaves open the possibility that lenders could be subjected to discovery concerning the nature of their business in connection with defendants trying to ascertain whether the principal purpose requirement of Section 20-489 could be satisfied.

For instance, defendants raising a defense founded upon a failure to comply with the licensing requirements of Section 20-489 could argue that they are entitled to discovery regarding the number of loans acquired by a particular lender, whether those loans were in default at the time of acquisition and whether foreclosure or other court proceedings were commenced to enforce the debt, all of which could arguably be relevant to ascertaining if the principal purpose of the lender's business is to buy and collect delinquent debt.

Such discovery, of course, could slow down the rate at which a lender can prosecute foreclosure litigation, much to the chagrin of lenders seeking to foreclose upon real property collateral.

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[1] Citibank, N.A. v. Yanling Wu , --- A.D.3d ----, --- N.Y.S.3d ----, 2021 N.Y. Slip Op. 04902 (2d Dep't Sept. 1, 2021).