

## Shrewsbury And Its Impact On Delaware Foreclosure Actions

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*Law360, New York (May 9, 2017, 10:42 AM EDT)* -- In *J.M. Shrewsbury v. Bank of New York Mellon*, (Del. Apr. 17, 2017), the Supreme Court of Delaware, sitting en banc, issued a decision of interest to lenders seeking to foreclose on real property in the state of Delaware. In reversing the order of the trial court granting summary judgment in favor of the foreclosing bank, the majority held that a mortgagee must be entitled to enforce the underlying promissory note in order to foreclose on the mortgage security. While this holding affects lenders' pursuit of foreclosure, the practical consequence appears limited, and the decision likely impacts counsel for lenders far more than the lenders themselves.



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In *Shrewsbury*, the bank filed an in rem action against the defendants' real property. The complaint does not make an express reference to a promissory note and largely ignores the underlying obligation to repay money; rather, the bank avers that the defendants caused a federal tax lien to be recorded on the real property in violation of certain covenants set forth in the mortgage. While the bank accelerated the amount of the loan, it did not seek an in personam judgment against the defendants. The complaint required the defendants to answer the allegations by affidavit in accordance with Title 10, Section 3901, of the Delaware Code. The defendants answered the complaint, in which they asserted, as an affirmative defense, that the bank was not the real party in interest and lacked standing to file suit.



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The bank pursued summary judgment based on the defendants' failure to set forth an allowable defense to the in rem action. In opposition thereto, the defendants asserted that summary judgment was inappropriate where the foreclosing bank failed to establish standing to file suit, because the bank was not the originating lender and there was no evidence that it possessed any right of enforcement under the promissory note. The court entered judgment as a matter of law in favor of the bank. While the court order does not provide a detailed basis for its finding that the bank satisfied its evidentiary burden, one may conclude from the background section that the defendants' failure to remit payment upon the bank's acceleration of the debt constituted sufficient grounds. The trial court did not find the defendants' standing argument persuasive because the originating lender assigned all of its interests to the foreclosing bank, and thus the foreclosing bank possessed legal standing as a valid assignee.

On appeal, the defendant asserted that the bank lacked standing to pursue foreclosure where the assignment conveyed rights under the mortgage alone and the original promissory note lacked a notation or indication of assignment. The bank argued that the defendant failed to raise an allowable defense to a foreclosure action. This occasion provided the Delaware Supreme Court with an opportunity to discuss the long line of Delaware cases recognizing the limited defenses to foreclosure, specifically payment, satisfaction and “plea in avoidance.”

The appellate court explained that the defense of plea in avoidance admits the allegations of the complaint while asserting information that defeats the foreclosing party’s right, for example, an act of God, illegality or fraud. The appellate court then construed the statute governing the commencement of a mortgage foreclosure action to require the mortgagee to be able to enforce payment of the promissory note to establish standing. The court explained that the mortgage merely secures payment of the promissory note, and thus, the underlying debt was necessary to the enforcement of the mortgage. Accordingly, the court recognized the right of enforcement of the promissory note, or the lack thereof, as a plea in avoidance defense to foreclosure. In doing so, the appellate court reversed the order of the trial court, with Chief Justice Leo Strine dissenting, and remanded the case for further proceedings to resolve a genuine issue of material fact.

The Shrewsbury decision proves confusing and incomplete. The bank sought the entry of in rem judgment based on, among other things, the mortgagor’s default on certain mortgage covenants. The complaint did not include any claims imposing personal liability on the defendants, yet the Delaware Supreme Court ignored the legal distinction between an in rem and an in personam judgment and blurred the line separating a mortgage from a promissory note by requiring a foreclosing party to possess a right to enforce the underlying note. The decision also rendered a breach under the mortgage of no consequence, effectively stripping a mortgagee of its contractual rights.

Further, the majority’s concern that the borrower could be subject to double penalty not only turns a blind eye to those provisions of Title 10, Section 5067, of the Delaware Code concerning the application of sheriff sale proceeds, but also ignores the defense of satisfaction and the role of the judiciary in preventing abuse.

Finally, the majority fails to consider the effect of its holding on foreclosure actions involving parties that obtained a personal discharge through bankruptcy proceedings, in which the lender is no longer permitted to collect the monetary debt from the borrower but its rights against the real property under the mortgage are preserved. This common scenario places the Shrewsbury decision at odds with the Bankruptcy Code and potentially incentivizes lenders to object to the personal discharge of borrowers, thereby increasing lenders’ expenses and further burdening the federal judiciary. Chief Justice Strine, in his dissent, hit the correct note in explaining that the issue of standing, in this context, concerns “who” rather than “what,” as well as in noting the key omission of the terms “promissory note,” “note” and “noteholder” from the statute governing mortgage foreclosure actions.

The Shrewsbury decision may ultimately prove to be of limited impact. In this specific instance, the case will be remanded to the trial court to address certain evidentiary shortcomings that gave rise to a genuine issue of material fact. On a broader level, until the Delaware Supreme Court provides further clarification, purchasers of mortgages from the originating party may want to acquire the mortgage and promissory note and expressly reference the transfer of all rights or interests in the note within the assignment agreement. The assignment agreement should be recorded with the recorder of deeds in the county in which the real property is situated in order to provide notice to all interested parties. The assignee should also take possession of the original promissory note, and the appropriate notations

should be made. Counsel for lenders should take heed of the majority's suggestion to include its preferred language alleging the borrower's breach of the terms of the promissory note in the in rem action. Finally, counsel may wish to give greater consideration to including a claim for in personam judgment against the borrower and any guarantor in the foreclosure complaint as a precautionary measure.

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