UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

IN RE:

RICHARD H. HALL
MARYBETH HALL

CASE NO. 00-60886

Chapter 13

Debtors

RICHARD H. HALL
MARYBETH HALL

Plaintiffs

vs.

ADV. PRO. NO. 00-80157A

FIRST UNION HOME EQUITY BANK and
FLEET NATIONAL BANK, f/k/a FLEET
BANK OF NEW YORK

Defendants

APPEARANCES:

WAYNE R. BODOW, ESQ.
Attorney for Plaintiffs
1925 Park Street
Syracuse, New York 13208

RICHARD J. SPATARI, ESQ.
Attorney for Defendant Fleet National Bank
201 Second Street
Liverpool, New York 13088

BARTLETT, PONTIFF, STEWART & RHODES, P.C.
Attorneys for Defendant First Union Home Equity Bank
P.O. Box 2168
One Washington Street
Glens Falls, New York 12801-2168

EILEEN M. HAYNES, ESQ.
Of Counsel

Hon. Stephen D. Gerling, Chief U.S. Bankruptcy Judge

MEMORANDUM-DECISION, FINDINGS OF FACT,

CONCLUSIONS OF LAW AND ORDER AND RECOMMENDATIONS

This proceeding is before the Court upon the complaint of Richard Hall and Marybeth Hall ("Debtors" or "Plaintiffs"), filed on July 31, 2000. The Debtors filed an amended complaint on September 27, 2001. An answer was filed on October 30, 2001, by First Union Home Equity Bank ("First Union"), one of the defendants, along with a cross-claim against the other defendant, Fleet National Bank ("Fleet"). Fleet filed its answer on November 13, 2001, along with a cross-claim asserted against First Union. Both defendants request a determination concerning the priority of their mortgage liens on the Debtors' residence.

The trial of the adversary proceeding was conducted on March 7, 2002, in Utica, New York. On April 4, 2002, the Debtors filed a motion seeking to again amend their complaint to conform to the evidence presented at trial pursuant to Rule 15(b) of the Federal Rules of Civil Procedure, incorporated by reference in Rule 7015 of the Federal Rules of Bankruptcy Procedure. On July 8, 2002, the Court issued its Memorandum-Decision, Findings of Fact, Conclusions of Law and Order ("July 8 Decision"), as amended by an *Errata* issued on July 10, 2002, in which it denied the Debtors' motion to add certain causes of action but acknowledged the withdrawal of two of their causes of action. Accordingly, the Court required that the Debtors file and serve a second amended complaint within fifteen days of the date of the Order and file and serve any post-trial memoranda of law within forty-five days of the date of the Order. The Debtors filed their second amended complaint ("Second Conformed Complaint"[1]) on July 22, 2002. The

[1] Accompanying their motion of April 4, 2002, was the Debtors "first conformed complaint," which they requested the Court to consider as one "conforming to the evidence presented at trial."

matter was submitted for decision on August 22, 2002.

JURISDICTIONAL STATEMENT

The Court has core jurisdiction over the parties and subject matter of this adversary proceeding pursuant to 28 U.S.C. §§ 1334(b), 157(a), (b)(1) and (b)(2)(A), (K),(O), (b)(3) and (c)(1).

In this case, it is clear that the determination of the extent and priority of Fleet's and First Union's liens is critical to confirmation of the Debtors' plan. Section 157(b)(3) of Title 28 states that "[a] determination that a proceeding is not a core proceeding shall not be made solely on the basis that its resolution may be affected by State law." The Court concludes that it has "related to" jurisdiction to address Debtors' four causes of action arising prepetition under state law as their determination will not impact on the Debtors' efforts to restructure their relationship with Fleet and First Union but will simply result in an award of damages in the event that the Debtors are successful. *See Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 71 (1982) (noting that "[t]he restructuring of debtor-creditor relations, which is at the core of the federal bankruptcy power, must be distinguished from the adjudication of state-created private rights, such as the right to recover contract damages . . . ."). Pursuant to 28 U.S.C. § 157(c)(1), the Court may only "submit proposed findings of fact and conclusions of law to the district court and may not enter final orders and judgment" with respect to matters "related to" the bankruptcy case. Therefore, the Court will issue its recommendations with respect to the Debtors' four causes of action.

FACTS

The Court will assume familiarity with the facts as set forth in detail in the July 8 Decision.

DISCUSSION

The Court will address the four causes of action set forth in the Second Conformed Complaint in the order they are asserted therein.

First Cause of Action -

First Union's Alleged Breach of New York Real Property Actions and Proceedings Law ("NYRPAPL") § 1921

Debtors assert that First Union had a statutory duty to ensure that a satisfaction of mortgage was issued by Fleet and also had a statutory duty to protect the Debtors by applying for relief pursuant to NYRPAPL § 1921(2) in New York State Supreme Court. *See* ¶ 56 of the Second Conformed Complaint. The statute on which Debtors rely states that

> any person having an interest in the mortgage or the debt or obligation secured thereby or in the mortgaged premises **may** apply to the supreme court or a justice thereof . . . for an order to show cause why an order should not be made by such court canceling and discharging the mortgage of record . . . .

NYRPAPL § 1921(2) (McKinney's 1979 & Supp. 2002) (emphasis added). The statute does not in and of itself impose a duty on First Union to make such an application. The statute "was enacted to compensate homeowners for any economic damages they might suffer from a

mortgagee's dilatoriness in issuing a satisfaction of mortgage, rather than to punish the offending mortgagee" and is limited to a recovery of the greater of $500 or a homeowner's economic loss. *Glatter v. Chase Manhattan Bank*, 239 A.D.2d 68, 71-3, 669 N.Y.S.2d 651 (N.Y. App. Div. 1998).

If anything, the statute provided First Union with a mechanism for protecting its own lien with respect to the Debtors' residence. *See e.g. Merrill Lynch Equity Management, Inc. v. Kleinman*, 246 A.D.2d 884 (N.Y. App. Div. 1998). As a result of its failure to confirm the payoff of the Fleet debt and to obtain a satisfaction of mortgage pursuant to NYRPAPL § 1921, First Union's lien was arguably relegated to a position behind that of Fleet. Based on the facts presented, the Court concludes that First Union did not breach NYRAPL § 1921.[2]

Second Cause of Action -

> First Union's Alleged Breach of Fiduciary Duty and Negligence in Failing to Exercise Reasonable Care to establish Accord and Procure and File a Satisfaction of Mortgage on Behalf of the Plaintiffs.

The Court notes that "[t]he legal relationship between a borrower and a bank is a contractual one of debtor and creditor and does not create a fiduciary relationship between the bank and its borrower or its guarantors." *Bank Leumi Trust Co. of New York v. Block 3102 Corp.*, 180 A.D.2d 588, 589, 580 N.Y.S.2d 299, 301 (N.Y. App. Div. 1992). Thus, there can be

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[2] The Court should also point out that even if it had found that First Union had a duty pursuant to NYRPAPL § 1921, the Debtors would have been time barred from recovering under the statute. "Where a duty and hence liability for its breach, would not exist but for a statute, an action to recover upon such liability" is governed by a three year statute of limitations. *European American Bank v. Cain*, 79 A.D.2d 158, 164 (N.Y. App. Div. 1981). The activities of which the Debtors complain arose in early 1996, and their complaint was filed in July 2000.

no claim against First Union for breach of fiduciary duty.

Debtors' second cause of action is also pleaded as one for damages based on the alleged negligence of First Union in failing to fulfil its contractual duties and/or failing to comply with normal commercial practices and standards in the banking industry. Causes of action based on negligence are generally subject to a three year statute of limitations. However,

> in applying the Statute of Limitations the courts look for the reality and essence of the action, and not to its mere name (citation omitted). The rule is readily applied in actions in which it is sought to recover damages for the breach of an implied contractual duty to exercise due care under given circumstances (citation omitted). In such cases, the implied contractual duty and the common-law duty to exercise due care are one and the same, and the action is one to recover damages for an injury to property or a personal injury resulting from negligence, no matter what it may be called, and is barred by [the three year limitation] . . . An action to recover damages for the breach of an implied or quasi-contractual obligation is not barred by the three- year limitation, however, if the contractual obligation claimed to have been breached is not a common-law or statutory duty to refrain from committing one of the tortious acts contemplated by section 49 of the Civil Practice Act and is entirely independent thereof (citation omitted).

King v. King, 13 A.D.2d 437, 439 (N.Y. App. Div. 1961).

While the Debtors' cause of action based on allegations of negligence may be time-barred, the Court will examine the essence of the Debtors' arguments with respect to a possible breach of contract. In that regard, the Debtors refer to a contract of January 19, 1996. The Court finds no such contract in evidence. However, the Court does find the existence of an implied contract. Indeed, First Union acknowledges that it "agreed to loan money to the plaintiffs in exchange for a valid first lien on their property." *See* First Union's Answer to Amended Complaint and Cross-Claim, filed October 30, 2001 at ¶ 62. First Union also admitted that the

parties intended "that a portion of the mortgage proceeds from First Union would be used to pay off and close [Fleet's] credit line mortgage account and to obtain a discharge of said credit line mortgage to insure that First Union had a valid first mortgage lien upon on [sic] plaintiff's property." *See id.* at ¶ 63.

Under the parties' agreement, the Debtors obtained a loan in exchange for the promise that they would repay the loan with interest to First Union. The Debtors allege that having First Union obtain a valid first lien on their real property was intended to be for their benefit. For the priority of the lien to have had any benefit for the Debtors at the time they contracted with First Union for the loan, they would not only have to have had an intent to file bankruptcy eventually, but they also would have to have had the intent to seek future advances from Fleet with the intent of not repaying them and ultimately being able to cramdown any claim Fleet might have at the time they filed. Certainly, there was no evidence elicited at trial to suggest any such intent and such a fraudulent intent would, of course, have voided any contract between the parties. It is more reasonable to conclude that at the time the Debtors contracted with First Union for the loan, the promise of a first lien on the Debtors' residence was intended to provide a benefit to First Union in the form of security for the repayment of the loan by the Debtors.

However, the fact that the first lien was not intended to benefit the Debtors does not alter the fact that a contract did exist between First Union and the Debtors. In consideration for Debtors' promise to pay back the loan, First Union promised to pay off certain debts then owing by the Debtors. The Court concludes that First Union breached its contract with the Debtors to the extent that the account with Fleet was not paid in full as part of the closing on the First Union loan. As a result, the Debtors were required to pay an additional $82.51 to reduce their account

with Fleet to zero before Fleet's mortgage could be satisfied. In addition, the Debtors paid First Union $4,527.30 in settlement charges in consideration for, *inter alia*, paying off certain of their debts, including that owed to Fleet. S*ee* Defendants' Exhibit D. According to the testimony, the issuance of the check after the rescission period in the amount of $71,224.73 did not represent full payment of the debt to Fleet. Therefore, it is the Court's opinion that First Union did breach its agreement with the Debtors, and they are entitled to an award of damages in the amount of $82.51, along with the settlement charges of $4,527.30 incurred by the Debtors in connection with the closing.

Third Cause of Action -

Defendant Fleet's Alleged Breach of NYRPAPL § 1921

Plaintiffs assert that Fleet failed to comply with NYRPAPL § 1921(1), which states that

> [a]fter payment of authorized principal, interest and any other amounts due thereunder or otherwise owed by law has actually been made, and in the case of a credit line mortgage . . . on request, a mortgagee . . . must execute and acknowledge . . . a satisfaction of mortgage.

NYRPAPL § 1921(1) (McKinney's 1979 & Supp. 2002). Fleet acknowledges having received and cashed the check dated January 22, 1996, and written on the account of Granito and Sondej in the amount of $71,224.73, which was intended to payoff the Debtors' credit line account. However, according to Fleet's records, it never received a written request to close the account and to issue the satisfaction of mortgage. Whether or not Fleet received such a request following the closing in January 1996 is of no import given the other evidence elicited at the hearing. Specifically, the check in the amount of $71,224.73 was not sufficient to pay off the Debtors' account in full. While Mary Hendel ("Hendel"), an employee of the law firm of Granito &

Sondej who handled the mortgage closing for First Union, testified that she was given the figure by First Union, there was no evidence of the basis for that figure. There was no testimony or documentary evidence in the form of correspondence from Fleet stating what the amount necessary to pay off the Debtors' account was. James Spalone ("Spalone"), Manager of Consumer Loans for Fleet, testified that he found nothing in Fleet's records to indicate that there had been any request for a payoff amount from First Union.

Debtor Marybeth Hall ("M. Hall") testified that she received her regular monthly statement from Fleet shortly after the closing with First Union, indicating a balance due of $82.51. The statement reflected the receipt of the check in the amount of $71,224.73. However, nothing in the statement makes reference to the payment of $82.51 as being necessary to pay off and close the account. According to her testimony, she did not contact First Union or its attorneys to question the balance. After verifying with Fleet that there was a balance due on the account, she issued a check to Fleet in that amount but failed to request that the account be closed and that a discharge of mortgage be issued. Nevertheless, the Debtors contend that Fleet "never provided the requested satisfaction of mortgage." *See* Second Conformed Complaint at ¶ 92.

Based on the evidence presented, the delivery of the check in the amount of $71,224.73 did not constitute "payment" in full of the credit line mortgage and did not create any obligation on the part of Fleet to issue a satisfaction of mortgage, whether or not there was a written request accompanying that check. *See Marine Midland Bank v. Rome Polymer, Inc.,* 244 A.D.2d. 967, 968, 665 N.Y.S.2d 160 (N.Y. App. Div. 1997) (stating that "[a]bsent payment in full, a mortgagee has no obligation to release a mortgage lien against real property."); *Household Finance Realty Corp. v. Delmerico*, 202 A.D.2d 636, 637, 609 N.Y.S.2d 310 (N.Y. App. Div.

1994). Furthermore, "the mere reduction to zero of the outstanding balance of a credit line mortgage during the term of the mortgage does not constitute payment of the mortgage for the purposes of determining whether the mortgagee must execute a satisfaction upon request." *Barclay's Bank of New York N.A. v. Market Street Mortgage Corp.*, 187 A.D.2d 141, 144, 592 N.Y.S.2d 874, 876 (N.Y. App. Div. 1993); *see also Kleinman*, 246 A.D.2d at 885 (noting that "a credit line mortgage anticipates numerous advances, payments and readvances which may frequently bring the loan to a zero balance during the time that the credit line is outstanding).

In this case, the record indicates that a shortfall existed at the time M. Hall made her inquiry following the closing. Fleet was under no obligation under NYRPAPL § 1921(1) to issue a satisfaction of mortgage once the balance on the account was reduced to zero because no request was made by the Debtors at that time that the account be closed and that a satisfaction of mortgage be issued. *See Barclay's Bank*, 197 A.D.2d at 144.

Fourth Cause of Action -

> Fleet's Alleged Breach of Fiduciary Duty and Negligence by Failing to Exercise Reasonable Care in Providing an Accord and Satisfaction of Indebtedness by Receipt of Payment in Full by the Plaintiffs.

Debtors assert that "Fleet in having accepted the funds necessary to payoff the open end line of credit mortgage with the plaintiffs and having received specific instructions to in fact perform said function had both statutory duty under New York RPAPL and a fiduciary duty to perform as directed or provide a reason to the plaintiffs for not having done so." *See* ¶ 124 of the Second Conformed Complaint. Debtors argue Fleet was negligent in failing to issue the satisfaction of mortgage.

As noted previously, generally the relationship between a borrower and a bank does not create a fiduciary relationship. Thus, there can be no claim against Fleet for breach of fiduciary duty based on the facts as presented in this case.

Debtors allege that Fleet failed to exercise reasonable care in providing an accord and satisfaction of indebtedness by receipt of payment in full by them. It is the Debtors' position that in accepting the initial payment of $71,224.73 and "demanding" the additional payment of $82.51, Fleet failed to perform the steps which would have allowed the Debtors to "procure their accord and satisfaction . . . " thereby breaching "a duty to perform in a commercially responsible manner as reasonably relied on by the Plaintiffs." *See* ¶ 130 of the Second Conformed Complaint.[3]

As discussed above, Fleet had no statutory obligation to issue a satisfaction of mortgage with a balance still owing. At the time it received the payment of the balance of $82.51 on or about March 5, 1996, which brought the account to zero, there were no instructions that it close the account and issue a satisfaction of mortgage. Instead, approximately two months after sending the payment of $82.51, the Debtors again accessed the account, borrowing $34,000 from Fleet on or about May 7, 1996.

From the perspective of the cause of action being one based on breach of contract, the Court notes that under New York law, "the doctrine of accord and satisfaction allows contracting parties to make a new contract discharging all or part of their obligations under the original contract. Accord and satisfaction are accomplished by the promisor's tender of alternative

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[3] Any cause of action based on negligence would be time barred, more than three years having lapsed since the "demand."

performance in satisfaction of his original obligation and by the promisee's acceptance of such alternative performance." *In re Elsa Designs, Ltd.*, 155 B.R. 859, 868 (Bankr. S.D.N.Y. 1993); *see also Altamuro v. Capoccetta*, 212 A.D.2d 904, 622 N.Y.S.2d 155 (N.Y. App. Div. 1995) (stating that "[t]o have a valid accord and satisfaction, the parties must enter into new contract wherein they agree that stipulated performance will be accepted in the future, in lieu of existing claim.").

The Debtors contend that Fleet "had full knowledge of the purpose and intent of the Plaintiffs' refinancing of the existing open end line of credit mortgage as evidenced by their demand for additional funds to in fact provide the services requested." *See* ¶ 127 of the Second Conformed Complaint; *see also* ¶ 129 (stating that "defendant Fleet did in accepting initial payment and later demanding additional payment to complete the accord and satisfaction process assume the duty of completing said function." (emphasis added). However, there was no evidence that Fleet ever "demanded" additional funds in order to close out the account. According to M. Hall's testimony, Fleet sent its regular monthly statement and she was surprised when she received it that it showed a balance of $82.51 still owing. The Court does not construe the monthly statement as a "demand" by Fleet for additional funds in order to close out the Debtors' account. Furthermore, there is no evidence of a new contract between Fleet and the Debtors whereby Fleet agreed upon receipt of the $82.51 to execute a discharge of mortgage without a written request from the Debtors to do so as set forth in the original mortgage documents.

M. Hall continued to use the checks originally provided by Fleet after March 1996 when she believed the account had been closed. She acknowledged that the account number on the

statements received after the advances beginning in May 1996 was the same as the account number on the allegedly closed account, although she explained that initially she had simply turned the statements over to her daughter for payment without examining the account number or amount of credit available. The Court notes that these Debtors were not unfamiliar with the loan process, having executed line of credit agreements in both 1988 and 1992 with Fleet. They were well aware of the application process which was necessary, and M. Hall testified that neither she nor her husband executed any additional documents before obtaining the $34,000 advance in May 1996, as well as additional advances, including one for $21,000 in October 1997. The Court does not find it reasonable that Debtors would have thought that Fleet would advance them additional funds simply based on their prior payment history without requiring some form of security. At a minimum, ordinary prudence would dictate that Debtors seek clarification of the status of what they believed to be a new credit line account, despite the fact that the account number and amount of credit was the same as their prior account. This is particularly true given the fact that they continued to use the same checks to obtain further advances, which at the time they filed their chapter 13 petition in March of 2000 amounted to approximately $63,945, according to their schedules. Accordingly, Debtors' fourth cause of action must also fail.

Cross-Claims of First Union and Fleet

The Court unquestionably has core jurisdiction over the cross-claims of First Union and Fleet pursuant to 28 U.S.C. § 157(b)(2)(O). The determination of priority of First Union's and Fleet's liens will impact on the Debtors' ability to confirm their chapter 13 plan. If Fleet's claim of approximately $63,945.06 is found to be secured by a first lien on the Debtors' residence, then

pursuant to Code § 1322(b)(2), the Debtors will be unable to cramdown First Union's claim of approximately $92,220.81 based on the appraised value of $74,000. On the other hand, if the Court should determine that First Union's claim is secured by a first lien on the Debtors' residence, the Debtors will be able to cramdown Fleet's secured claim to zero, notwithstanding Code § 1322(b)(2), based on a lack of any equity in the real property to secure it. *See In re Pond,* 252 F.3d 122 (2d Cir. 2001).

In its earlier discussion in regard to the Debtors' first cause of action, the Court commented that First Union's lien was "arguably relegated to a position behind that of Fleet." First Union, citing to *Barclay's Bank*, 197 A.D.2d at 145, argues that it took the additional steps of requesting a payoff and making a demand for issuance of the satisfaction of mortgage. *See* First Union's Post Trial Brief, filed August 19, 2002, at 5. Therefore, it contends that Fleet was required to issue the satisfaction. However, based on the testimony and the evidence presented at trial, the request that the Debtors' account with Fleet be closed and a satisfaction issued, if received along with the check for $71,224.73, did not require Fleet's compliance as long as there was a balance owed on the account. First Union offered no proof, either in the form of testimony or correspondence, to support its assertion that the payoff figure was $71,224.73. Hendel testified that the figure had been given to her by First Union as part of the closing documents. According to the testimony of Spalone, there was nothing in the Debtors' file with Fleet to indicate that there had been a request for a payoff figure. Hendel testified that she made no further inquiry or follow-up with regard to the requested satisfaction of mortgage and apparently it was not the practice of Granito & Sondej to include a satisfaction or discharge of mortgage with the payoff check for execution by the entity whose mortgage was being satisfied. It appears

clear to the Court that First Union failed to protect its priority position by not making further inquiry when the satisfaction of mortgage was not received within a reasonable time. NYRPAPL § 1921 requires the issuance of a satisfaction of mortgage within forty-five days following full payment of the mortgage obligation. It appears reasonable that First Union, a check having been sent to Fleet on or about January 22, 1996, should have made further inquiry when no satisfaction of mortgage had been received by the end of March 1996.[4] Had it done so, it would have discovered that the Debtors had paid the account down to zero on or about March 5, 1996, but had not requested that the account be closed and a satisfaction of mortgage issued. Had First Union made such an inquiry and obtained a satisfaction of mortgage at that time, the Debtors presumably would not have been able to borrow monies from Fleet in May 1996 on the same account.

Having considered all the facts in this case, the Court concludes that Fleet holds a first mortgage on the Debtors' residence.

Based on the above, it is hereby

ORDERED that Fleet's cross-claim against First Union is granted based on the finding that Fleet has a first lien on the Debtors' residence, and it is further

ORDERED that First Union's cross-claim against Fleet is denied; it is further

RECOMMENDED to the United States District Court for the Northern District of New York that the Debtors' first cause of action against First Union pursuant to NYRPAPL § 1921

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[4] As noted in the Court's July 8th Decision, Hendel testified that she received a Discharge of Mortgage from Fleet, dated January 25, 1996, with respect to the prior credit line obtained by the Debtors in 1988, which allegedly had been closed by Fleet in February 1993 using the monies from the credit line obtained from Fleet in November 1992.

be dismissed; it is further

RECOMMENDED to the United States District Court for the Northern District of New York that the Debtors' second cause of action, insofar as it alleges breach of an implied contract, be granted and judgment against First Union in the amount of $4,609.81, plus interest of 5.0% per annum from January 16, 1996, at the postjudgment rate of 1.73% until paid be entered;[5] it is finally

RECOMMENDED to the United States District Court for the Northern District of New York that the Debtors' third and fourth causes of action against Fleet be dismissed.

Dated at Utica, New York

this 3rd day of October 2002

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STEPHEN D. GERLING
Chief U.S. Bankruptcy Judge

[5] 28 U.S.C. § 1961 was revised in December 2000 to provide that postjudgment Interest rates in the Federal Courts are based on U.S. Government Securities - Treasury Constant Maturities - 1 year. As of the end of the week of September 20, 2002, the rate was 1.73% per annum. The Court has discretion to award prejudgment interest. *See Northern, Inc. Employment Practices Litigation*, 810 F.2d 601 (7th Cir. 1986). Between January 4, 1996 and November 28, 2000, the Treasury Bill rates of interest varied from 4.24% to 6.375%. The Court concludes that a rate of 5.0% is a reasonable rate of interest for that period, particularly given the fact that the interest rate on the mortgage with First Union was at the rate of 7.99%.