| **Batavia Townhouses, LTD. v Council of Churches Hous. Dev. Fund Co., Inc.** |
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| 2019 NY Slip Op 34037(U) |
| August 16, 2019 |
| Supreme Court, Genesee County |
| Docket Number: E67594 |
| Judge: Timothy J. Walker |
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STATE OF NEW YORK
SUPREME COURT : COUNTY OF GENESEE

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BATAVIA TOWNHOUSES, LTD.,
ARLINGTON HOUSING CORPORATION, and
BATAVIA INVESTORS, LTD.,

Plaintiffs

v.

COUNCIL OF CHURCHES HOUSING
DEVELOPMENT FUND COMPANY, INC.,

Defendant.

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**COMMERCIAL DIVISION**
**DECISION AND ORDER**
Index No. E67594

BEFORE: **HON. TIMOTHY J. WALKER, Presiding Justice**

APPEARANCES: **HARTER SECREST & EMERY, LLP**
Jeffrey A. Wadsworth, Esq., Of Counsel
And
**HOLLAND & KNIGHT LLP**
Stephen D. Gordon, Esq., Of Counsel (*pro hac vice*)
Attorneys for Plaintiffs

**MCCONVILLE CONSIDINE COOMAN & MORAN, PC**
William E. Brueckner, Esq., Of Counsel
Attorneys for Defendants

**WALKER, J.**

The limited partners of Plaintiff, Batavia Townhouses, Ltd. (the "Partnership"), commenced this derivative action to establish that a note and its associated mortgage ("WrapAround Note and Mortgage") signed by the Partnership and held by the general partner of the Partnership, Defendant, Council of Churches Housing Development Fund Company, Inc. ("Council"), is unenforceable because the statute of limitations has expired. Plaintiffs seek to

cancel and discharge the WrapAround Note and Mortgage, together with associated declaratory and injunctive relief. The parties have filed competing applications for summary judgment pursuant to CPLR 3212, asserting there are no genuine issues of material fact to be resolved. For the following reasons, Defendant's application is denied, and Plaintiffs' cross-application is granted.

**BACKGROUND**

In 1971, Council borrowed more than $4.7 million from a private lender to develop Birchwood Village Apartments in Batavia, New York ("Birchwood Village"). The loan was insured by the U.S. Department of Housing and Urban Development ("HUD"). Council owned and managed Birchwood Village until 1979, but ultimately defaulted on the loan. At that point, the lender filed a claim under its FHA loan insurance policy and HUD paid off the lender, thereby acquiring the note and associated mortgage. Thereafter, Council continued to default on loan payments and HUD was about to foreclose (Affidavit of Lawrence F. Penn, sworn to July 16, 2019 ["Penn Aff."], ¶¶ 6-7).

At this juncture, Plaintiff, Batavia Investors, Ltd. ("Investors"), in conjunction with Council, proposed to HUD that the ownership of Birchwood Village be changed to bring in private investors. HUD approved this proposal, but required that a new owner replace Council as the entity managing Birchwood Village (*Id.*, at ¶ 9). Accordingly, the Partnership was established to acquire and operate Birchwood Village. The Partnership purchased Birchwood Village from Council in 1979 for $5,500,000, and executed the WrapAround Note and Mortgage in that amount in favor of Council (*Id.*, at Ex. B). The WrapAround Note and Mortgage were subordinate to, and "wrapped around," the separate HUD loan. Council remained the obligor on

the HUD loan which, after modification, amounted to $5,588,357.75 as of June 1, 1985 (*Id.*, at ¶¶ 10-12)

The Partnership Agreement provided that the Partnership would operate Birchwood Village "in such manner as will conform to all rules and regulations of [HUD], and insofar as is consistent therewith, will maximize the Federal, state and local income tax benefits available to the Partnership" (*Id.*, at Ex. A, § 2.4). It further provided that the limited partners would receive almost all of the tax benefits and a primary share of any Partnership profits and/or residual equity (*Id.*, at Ex. A, §§ 4.1, 4.2, 5.1, and 13.2).

Originally, the Partnership had two general partners, Council and David C. Green, and one limited partner, Investors. In 1982, Plaintiff, Arlington Housing Corporation ("Arlington") replaced Mr. Green as a general partner. In 2004, Arlington converted to a limited partner, leaving Council as the sole general partner (*Id.*, at ¶ 13).

Both the HUD mortgage loan and the WrapAround Note and Mortgage matured on March 1, 2012. Until that time, income generated by Birchwood Village was used by the Partnership to pay debt service on the WrapAround Note and Mortgage and, in turn, those funds were used by Council to pay monthly debt service on the HUD mortgage loan in the amount of $25,288.40. The HUD mortgage loan was paid off on schedule in February 2012, leaving the WrapAround Note and Mortgage as the sole encumbrance on Birchwood Village (*Id.*, at ¶¶ 14-15).

After March 1, 2012, Council stopped using the income generated by Birchwood Village to make any debt service payments on the WrapAround Note and Mortgage.

In August 2018, Arlington and Investors accused Council of violating its duties as the general partner by keeping the rents at Birchwood Village artificially low and preventing the Partnership from paying off the WrapAround Note and Mortgage, thereby siphoning the equity interest of Arlington and Investors to its own account. On November 19, 2018, Arlington and Investors moved to remove Council as general partner of the Partnership by sending a 30-day notice of removal to Council that would take effect on December 19, 2018. On December 17, 2018, Council filed suit in federal court - *Council of Churches Housing Development Fund Company, Inc. v. Arlington Housing Corporation* (No. 6:18-cv-06920 [W.D.N.Y.]), seeking to block its removal. Arlington and Investors then filed a counterclaim to enforce the removal of Council (*Id.*, at ¶¶ 31-33).

Although the WrapAround Note and Mortgage matured on March 1, 2012, Council has never commenced an action to foreclose on it (*Id.*, at ¶ 16). No payments on the WrapAround Note and Mortgage were made by the Partnership from March 1, 2012, when it matured, until March 6, 2019 (*Id.*, at ¶ 21). Council made no demand for payment from the Partnership at any time until February 7, 2019, when Council's Board of Directors adopted a resolution that Council, as holder, demand that the Partnership "resume monthly debt service payments of interest on the Note & Mortgage in the amount of $27,500.00 per month in accordance with paragraph 3 of the Note & Mortgage, commencing August 2018" (*Id.*, at ¶¶ 18-20 and Ex. C). Council, as general partner of the Partnership, has made such payments to Council as holder starting on March 6, 2019. To date, $330,000 has been paid by the Partnership to Council pursuant to this resolution (*Id.*, at ¶ 22). These payments have been made without the consent of the limited partners.

Pursuant to Sections 14.1 and 14.2 of the Partnership Agreement, the general partner is required each year to prepare a written financial statement for the Partnership and distribute it to the limited partners. Accordingly, annual written financial statements were prepared under the oversight of a certified public accounting firm and were provided to the limited partners and to the general partner(s), together with an auditor's report certifying that the financial statements fairly presented the financial position of the Partnership. These financial statements list the WrapAround Note and Mortgage as a liability of the Partnership.

Important here, the financial statements are not signed. The auditor's reports are signed by the accounting firm.[1]

## DISCUSSION

### A. The Statute of Limitations

An action to foreclose a mortgage is subject to a six-year statute of limitations[2] (CPLR 213[4]; *see also, 53 PL Realty, LLC v. U.S. Bank Nat. Ass'n.*, 153 AD3d 894, 895 [2d Dept. 2017]). "It is well established that the six-year period begins to run when the lender first has the right to foreclose on the mortgage, that is, the day after the maturity date of the underlying debt ..." (*CDR Creances S.A. v. Euro-American Lodging Corp.*, 43 AD3d 45, 51 [1st Dept. 2007]). Here, the six-year limitations period began to run on March 2, 2012, and expired on March 2, 2018.

Under New York law, a debt barred by the statute of limitations is legally unenforceable (*Mintz v. Greenberg*, 5 AD2d 774 [2d Dept. 1958]); *Spas v. Wharton*, 106 Misc2d 180, 184 (Sup

[1] The Partnership's financial statements for 2012-2018 are Exhibits D-I to the affidavit of Joseph Flynn submitted in support of Defendant's motion for summary judgment.

[2] The enforceability of the WrapAround Note and Mortgage is governed by New York law, because it was executed in New York and involves real property located in New York.

Ct, Albany Cty 1980]). A mortgage barred by the statute of limitations can be cancelled and discharged (RPAPL §1501[4]). Plaintiffs have made "a *prima facie* showing of [their] entitlement to judgment as a matter of law by establishing that the subject mortgage is unenforceable since ... the six-year limitations period for the commencement of an action to foreclose the mortgage expired, causing the commencement of a new foreclosure action to be time-barred" (*Deutsche Bank National Trust Co. v. Lee*, 60 Misc3d 171, 175 (Sup Ct, Westchester Cty 2018]); *see also Defelice v. Frew*, 166 AD3d 725, 725-26 [2d Dept. 2018]).

**B. Tolling and Revival**

The applicable statute of limitations has expired. Thus, the burden shifted to Council to show that the limitations period has either been tolled or revived (*JBR Const. Corp. v. Staples*, 71 AD3d 952, 953 [2d Dept. 2010]); *Persaud v. U.S. Bank National*, 62 Misc3d 193, 195 (Sup Ct, Queens Cty 2018]). Council contends that the WrapAround Note and Mortgage remains enforceable because, during the period since March 1, 2012, the Partnership continued to include the debt in its annual financial statements and made partial payments of the debt. These facts are insufficient to toll or revive the statute of limitations.

**1. The Annual Financial Statements**

**a. GOL § 17-105**

Because the WrapAround Note and Mortgage is a mortgage of real property, the issue whether it has been tolled or revived is **not** governed by GOL §17-101, as Council asserts. Section 17-101, by its explicit terms, is inapplicable to actions for the recovery of real property:

> An acknowledgment or promise contained in a writing signed by the party to be charged thereby is the only competent evidence of a new or continuing contract whereby to take an action out of the

> operation of the provisions of limitations of time for commencing actions **other than an action for the recovery of real property**. This section does not alter the effect of a payment of principal or interest (emphasis added).

(*See, Goldrick v. Goldrick*, 99 Misc2d 749, 755 (Sup Ct, Suffolk Cty 1979] [recognizing that GOL §17-101 does not apply to mortgage debts]).

Instead, GOL §17-105 applies, which provides that,

> [a] waiver of the expiration of the time limited for commencement of an action to foreclose a mortgage of real property … or **a promise to pay the mortgage debt**, if made after the accrual of a right of action to foreclose the mortgage and made, either with or without consideration, **by the express terms of a writing signed by the party to be charged is effective**, subject to any conditions expressed in the writing, to make the time limited for commencement of the action run from the date of the waiver or promise" (emphasis added).

(*See also*, Bergman, *New York Mortgage Foreclosures* § 5.11[7] ["[A] cursory look at General Obligations Law sections 17-101 and 17-103 might lead one to the erroneous conclusion that they are applicable to mortgage foreclosure; in fact, it is the provisions of GOL section 17-105 that are controlling"]).

The terms of §17-105 are narrower than §17-101 because they provide that only a "promise to pay the mortgage debt" (as opposed to "an acknowledgment or promise") can revive the debt. This distinction is significant. "At common law, an acknowledgment or promise to perform a previously defaulted contract obligation was effectual, whether oral or in writing, at least in certain types of cases, to start the statute of limitations running anew" (*Scheur v. Scheur*, 308 NY 447, 450-51 [1955]). Although an acknowledgment of a debt is not a promise to repay it, the acknowledgment provides a basis from which the common law would imply such a

promise. "A review of the cases, on the question of what is necessary to revive a debt barred by the statute of limitations, will clearly show that a bare or mere acknowledgment of the existence of the debt is sufficient, as the law will imply or infer from its existence a promise to pay it ..." (*Henry v. Root*, 33 NY 526, 530 [1865]). "A mere acknowledgment of an indebtedness, is but evidence from which a promise to pay may be inferred" (*Bloodgood v. Bruen*, 8 NY 362, 368 [1853]). "If the admission is unequivocal and unconditional, 'the law will imply a promise to pay from a bare acknowledgment'" (31 *Williston on Contracts* § 79:77 [4th ed]).

Against this background, the legislature provided in GOL §17-101 that a written "acknowledgment or promise" is sufficient to revive most contracts and debts, but adopted a different standard with respect to reviving debts involving real property. For the latter category, it provided that only "a promise to pay the mortgage debt ... made ... by the express terms of a writing signed by the party to be charged is effective" (GOL §17-105). A court is "bound, of course, in interpreting a statute, to construe it in view of other statutes relating to the same subject-matter, in accordance with the sense of its terms and the intention of the framers of the law" (*Town of Putnam Valley v. Slutzky*, 283 NY 334, 343 [1940]). "A court cannot by implication supply in a statute a provision which it is reasonable to suppose the Legislature intended intentionally to omit; and the failure of the Legislature to include a matter within the scope of an act may be construed as an indication that its exclusion was intended" (Statutes §74; *see also*, *Kucher v. DaimlerChrysler Corp.*, 9 Misc3d 45, 50 [Sup Ct, App Term 2005]). Thus, the omission of an "acknowledgment" as a means of tolling or reviving a mortgage debt must be construed as a deliberate policy choice by the legislature; only a written promise to pay the debt will suffice.

**b. The Financial Statements Do Not Satisfy GOL §17-105**

In the instant matter, there is no writing by the Partnership during the six-year period from March 2, 2012 until March 2, 2018, that promises to pay the WrapAround Note and Mortgage, as required by GOL §17-105. The annual financial statements merely list the WrapAround Note and Mortgage as a liability; this does not constitute a promise to pay the debt. Therefore, the limitations period was not tolled by the financial statements and it expired on March 2, 2018.

**c. The Financial Statements Do Not Constitute an Acknowledgment of the Debt**

Furthermore, the financial statements are insufficient, for several reasons, to constitute even an "acknowledgment" of the debt. First, they do not qualify as an acknowledgment because they were not signed by the Partnership (*See, Shelley v. Dixon Equities*, 300 AD2d 566, 567 [2d Dept 2002] [financial records prepared by accountant, and not certified or signed by a principal of the debtor, were not an acknowledgment]); *20 Plaza Housing Corp. v. 20 Plaza East Realty*, 37 Misc3d 601 [NY Cty 2012] [inclusion of debt on annual reports not sufficient to revive claim because not signed by defendant]).

Second, "any purported acknowledgment must import 'a clear intention to pay'" (*Gizzi v. Gizzi*, 57 Misc3d 1217(A), 2017 WL 5244810, at *2 [Monroe Cty 2017]). Thus, "[t]he mere fact that the debt was carried on the defendants' books and tax returns would not, in and of itself, constitute the required acknowledgment" (*Skiadas v. Terovolas*, 271 AD2d 521 [2d Dept. 2000]); *accord Estate of Vengroski v. Garden Inn,* 114 AD2d 927, 928 [2d Dept. 1985] [the mere fact that the debt was carried on defendant's books and tax returns would not in and of itself constitute the required acknowledgment; critical determination is whether the acknowledgment

imports an intention to pay]; *Curtiss-Wright Corp. v. Intercontinent Corp.*, 277 AD 13, 18 [1st Dept 1950] [Van Voorhis, J., concurring] ["Merely carrying an account payable to plaintiff on defendant's books, would not constitute an acknowledgment or promise"]. "In general, [New York] courts have concluded that financial statements and tax returns *alone* are insufficient to restart the statute of limitations" (*Moore v. Candlewood Holdings, Inc.*, 714 FSupp2d 406, 410 [EDNY 2010] (emphasis in the original).

Council's contention that "courts have universally accepted that a debtor's financial statements … will serve as an acknowledgment that revives a debt under the statute" (Def's. Memo., at 12) is misplaced. Council relies on *Chase Manhattan Bank v. Polimeni* (258 AD2d 361 [1st Dept 1999]), which held that the defendant's personal financial statement, which carried his debts to plaintiff, constituted an acknowledgment where the defendant authorized his secretary to sign a transmittal letter covering the financial statement and to send those documents to plaintiff. It was the debtor's formal transmission of the financial statement to the creditor, not the statement by itself, that constituted the acknowledgment.

Council also relies on *In re Meyrowitz' Estate* (114 NYS2d 541 [NY Cty Surr Ct 1952]), which held that the inclusion of debts owed by the deceased president to a corporation in the corporate balance sheets constituted an acknowledgment by the president where he was also the controlling stockholder and the other directors were corporate employees under his supervision and control. After reviewing these unusual facts, the court reasoned that, "[i]n the manner in which this corporation conducted its affairs, there was no occasion for the debtor to acknowledge the continued existence of the debt and to reiterate his promises to pay, except in the annual balance sheets" (*Id.* at 547). The facts here present the opposite situation.

The final case, *Clarkson Co. Ltd. v. Shaheen* (533 FSupp 905, 932 [SDNY 1982]), asserts without further analysis that "[the defendant's] acknowledgment of its 'longstanding' obligation to SNR in its 1980 annual report ... and the fact that the debt was carried on [the defendant's] books from at least 1978 through 1980 ... is a clear recognition of the continuing validity of the obligation." This cryptic language has since been construed as holding that "an acknowledgment of a debt to a third party will be effective to revive the limitation period if it appears that the debtor's intention was to communicate the acknowledgment to the creditor" (*In re Brill*, 318 BR 49, 59 [Bankr SDNY 2004]. In any event, to the extent this federal decision concludes that merely carrying a debt on a debtor's books constitutes an acknowledgment, this Court does not follow it, because it is at odds with prior and subsequent New York appellate decisions.

Additionally, the financial statements were not communicated to the debt-holder, much less with an intent to influence the debt-holder's conduct (*See, Lynford v. Williams*, 34 AD3d 761, 763 [2d Dept. 2006]). Here, the financial statements were prepared as required by the Partnership Agreement for distribution to the limited partners. Council, **as the general partner**, arranged for their preparation and received a copy of the statements. This is not the equivalent of a "communication" to Council **as the debt-holder**, nor were they intended to influence Council's conduct as the debt-holder. Council could have protected its interest as debt-holder, either by foreclosing on the WrapAround Note and Mortgage, or by causing the Partnership to explicitly reaffirm the debt. Council owed a fiduciary duty to the limited partners, and it was incumbent on Council to have the Partnership reaffirm the debt openly and formally, with full disclosure (*See, Tucker Anthony Realty Corp. v. Schlesinger*, 888 F2d 969, 973-74 [2d Cir 1989] [general partner who engages in self-interested transaction must establish its fairness by taking steps such as arm's

length negotiations, competitive bidding, or limited partner review and approval]). Having failed to do so, Council cannot now claim that the Partnership implicitly acknowledged the debt to it, as debt-holder, simply by continuing to list the WrapAround Note and Mortgage on internal financial statements.

**2. The Payments in 2019 Did Not Revive the Limitations Period**

The WrapAround Note and Mortgage became unenforceable on March 3, 2018, because Council did not commence a foreclosure proceeding during the limitations period. Council's actions to re-commence payments a year later -- in the midst of litigation over whether it should be removed as general partner -- constitutes a breach of its fiduciary duty as general partner of the Partnership (*See, Szelega v. O'Hara*, 159 AD2d 890, 891 [3d Dept 1990] [officer and majority shareholder of small corporation breached her fiduciary duty to the corporation by causing it to repay time-barred debts to her]).[3] As such, the 2019 payments are invalid and must be set aside, and the funds restored to the Partnership (*See, May v. Flowers*, 106 AD2d 873, 874-75 [4th Dept 1984] [where a general partner breaches its fiduciary duty to limited partners, the transaction is invalid and should be set aside]); *Marston v. Gould*, 69 NY 220, 225 [1877] ["Courts of equity hold each partner responsible to the other for all losses sustained by the misconduct [breach of trust] or a misapplication of the partnership funds"]); *In re Grotzinger*, 81 AD2d 268, 281 [1st Dept. 1981] ["limited partners are *cestui que trusts* and 'no injury ... [they] may sustain by a

[3] The Partnership Agreement is governed by D.C. law but this does not alter the analysis. Under D.C. law, "partners owe each other the duty of 'the utmost good faith in all that pertains to their relationship,'" especially "in the case of managing general partners in a limited partnership, on whose good faith the other partners depend entirely" (*Washington Med. Cntr., Inc. v. Holle*, 573 A2d 1269, 1285 & n. 26 [DC 1990]) (citation omitted). "Good faith will not permit any one partner to advantage himself singly and alone, at the expense of the firm" (*Marmac Inv. Co., Inc. v. Wolpe*, 759 A2d 620, 626 [DC 2000]). Further, D.C. law has long held that a lender should not be permitted "to benefit from any breach of trust by one of its own officers or agents in respect of the borrower" (*Sheridan v. Perpetual Bldg. Ass'n*, 299 F2d 463, 465 [DC Cir 1962] [*en banc*].

fraudulent breach of trust, can, upon the general principles of equity, be suffered to pass without remedy'").[4]

The WrapAround Note and Mortgage matured on March 1, 2012. During the next six years, no payment was made on the Note, no demand for payment was made by Council, and Council did not commence a foreclosure action. The Partnership took no action during this period that would toll or extend the limitations period. Accordingly, the statute of limitations expired and the WrapAround Note and Mortgage became unenforceable on March 3, 2018.

In light of the foregoing, it is hereby

**ORDERED**, that Council's motion for summary judgment is denied; and it is further

**ORDERED**, that Plaintiffs' cross-motion to cancel and discharge the WrapAround Note and Mortgage, and for an order requiring Council to restore to the Partnership all mortgage loan payments that it has collected pursuant to the February 7, 2019 resolution, is granted; and it is further

**ORDERED**, that Council's actions, subsequent to the expiration of the statute of limitations on March 3, 2018, to re-commence payments on the WrapAround Note and Mortgage (starting in February 2019) are invalid and are hereby set aside.

[4] "[T]he law that governs remedies is the law of the forum" (*Meacham v. Jamestown, F. & C.R. Co.*, 211 NY 346, 352 [1914] [Cardozo, J., concurring]).

This constitutes the Decision and Order of this Court. Submission of an order by the parties is not necessary. The delivery of a copy of this Decision and Order by this Court shall not constitute notice of entry.

Dated: August 16, 2019
Buffalo, New York

**HON. TIMOTHY J. WALKER, J.C.C.**
Acting Supreme Court Justice