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WISCONSIN SUPREME COURT ISSUES OPINION WITH STRONG POTENTIAL FOR SIGNIFICANT IMPACT ON LENDERS AND SERVICERS

Overview

On February 17, 2015, the Supreme Court of Wisconsin issued its opinion in *Bank of New York Mellon v. Carson*, 2015 WI 15. This opinion may prove to have significant implications for lenders and servicers in Wisconsin where a mortgaged property is abandoned prior to commencement of a foreclosure action or becomes abandoned any time prior to confirmation of the foreclosure sale.

Background

Shirley Carson defaulted on her mortgage loan and the bank brought a foreclosure action. The bank waived its right to seek a deficiency judgment, represented that the property was non-owner occupied, and obtained a judgment of foreclosure with a three-month period of redemption (in Wisconsin, waiver of deficiency judgment provides a six-month period of redemption for owner-occupied properties and three-month period of redemption for non-owner occupied properties, and abandoned properties provide for a five-week period of redemption).

After the three-month redemption period expired, the bank did not take the property to sheriff's sale. The record of the case indicates that representatives of the bank knew the property was not occupied and was uncared for and derelict even before the bank obtained the foreclosure judgment. Approximately sixteen months after the bank obtained the foreclosure judgment, Carson brought a post-judgment motion to amend the judgment of foreclosure requesting the lower court (Circuit Court) to specifically find that the property had been legally abandoned (as opposed to merely vacated) and that the bank was required to take the property to sheriff's sale.

The Circuit Court found that during the months after the bank obtained its foreclosure judgment, the house was uncared for, burglarized, and vandalized on numerous occasions, all while slipping into a condition that led to the municipality fining Carson \$1,800.00 and that Carson and the bank failed to take effective steps to prevent waste on the property, or to ensure it was secured against unauthorized entry.

However, the Circuit Court denied Carson's motion because the court determined that the court lacked the authority to order the bank to sell the property even if the court were to find the property was deemed abandoned under Wis. Stat. § 846.102.

Carson appealed the court's ruling and the Court of Appeals reversed the Circuit Court's ruling. The Court of Appeals held that the language of the abandonment statute allowed the Circuit Court to make a finding of abandonment on a motion by an interested party other than the plaintiff (i.e. Ms. Carson, the mortgagor) and to require the bank to take the property to foreclosure sale.

The bank appealed the Court of Appeals' ruling to the Supreme Court of Wisconsin. The Wisconsin Supreme Court agreed with the Court of Appeals and ruled that Wisconsin courts do have that authority to order abandoned properties to sale, "based upon the statute's plain language and context we conclude that when the court determines that the property is abandoned, Wis. Stat. § 846.102 authorizes the circuit court to order a mortgagee to bring a mortgage property to sale after the redemption period."

Impact

(1) Borrowers Can Force A Sale on Abandoned Properties:

Under the Wisconsin Supreme Court's ruling, "Wisconsin Stat. § 846.102 *mandates that the court order a sale* of the mortgaged premises if certain conditions are met. *Those conditions do not depend on action by the mortgagee alone and are not dependent on its acquiescence or consent*" (emphasis added). As a consequence of this ruling, it is likely that certain borrowers and their counsel may see § 846.102 as a means to manipulate the equities to the detriment of lenders. Once a judgment is issued, a party with no likelihood of surplus may construe the above interpretation as an incentive to abandon care and seek to force the property to a quick foreclosure sale under the abandonment statute.

Perhaps of greater concern, given that the Court does allow for review of the circumstances surrounding abandonment, certain cities, most notably Milwaukee, have indicated that they intend to be very aggressive in seeking to exercise this new opportunity. However, if the city is not a party to the action, the city's lack of standing in the action may prevent it from advocating abandonment. But again, this impediment will be removed in cases where the city is named as a party (either due to municipal fines, holding of a junior mortgage, or junior judgment lien). This decision may increase costs for lenders and, presumably have a deterrent effect on lending.

(2) Defining Abandonment in Wisconsin:

Abandonment in Wisconsin is not the same as vacancy. A property that is vacant, but cared for is not necessarily an abandoned property. However, if a property is left uncared for, the conditions for abandonment logically follow and are closely linked to the characteristics of neglect that municipalities closely monitor and pursue penalties for reasons of public safety, crime, and health. Indicia of abandonment per Wis. Stat. § 846.102(2) include:

- (a) Boarded, closed, or damaged windows or doors to the premises.
- (b) Missing, unhinged, or continuously unlocked doors to the premises.
- (c) Terminated utility accounts for the premises.
- (d) Accumulation of trash or debris on the premises.
- (e) At least 2 reports to law enforcement officials of trespassing, vandalism, or other illegal acts being committed on the premises.
- (f) Conditions that make the premises unsafe or unsanitary or that make the premises in imminent danger of becoming unsafe or unsanitary.

It seems clear that failure to maintain property in condition that rises to a level of abandonment is unanimously viewed as a basis for at least allowing interested parties to seek a judicial order for “sale of his or her property or the conveyance of his or her property.” Probably the most clearly expressed message from the Wisconsin Supreme Court is that ineffective and untimely property preservation will have serious implications for the rights of a Plaintiff.

Had the servicer taken effective steps to remedy the city’s complaints and maintain the Carson property, it is likely that the property in *Carson* would *not* have been deemed abandoned (even had an action been brought) and, as such, Wis. Stat. 846.102 would not have applied. As a result, the bank would have had time to sell its interest, donate via quit claim, or place the property into REO.

In short, we see this ruling as warning servicers and investors that if one causes a property to be vacated through foreclosure proceedings (including pre-foreclosure), one must take positive action to ensure that that property does not become a source of burden, and must dispose of it in some form (and, in the interim, preserve it from draining the municipal purse until such time as legitimate options for disposal can be identified) or be forced to proceed to sale of the property post-judgment. Steps taken should include assurance or implementation of streamlined procedures for investors to provide servicers timely notice of complaints and orders to correct violations, in order for Servicer property preservation functions and legal counsel to be in a position to take early proactive action to minimize or prevent maintenance issues and municipality complaints.

(3) Potential for Both Short-Term and Continuing Impact:

Carson only applies where a judicial finding of abandonment has been entered, or the conditions that provide a potential basis for such a finding are allowed to develop. While the change only applies to vacant and ill cared-for properties, the factors for abandonment are such that vacancy, coupled with a cessation of maintenance, can be expected to rapidly provide a motivated borrower or municipality with a basis for intervention. As such, all properties potentially represent a possible future candidate for abandonment in on-going course of proceedings, until confirmation of sale is actually achieved.

A borrower can also apparently now force a servicer to inherit the liability for neglect or even, potentially, affirmative wastage of a property by the borrower during a period where the lender/servicer had no control over the property. In short, the lender loses not only the amount of the debt unrepaid, but also the cost of repair or other palliative action. Moreover, the impact is not limited to properties on which judgment has been already secured. Any property on which a motion for judgment in foreclosure has been filed will now be potentially subject to third-party assertions of abandonment, unless there is clear evidence that a borrower is affirmatively in possession or the property is adequately maintained.

(4) Abandoned Properties must be Promptly Sold:

“...The circuit court shall order the property to be brought to sale within a reasonable time after the redemption period. The circuit court’s determination of what constitutes a reasonable time should be based on the totality of the circumstances in each case.”

While the opinion did not specifically require that a lender bid on the property at sale, the court may have the power to order the lender to make repeated efforts to conduct sheriff’s sales of the property which can be a costly utilization of staff and out-of-pocket costs; and, the text of the opinion appears to envisage that

the servicer or lender will bid (and move for confirmation promptly thereafter depending on the circumstances of each case). We also note that it is currently unclear how courts will look upon servicer or lien ownership transfers of such properties once a motion for abandonment is filed, and particularly, after a sale timetable has been court ordered.

Conclusion

At this time, the implications of the new opinion have not been tested. Therefore all conclusions are, obviously, somewhat speculative. However, we believe that the Carson opinion is likely to prove significant for lenders and servicers of loans. The lack of certainty is over precisely how radical a change has been mandated.

Lenders and servicers of loans on property in major conurbations, notably Milwaukee, should expect particularly aggressive action by the municipality to address any properties that are currently vacant and subject to complaints and fines, and from borrowers or their counsel trying to force sale on abandoned properties. Accordingly, we recommend focus on ensuring that violation orders and complaints are notified to servicers and in turn to local counsel that address municipal violations as soon as possible, which is essential to minimizing the risk of abandonment.

We will continue to monitor both application and interpretation of the Carson opinion in the weeks and months ahead.

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If you have any questions about whether the information reviewed in this article may affect your financial institution, please contact Matthew Gerdisch (mgerdisch@kmksc.com) or Christopher Shattuck (cshattuck@kmksc.com) at (414) 962-5110.

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