Do I have to file a claim to foreclose on a deceased borrower’s mortgage?

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McGlinchey’s Commercial Law Bulletin is a biweekly update of recent, unique, and impactful cases in state and federal courts in the area of commercial litigation.

Ohio

Insurance coverage for data breach

***Emoi Servs., LLC v. Owners Ins. Co.*, 2d Dist. Montgomery No. 29128, 2021-Ohio-3942**
In this appeal, the Second Appellate District reversed and remanded the trial court’s decision, finding that the plaintiff’s software and data were damaged in the ransomware attack, that said damage was not merely loss of access or use, and that the claim may be covered by the insurance policy’s endorsement.

The Bullet Point: At issue in this dispute between a medical billing company and its insurance company was whether the subject insurance policy covered damage to software and data following a ransomware attack. In this case, the plaintiff’s proprietary software used by its customers was hacked and the files were encrypted. Ultimately, the plaintiff paid the hacker a ransom and after running and re-running a decryption program, the files were decrypted. The plaintiff submitted a claim to its insurance company, which summarily concluded there was no coverage under any of the provisions of the insurance policy, including the Data Compromise endorsement and the Electronic Equipment endorsement. The plaintiff filed suit and the insurance company moved for summary judgment, arguing that no direct physical loss or damage had occurred as required by the Electronic Equipment endorsement. The insurance company further argued that the Data Compromise endorsement did not extend to the type of loss incurred by the plaintiff, as it did not involve “affected persons” or “personally identifying information.” The trial court granted the insurance company’s motion, and the plaintiff appealed, disputing the conclusion that its software was not damaged and asserting that said damage was covered under the Electronic Equipment endorsement. The plaintiff indicated that it was “not seeking merely to recover for lost data,” which it acknowledged was not covered by the policy. Rather, the plaintiff argued it was seeking coverage for “the damage to the media, not the information or data contained on the media.” The plaintiff explained that the software, a computer program, “was damaged by a computer hacker who manipulated the computer software program, encrypting the program to prevent [the plaintiff’s] use of the software and access to the data…Thus, the computer software was damaged.” In response, the insurance company argued the policy required direct physical loss or damage, and because the plaintiff's software was intangible, it was not covered by the Electronic Equipment endorsement. Further, the insurance company claimed the plaintiff misconstrued the definition of "media," emphasizing that the endorsement contemplates tangible items that are subject to physical damage.

On appeal, the court first looked to the plain language of the endorsement's definitions. Giving the language of the provision's plain and ordinary meaning, the court found that the plaintiff's servers constituted materials on which the plaintiff's information was recorded and thus arguably met the policy's definition of media. The court then analyzed the testimony of the plaintiff's expert and determined the evidence demonstrated that the plaintiff's software was, in fact, damaged by the malicious encryption. The expert testified that the hacker encrypted all of the digital information, which is "basically what runs the whole software – * * * the system." Moreover, portions of the software remained damaged even after decryption. The court also rejected the insurance company's contentions that the plaintiff's system was not physically damaged because once the decryption program was run, the files opened and operated as intended. In reaching this decision, the court noted that there was little evidence in the record regarding the technicalities of how encryption and decryption occur, and the effects on the item being encrypted. Nevertheless, the plaintiff's expert's testimony supported the conclusion that the encryption damaged the software and data, and that the damage was not just aesthetic or amounting to mere loss of access or use. Further, even after the decryption key was obtained, the software was still damaged as it became encrypted again. Moreover, the plaintiff suffered several other problems running software even after decryption. Therefore, as the court found that the policy language contemplated that the plaintiff's software and reproduction of data were capable of being physically damaged, and the evidence demonstrated that such damage occurred, summary judgment was improper as genuine issues of material fact existed as to whether the claim was covered by the Electronic Equipment endorsement.

Foreclosure of mortgage is not a claim against a decedent's estate

***Bankers Guar. Title & Trust Co. v. Moyer*, 11th Dist. Lake No. 2021-L-029, 2021-Ohio-4058**
In this appeal, the Eleventh Appellate District affirmed the trial court's decision, agreeing that the mortgagee could foreclose on a residential mortgage even though its claim against the deceased borrower's estate for default on the promissory note was barred under R.C. 2117.12.

The Bullet Point: Pursuant to R.C. 2117.12, when a claim against an estate is rejected, the claimant must commence an action on its claim within two months after said rejection or be forever barred from maintaining an action on the rejected claim. In this matter, the mortgagee presented its claim on a defaulted note against the deceased borrower's estate. The estate rejected the claim, but the mortgagee did not commence an action on the defaulted note within the two-month timeline under R.C. 2117.12. Subsequently, the probate court issued a judgment entry that the mortgagee's claim consisting of a securitized promissory note and its mortgage was "barred as a claim against the estate pursuant to Chapter 2117 of the Ohio Revised Code." Thereafter, the mortgagee filed the instant foreclosure complaint, alleging it was the holder of a promissory note secured by a mortgage that was in default. In defense of the foreclosure, the administrator of the estate argued that the mortgagee was barred from bringing an action on both the note and mortgage by operation of R.C. 2117.12. As there was no dispute the note was in default, the trial court granted summary judgment in favor of the mortgagee. On appeal, the administrator contended the mortgagee was not entitled to foreclosure on the mortgage because the note was barred as a debt against the decedent's estate and heirs by judgment of the probate court. Specifically, the administrator argued that because the mortgagee was barred from asserting its claim against the estate under R.C. 2117.12, it could not establish the note was in default and thus could not properly support its motion for summary judgment in the foreclosure action. This argument was summarily rejected, as R.C. 2117.12 does not support the position that failure to commence an action within two months of a claim's rejection by the estate precludes the possibility of the note being in default. On the contrary, if the note were not in default, there would be no claim against the estate to be barred. As the appellate court explained, there are several options available for collecting a debt when an estate defaults on the repayment of a loan: "First, the mortgagee may seek a personal judgment against the mortgagor to recover the amount due on the promissory note, without resort to the mortgaged property. * * * Second, the mortgagee may bring an action to enforce the mortgage, which 'is for the exclusive benefit of the mortgagee and those claiming under him.' * * * Third, based on the property interest created by the mortgagor's default on the mortgage, the mortgagee may bring a foreclosure action to cut off the mortgagor's right of redemption, determine the existence and extent of the mortgage lien, and have the mortgaged property sold for its satisfaction." These are separate and distinct remedies which may be pursued concurrently, as an action for a personal judgment on a promissory note and an action to enforce mortgage covenants are "separate and distinct" remedies. Based on the distinction between these causes of action—i.e., one is an action on a contract, while the other is an action to enforce a property interest created by the mortgage—Ohio courts have long held that "the bar of the note or other instrument secured by mortgage does not necessarily bar an action on the mortgage." Further, an action to foreclose may be maintained even when the note itself has become unenforceable, such as is the case where the obligation to pay the note is no longer enforceable if discharged in bankruptcy or where a note's statute of limitations has run. Similarly, while the note in the instant case was unenforceable against the estate despite being in default, the foreclosure action was not a claim against the estate and was not barred by operation of R.C. 2117.12.

Florida

Challenge to Foreclosure Sale Based on Right of Redemption

***2275 NE 120 Street, LLC v. Sanchez Struve Business Advisors, LLC*, No. 3D20-1277 (Fla. 3d DCA Nov. 10, 2021)**
A mortgagor challenged a foreclosure sale based on the fact that the trial court failed to reduce the amount of indebtedness in the final judgment by the net funds derived from prior successful foreclosure sales, which prevented it from exercising its right of redemption. The Third District Court of Appeals found no error with the trial court's ruling denying the mortgagor's motion to vacate the foreclosure sale because it was untimely under Florida's redemption statute.

The Bullet Point: In Florida, the right of redemption is codified within Fla. Stat. § 45.0315. The statute permits the mortgagor or the holder of any subordinate interest to cure the mortgagor's indebtedness and prevent a foreclosure sale by paying the amount specified in a final judgment of foreclosure. This may happen any time before the later of two events: the filing of a certificate of sale by the clerk of the court, or the time specified in the judgment, order, or decree of foreclosure. The Florida Supreme Court has determined that a sale can be prevented even after the auction of the property; however, the right of redemption expires when the clerk files the certificate of sale.

Here, the mortgagor filed an unverified motion to vacate the sale four months after the certificate of sale was filed by the clerk. The motion did not allege that it was hindered in its ability to satisfy the indebtedness. Rather, it asserted in a conclusory matter that its "redemption rights [were] inappropriately and negatively impacted by improper calculations" and the mortgagee "was given an unfair advantage of being able to credit its bid judgment for an amount higher than what was actually owed." The mortgagor had ample opportunity over the span of two years to tender payment and did not do so, and it further failed to timely object to the procedure of the sale. Given these circumstances, the Third District concluded that the trial court acted within its discretion in denying the motion to vacate the foreclosure sale and ordering the clerk to issue the certificate of title.

Rule of Comity

***Roche v. Cyrulnik*, Case No. 3D21-1741 (Fla. 3d DCA Nov. 10 2021)**

Extraordinary circumstances are required to avoid the general rule of comity that a subsequently filed state court action should defer to a previously filed federal court action.

The Bullet Point: The parties had signed a memorandum of understanding to form a law firm. In the ensuing months, the working relationship between the parties deteriorated, resulting in the defendant law firm's filing of a declaratory action in federal court. The plaintiff subsequently filed this matter in state court against the defendant wherein each of the claims asserted arose from the nucleus of facts upon which the declaratory action was premised. The trial court denied the defendant's motion to stay the state court action, which was appealed by the defendant.

Generally, when a state lawsuit is filed that involves the same nucleus of facts as a previously filed federal lawsuit, principles of comity and the desire to avoid inconsistent results require the stay of the subsequently-filed state action until the prior-filed federal action has been adjudicated. Courts have recognized an exception to this rule when the party opposing the stay has made a showing of extraordinary circumstances. While Florida decisional law provides little guidance on what constitutes "extraordinary circumstances," the Florida Supreme Court has stated that there may be circumstances in which the denial of a stay could be justified upon a showing of prospects for undue delay in the disposition of the prior action.

While the trial court made the express (although conclusory) finding that the litigation in the federal court will cause undue delay of the state action if stayed, that determination was made without any evidentiary basis in the record. The only suggestion that there would be any delay was the mere supposition of the plaintiff's counsel at the motion for stay hearing; however, such supposition alone constitutes an insufficient showing. There being no showing of extraordinary circumstances on this or any other basis in the lower proceeding, the Third District concluded that, based on the record, the "extraordinary circumstances" exception was inapplicable, and the trial court should have granted the petitioners' motion to stay.

Easements

***Crescent Shore Condo. Ass'n v. Lani Kai, L.P.*, No. 2D21-234 (Fla. 2d DCA Nov. 10, 2021)**

Because the condominium association's 2018 claim against the owner of an adjacent property for failing to adhere to an easement agreement was based on a separate, new violation of the easement agreement than its 2000 claim, the 2018 claim was not barred by res judicata.

The Bullet Point: Florida's doctrine of res judicata bars a subsequent lawsuit when there is: (1) identity of the thing sued for; (2) identity of the cause of action; (3) identity of the parties; and (4) identity of the quality in the person for or against whom the claim is made. This rule also bars relitigation in a subsequent cause of action not only of claims raised, but also claims that could have been raised.

In this case, the parties had signed an easement agreement in 1979. In 2000, the plaintiff filed a lawsuit against the defendant alleging that the defendant was storing trash bins and dumpsters on the easement property, causing rodents and unpleasant odors to infiltrate the plaintiff's property. The parties settled that matter and the 2000 lawsuit was dismissed with prejudice. In 2018, the plaintiff again filed lawsuit against the defendant for failing to adhere to the terms of the easement agreement. The complaint filed in the 2018 action did not reference any improper storage of trash bins or dumpsters on the easement. The defendant filed a motion for summary judgment alleging that the matter was litigated 18 years prior, which resulted in a dismissal with prejudice and therefore the plaintiff was estopped from its 2018 lawsuit. The plaintiff's response was that the 2018 violations constituted new violations of the 1979 easement agreement. Following a hearing, the trial court granted summary judgment in the defendant's favor; however, the trial court's order did not contain specific findings or reference any specific terms of the settlement agreement.

The trial court's decision was reversed on appeal because although three of the four elements required for res judicata were present, one element (identity of the cause of action) was missing. Likewise, there was also an entirely different time period at issue between the 2000 and 2018 complaints. The doctrine of res judicata is not applicable where the claims in the two cases concern two different time periods. The order granting summary judgment in favor of the defendant was therefore inappropriate.

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