

2012

## Losing the Paper - Mortgage Assignments, Note Transfers and Consumer Protection

Alan M. White

*Professor of Law Valparaiso Law School*

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### Recommended Citation

Alan M. White *Losing the Paper - Mortgage Assignments, Note Transfers and Consumer Protection*, 24 Loy. Consumer L. Rev. 468 (2012).  
Available at: <http://lawcommons.luc.edu/lclr/vol24/iss4/3>

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# LOSING THE PAPER – MORTGAGE ASSIGNMENTS, NOTE TRANSFERS AND CONSUMER PROTECTION

*Alan M. White* \*

## ABSTRACT

In this article, I survey the state of the mortgage loan transfer system, the legal rules that govern it, and the widening gap between those rules and the practices in the secondary mortgage market just prior to the 2008 crisis. The review includes some empirical assessment of the extent of errors and execution problems; the damage done by “robo-signing;” the Mortgage Electronic Registration System (“MERS”) and note delivery practices; and the extent to which courts will prevent or reverse foreclosure sales based on those errors and problems. I then examine why existing legal structures, for both paper-based and electronic transfers, are not working, and the extent to which they have failed, I also identify the key consumer and investor protection values and interests (finality, transparency, fraud protection, and so forth) that must be addressed by the law governing secondary market transfers of home loans. I conclude by outlining options for reforming the mortgage loan transfer system, including the use of a single document merging the note and mortgage, and a structure for the registration of a single authoritative electronic version of the mortgage/note and of all changes in parties to, and terms of, the transaction.

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\* Professor of Law, Valparaiso Law School. Special thanks to Whitney Dickison, Christopher Erickson and Anne Zygaldó for their invaluable assistance with the MERS foreclosure record survey and with additional legal research.

## INTRODUCTION

Five years into the subprime mortgage crisis,<sup>1</sup> the foreclosure machinery has slowed to a crawl.<sup>2</sup> Historically high levels of mortgage defaults continue to overwhelm the foreclosure system.<sup>3</sup> At the same time, 2010 and 2011 saw a second wave of the foreclosure crisis, brought on in part by relatively obscure legal rules that govern the transfer of mortgage loans from one lender to another and the shortcuts to circumvent those rules. Those shortcuts have come to be known as the “robo-signing” scandal.<sup>4</sup> Robo-signing describes

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<sup>1</sup> Also termed the global financial crisis (“GFC”), or the Great Recession, the financial collapse of 2008 was precipitated by rapidly escalating defaults and foreclosures on subprime mortgage loans in the United States, and by the resulting losses experienced by investors in those mortgages and mortgage-backed securities. See generally KATHLEEN C. ENGEL & PATRICIA A. MCCOY, *THE SUBPRIME VIRUS: RECKLESS CREDIT, REGULATORY FAILURE, AND NEXT STEPS* (2011) (delving into the history and causes of the global financial crisis); ROBERT J. SCHILLER, *THE SUBPRIME SOLUTION: HOW TODAY’S GLOBAL FINANCIAL CRISIS HAPPENED, AND WHAT TO DO ABOUT IT* (2008) (providing similar analysis as to the background of the global financial).

<sup>2</sup> See *2011 Year-End Foreclosure Report: Foreclosures on the Retreat*, REALTYTRAC (Jan. 9, 2012), <http://www.realtytrac.com/content/foreclosure-market-report/2011-year-end-foreclosure-market-report-6984> (reporting that the average foreclosure in 2011 took 348 days to complete, and more than 1,000 days to complete in New York).

<sup>3</sup> See Mary Ellen Podmolik, *Foreclosure Process Caught in State Bottleneck*, CHI. TRIB., Sep. 22, 2011, available at [http://articles.chicagotribune.com/2011-09-22/business/ct-biz-0922-foreclose-20110922\\_1\\_foreclosure-auctions-foreclosure-case-foreclosure-filings](http://articles.chicagotribune.com/2011-09-22/business/ct-biz-0922-foreclose-20110922_1_foreclosure-auctions-foreclosure-case-foreclosure-filings).

<sup>4</sup> See U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-11-433, *MORTGAGE FORECLOSURES DOCUMENTATION PROBLEMS REVEAL NEED FOR ONGOING REGULATORY OVERSIGHT* (May 2011), available at <http://www.gao.gov/assets/320/317923.pdf>; CONG. OVERSIGHT PANEL, *EXAMINING THE CONSEQUENCES OF MORTGAGE IRREGULARITIES FOR FINANCIAL STABILITY AND FORECLOSURE MITIGATION* (Nov. 16, 2010), available at <http://www.gpo.gov/fdsys/pkg/CPRT-111JPRT61835/pdf/CPRT-111JPRT61835.pdf>; FED. RESERVE SYS., OFFICE OF COMPTROLLER OF THE CURRENCY, OFFICE OF THRIFT SUPERVISION, *INTERAGENCY REVIEW OF FORECLOSURE POLICIES AND PRACTICES* (2011) [hereinafter “INTERAGENCY REVIEW”], available at [http://www.federalreserve.gov/boarddocs/rptcongress/interagency\\_review\\_foreclosures\\_20110413.pdf](http://www.federalreserve.gov/boarddocs/rptcongress/interagency_review_foreclosures_20110413.pdf). The interagency review focused primarily on robo-signing of affidavits submitted in judicial foreclosures, as well as on problems with the Mortgage Electronic Registration System (MERS). Robo-signing also refers to high-volume signing of mortgage assignments and note endorsements, sometimes years after the intended secondary market transfer of the mortgage loan, in

mortgage servicers' response to the tremendous volume of mortgage defaults and foreclosures after 2007: assembly-line signing and notarizing of affidavits for foreclosure cases, mortgage assignments, note allonges and related documents, all filed in courts and deed recorders in counties across the United States. In early 2012, the state attorneys general, together with the Federal Department of Housing and Urban Development and other agencies, announced a settlement with five major banks and mortgage servicers of robo-signing related claims.<sup>5</sup> Many hope that this settlement would not only resolve some of the liabilities arising from robo-signing but also somehow resolve legal questions about a variety of mortgage industry practices, allowing the foreclosure process and housing markets to return to normal.<sup>6</sup>

Lying at the intersection of contract assignment and property transfer law, the structures and practices governing mortgage loan transfers find themselves in a state of confusion. While the recording and transfer of corporate debt and stock securities successfully shifted to an electronic system in the 1970's, with legal support from Article 8 of the Uniform Commercial Code and relevant Securities and Exchange Commission rules,<sup>7</sup> the law and practice of electronic transfers of the largest individual credit obligations, home mortgage loans, have not yet converged. On the practice side, the Mortgage Electronic Registration System ("MERS") came about in the 1990's on the basis of a legal opinion letter, completely devoid of any statutory or regulatory authority.<sup>8</sup> On the legal side, the Federal E-Sign statute, providing for electronic Note negotiation,<sup>9</sup> as well as the

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preparation for an impending foreclosure.

<sup>5</sup> See Jim Puzanghera & Alejandro Lazo, *Mortgage settlement is also housing relief package*, L.A. TIMES, Feb. 10, 2012, available at <http://articles.latimes.com/2012/feb/10/business/la-fi-mortgage-settlement-20120210>.

<sup>6</sup> See Derek Kravitz, *Questions and answers about what the foreclosure-abuse deal will and won't do*, STAR TRIB., Feb. 9, 2012, available at <http://www.startribune.com/business/139048784.html>.

<sup>7</sup> See generally Richard A. Hakes, *UCC Article 8: Will the Indirect Holding of Securities Survive the Light of Day?*, 35 LOY. L.A. L. REV. 661 (2002) (detailing both the history and subsequent evolution of Article 8 of the Uniform Commercial Code).

<sup>8</sup> Christopher Peterson, *Two Faces: Demystifying the Mortgage Electronic Registration System's Land Title Theory*, 53 WM & MARY L. REV. 111, 116-17 (2011).

<sup>9</sup> 15 U.S.C.A. § 7021 (West 2012) (defining "transferable records" and authorizing electronic equivalent to a paper negotiable instrument); see also Jane K. Winn, *What Is a Transferable Record and Who Cares?* 7 B.U. J. SCI. & TECH. L.

Uniform Real Property Electronic Recording Act, have lain dormant and largely unused.<sup>10</sup> As the volume of mortgage transfers and foreclosures exploded, the mortgage industry was either unwilling or unable to follow the old paper-based rules, but it had no effective alternative to support the dematerialization of mortgage loan sales.

In this paper, I survey the state of the mortgage loan transfer system, through a law and society lens. First, I consider empirically how mortgage loan assignments and transfers were actually handled during the subprime boom, and to what extent courts have actually cast doubt on the validity of foreclosures and foreclosure sales affected by robo-signing, MERS, and related problems. This section includes a report on my own empirical survey of the accuracy of MERS records. Next, I identify the key consumer and investor protection values and interests that must be addressed in developing new laws and practices to govern transfers of home finance transactions. Finally, I offer a few suggestions for moving towards a true electronic mortgage loan transfer system with full consumer protection.

## I. HOW WIDESPREAD ARE MORTGAGE TRANSFER DEFECTS, AND WHAT IMPACT WILL THEY HAVE ON TITLE STABILITY?

Most mortgage loans made between 1990 and 2007 were sold on the secondary market, and then ultimately resold to securities investors through a process known as securitization.<sup>11</sup> As a result, the bank or mortgage company to whom the homeowner originally promised to make payments had to assign its rights in the Note, which is the contract promising payment, and the Mortgage, which is the conveyance of an interest in real estate as security for the loan.<sup>12</sup>

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203 (2001).

<sup>10</sup> See David E. Ewan et al., *It's the Message, not the Medium! Electronic Record and Electronic Signature Rules Preserve Existing Focus of the Law on Content, Not Medium of Recorded Land Title Instruments*, 60 BUS. LAW. 1487 (2005) (advocating wider use of electronically scanned mortgage documents and reliance on the Uniform Real Property Electronic Recording Act).

<sup>11</sup> See Kathleen C. Engel & Patricia A. McCoy, *Predatory Lending: What Does Wall Street Have to Do with It?*, 15 HOUSING POL'Y DEBATE 715 (2004).

<sup>12</sup> See Elizabeth Renuart, *Property Title Trouble in Non-Judicial Foreclosure States: The Ibanez Time Bomb?* 16-19 (Feb. 22, 2012) (unpublished manuscript) (on file with the Albany Law School), available at <http://ssrn.com/abstract=1968504> (discussing post-sale challenges to foreclosure deeds in non-judicial foreclosure states based on note or mortgage transfer issues).

Each of these two assignments followed different rules, and required the creation, endorsement and delivery of different documents, in order to be legally effective. If a homeowner defaults on a mortgage loan, the party that purchased the rights to the loan will want to enforce the mortgage by foreclosure, to obtain valid title to the home and to sell it. Purchasers of the foreclosed home likewise will expect that the party foreclosing and selling the house had the legal right to do so and that the resulting title is valid and not subject to later challenges. Invalid transfers of the mortgage or note may or may not impair the validity of title, depending on various rules that balance policies of accuracy and integrity against policies of finality and certainty.

Title problems affecting the validity of foreclosures and foreclosure sales arising from secondary market sales and securitization of mortgage loans can be classified on three dimensions: whether defects are in the transfer of the note or of the mortgage, whether a foreclosure is judicial or non-judicial,<sup>13</sup> and whether a foreclosure is challenged before or after sale (or judgment in judicial state.) What follows is a survey of actual practices used to transfer notes and mortgages and of judicial decisions about what happens to foreclosure sales and titles when the note and mortgage transfers failed.

### A. Transfer of Note

#### 1. The Legal Methods Available – Article 3 and Common Law

Most judges seem to assume that mortgage notes are negotiable instruments, and, therefore, Article 3 of the Uniform Commercial Code determines the right of a secondary market purchaser to enforce a mortgage note.<sup>14</sup> The touchstone of proper acquisition of the right to enforce a negotiable instrument is physical delivery of the original note, endorsed by the prior payee either in blank or to the new owner.<sup>15</sup> In exceptional cases, a lender who has

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<sup>13</sup> A bit fewer than half the states require mortgage lenders to file a court action to foreclose and sell the mortgaged property, while the remaining states permit foreclosure by notice and sale, i.e., non-judicial foreclosure. *Id.* at 30-33.

<sup>14</sup> *See, e.g.,* Eaton v. Fed. Nat. Mortg. Ass'n, No. SUCV201101382, 2011 WL 6379284 (Mass. Super. Ct. June 17, 2011); *see also, e.g.,* Dale Whitman, *How Negotiability Has Fouled up the Secondary Mortgage Market, and What to Do About It*, 37 PEPP. L. REV. 737 (2010) (surveying cases that either address negotiability or assume mortgage notes are negotiable).

<sup>15</sup> *See* Gee v. U.S. Bank Nat'l Ass'n, 72 So. 3d 211, 213-14 (Fl. Dist. Ct. App.

the original note and can show that it purchased the payee's rights from the prior holder, but is nonetheless missing proper endorsements, can also enforce a note.<sup>16</sup> Even more exceptionally, the note buyer can enforce the note if the note itself is missing or lost, but it can be proven to have been in the prior owner's possession at the time of the loss or theft.<sup>17</sup> These rules have led to some fairly straightforward results denying the validity of a foreclosure when the plaintiff or selling party does not have possession of the note,<sup>18</sup> or if the plaintiff has the note, but the note is payable or endorsed to someone else and there is no other evidence that the party in possession purchased the note from the original payee.<sup>19</sup>

If mortgage notes are not Article 3 negotiable instruments, then presumably the common law of contracts governs their assignment. In addition, some provisions of U.C.C. Article 9 arguably permit proof of a mortgage note transfer without endorsement and delivery, by proving the existence of a separate written agreement to sell the note.<sup>20</sup> The foreclosing party's attempt to prove note transfer via this alternative was unsuccessful in the Massachusetts cases, discussed below,<sup>21</sup> and, for the most part, the industry and the courts have looked to the traditional method of endorsement and delivery as the preferred way for a party to prove it is entitled to enforce the mortgage note.<sup>22</sup>

## 2. How Were Notes Actually Transferred, Empirically

How mortgage notes were handled between 1990 and 2007 depended on whether the purchaser was Fannie Mae, Freddie Mac, or a private-label securitizer, i.e. a commercial or investment bank packaging mortgages and issuing mortgage-backed securities, such as Bear Stearns. Fannie Mae's note handling procedures are detailed in a fascinating 2006 investigative report by its law firm, Baker Hosteteler, written in response to the complaints of a gadfly and

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2011).

<sup>16</sup> U.C.C. § 3-301(ii) (2010).

<sup>17</sup> *Id.* at §§ 3-301(iii), 3-309 (2002).

<sup>18</sup> *Kemp v. Countrywide Home Loans, Inc. (In re Kemp)*, 440 B.R. 624 (Bankr. D. N.J. 2010) (disallowing bankruptcy claim when note was neither endorsed nor delivered); *see infra* note 40.

<sup>19</sup> *See, e.g., In re Deed of Adams*, 693 S.E.2d 705 (N.C. Ct. App. 2010).

<sup>20</sup> Renuart, *supra* note 12, at 24-25.

<sup>21</sup> *See infra* notes 109-113 and accompanying text.

<sup>22</sup> For a thorough discussion of Article 3 and Article 9 note transfer law, *see Veal v. Am. Home Mortg., Inc. (In re Veal)*, 450 B.R. 897, 908-13 (B.A.P. 9th Cir. 2011).

shareholder, Nye Lavalley.<sup>23</sup> According to the report, Fannie Mae's policy was to have loan originators endorse all mortgage notes in blank, converting them to bearer paper.<sup>24</sup> The notes would then be delivered to one of three places: the Fannie Mae storage facility in Herndon, Virginia; to one of 58 certified independent custody agents; or to the mortgage servicer.<sup>25</sup> From these facilities, Fannie Mae could then provide the notes to lenders or foreclosing attorneys in states whose law required it ("Original Note States") for foreclosure, to lenders who requested all original notes to be returned upon liquidation (payment in full or foreclosure). Otherwise, Fannie Mae destroyed the notes ninety days after the loan was reported liquidated on its electronic reporting system.<sup>26</sup> However, at the time of the report, Fannie Mae had no central reporting or inventory of lost notes.<sup>27</sup> Fannie Mae's own custodian reported fewer than 200 lost note affidavits per year, but the report does not give data on lost notes or lost note affidavits for the independent document custodians or for servicers.<sup>28</sup>

Private-label securitization practices regarding notes were inconsistent. The standard language in securitization contracts usually required either A) that the note be endorsed specially by the payee to the first transferee, by the first transferee to the second, and so on, or B) that the note be endorsed in blank, and physically delivered to the

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<sup>23</sup> Mark A. Cymrot & Amika Biggs, Report to Fannie Mae Regarding Shareholder Complaints by Mr. Nye Lavalley (May 19, 2006) (unpublished, internal report), available at <http://4closurefraud.org/2012/02/04/ocj-case-no-5595-confidential-report-to-fannie-mae-regarding-shareholder-complaints-of-foreclosure-fraud-by-mr-nye-lavalley/>; see also Gretchen Morgenstern, *A Mortgage Tornado Warning, Unheeded*, N.Y. TIMES, Feb. 5, 2012, at BU1, available at <http://www.nytimes.com/2012/02/05/business/mortgage-tornado-warning-unheeded.html?pagewanted=all>.

<sup>24</sup> Cymrot & Biggs, *supra* note 23, at 45-48. See also *Selling Guide: Fannie Mae Single Family*, FANNIE MAE, 919 (Dec. 20, 2011), <https://www.efanniemae.com/sf/guides/ssg/sg/pdf/sel122011.pdf> ("The originating lender must be the original payee on the note, even when MERS is named as nominee for the beneficiary in the security instrument. The note must be endorsed to each subsequent owner of the mortgage unless one or more of the owners endorsed the note in blank. The last endorsement on the note should be that of the mortgage seller. The mortgage seller must endorse the note in blank and without recourse."); U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 4, at 44-45.

<sup>25</sup> Cymrot & Biggs, *supra* note 23, at 49.

<sup>26</sup> *Id.* at 50-51.

<sup>27</sup> *Id.* at 54.

<sup>28</sup> *Id.* at 55.



trustee for the securitization.<sup>29</sup> Much anecdotal evidence suggests that servicers of private-label securitized mortgages either delivered original notes without endorsements to document custodians for the trust,<sup>30</sup> routinely prepared lost note affidavits in lieu of delivering notes to foreclosure attorneys and trustees, routinely destroyed original notes,<sup>31</sup> and/or obtained or forged necessary endorsements long after the transfers were supposed to have taken place.<sup>32</sup>

There is evidence that, especially during the subprime lending boom of 2004-2007, notes were neither endorsed nor delivered.<sup>33</sup> For example, an informal survey of Florida foreclosures found that copies of mortgage notes originated by New Century Mortgage and filed with foreclosure suits were never endorsed.<sup>34</sup> Similarly, Fortune Magazine surveyed foreclosure files in New York and found that in every case out of the 103 it examined, when Countrywide was the original note payee, the notes were not endorsed, either in blank or to a specific payee, despite the fact that all of the foreclosures were in the name of a securitization trust.<sup>35</sup> The survey was conducted in response to the widely reported testimony of one bank employee, who told a bankruptcy court that it was Countrywide's practice never to deliver original mortgage notes to the trustee after securitization.<sup>36</sup>

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<sup>29</sup> *Robo-Signing, Chain of Title, Loss Mitigation, and Other Issues in Mortgage Servicing: Hearing Before the Subcomm. on Hous. and Comty. Opportunity of the H. Fin. Servs. Comm.*, 111th Cong. 2d Sess. (2010) [hereinafter "Levitin testimony"] (testimony of Adam J. Levitin, Associate Professor of Law, Georgetown University Law Center), available at <http://financialservices.house.gov/Media/file/hearings/111/Levitin111810.pdf>.

<sup>30</sup> See, e.g., *Veal v. Am. Home Mortg., Inc. (In re Veal)*, 450 B.R. 897, 903-04 (B.A.P. 9th Cir. 2011) (note endorsed specially to moving creditor's predecessor, not to moving creditor or in blank).

<sup>31</sup> Levitin testimony, *supra* note 29, at 24, n. 99.

<sup>32</sup> See, e.g., *Mortg. Elec. Registration Sys., Inc., v. Saunders*, 2 A.3d 289 (Me. 2010) (finding that note was endorsed and delivered to securitization trustee three years after mortgage origination and several months after judicial foreclosure filing); see also Scot J. Paltrow, *Legal Woes Mount for a Foreclosure Kingpin*, REUTERS (Dec. 6, 2010), <http://us.mobile.reuters.com/article/topNews/idUSTRE6B547N20101206> (describing one firm's practice of mass producing mortgage assignments with bogus information for foreclosure law firms.).

<sup>33</sup> Whitman, *supra* note 14, at 758.

<sup>34</sup> Scot J. Paltrow, *Mortgage Mess Redux: Robo-Signers Return*, REUTERS (July 19, 2011), <http://graphics.thomsonreuters.com/11/07/Foreclosure.pdf>.

<sup>35</sup> Abigail Field, *At Bank of America, More Incomplete Mortgage Docs Raise More Questions*, CNN (June 3, 2011), <http://finance.fortune.cnn.com/2011/06/03/at-bank-of-america-more-incomplete-mortgage-docs-and-more-questions>.

<sup>36</sup> See *Kemp v. Countrywide Home Loans, Inc. (In re Kemp)*, 440 B.R. 624 (Bankr. D. N.J. 2010).

On the other hand, Moody's reported that it surveyed the entire pool of mortgages at issue in the same case and found missing assignments or note endorsements in only 180 out of 9,233 cases.<sup>37</sup>

It is difficult to reconcile these small sample surveys and reports. Clearly, some lenders and servicers stopped bothering to endorse and deliver notes, while others sometimes used lost note affidavits as a short cut to avoid the expense of retrieving notes that, in fact, had been endorsed and delivered. Servicers sometimes dealt with missing endorsements by obtaining or preparing endorsements on "allonges", *i.e.* documents separate from the note, whose legitimacy can be called into question.<sup>38</sup> Some of these problems can be cured in individual cases, albeit often at considerable expense. For example, missing endorsements can sometimes be obtained or a servicer in possession of a note can establish rights of a non-holder in possession with contract documents. Some of the cases dismissing foreclosures or even invalidating sales seem to result from note transfer failures that could be remedied.<sup>39</sup> Nevertheless, there is substantial evidence of a significant breakdown in the system of endorsement and delivery of mortgage notes in the pre-2007 period.

### 3. When a Mortgage Note is Not Properly Transferred, What are the Consequences?

#### a. Judicial State Before Judgment and Sale

In most, but not all, judicial foreclosure states, a foreclosure will be dismissed on the grounds of lack of standing if the plaintiff cannot establish it is a person entitled to enforce a note under the U.C.C. §3-301 or under common law.<sup>40</sup> A few states, notably Pennsylvania, seem to require only a valid mortgage assignment for

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<sup>37</sup> U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 4, at 48.

<sup>38</sup> See *Morgan v. HSBC Bank USA, NA*, 2011 WL 3207776 (Ky. App. 2011) (finding it "troubling" that plaintiff first asserted that the note was unavailable, then filed a note payable to a prior lender, and then with its motion for summary judgment produced a new allonge to the note endorsing the note to the plaintiff); *In re Kemp*, 440 B.R. at 629.

<sup>39</sup> See, *e.g.*, *Ocwen Loan Servicing, LLC v. Kroening*, 2011 WL 5130357 (N.D. Ill. 2011) (granting summary judgment for foreclosure over standing objections where MERS was plaintiff, record mortgagee and also had physical possession of the note, endorsed in blank by the original lender, and was thus a holder under Article 3).

<sup>40</sup> *In re Foreclosure Cases*, 521 F. Supp. 2d 650 (S.D. Ohio 2007); *Riggs v. Aurora Loan Serv., LLC*, 36 So. 3d 932, 933 (Fla. Dist. App. 2010); *Bank of New York v. Silverberg*, 86 A.D.3d 274 (N.Y.A.D. 2011).

the plaintiff to make out a prima facie case and do not require proof that the plaintiff has rights in the note.<sup>41</sup> The more typical position is the reverse, i.e., that the plaintiff must show it has rights in the note, which is the basic contract for payments, even if the mortgage has not yet been assigned because the note transfer carries with it an equitable right to the mortgage.<sup>42</sup> The rights in the note must exist prior to filing the foreclosure action.<sup>43</sup> To vest the plaintiff with the right to enforce the note, the prior holder must have endorsed and delivered the note, or executed some separate agreement to sell the note, prior to the foreclosure. Thus, note transfer failures will prevent judicial foreclosures, in the event the borrower defends the case, unless and until the note transfer defect can be cured. Of the various scenarios discussed, this one appears to have resulted in the largest number of failed foreclosures.

#### b. Judicial State After Judgment and Sale

After a judgment is entered, the policies of finality of judgments and title transfers come into play, especially when the foreclosed home has been resold to a bona fide purchaser. For example, in *Mortgage Electronic Registration Services v. Barnes*, the Illinois Appellate Court rejected a post-judgment challenge to a foreclosure by MERS, despite the apparently undisputed fact that MERS was never the holder or owner of the note. While the court recognized that a proper transfer of the note is a precondition to a valid foreclosure,<sup>44</sup> the court reasoned that the Illinois foreclosure statute authorized an agent of the note holder to foreclose, and that MERS could easily have amended its Complaint to allege its status as agent rather than as principal holder of the note.<sup>45</sup> The default judgment entered against the homeowner was essentially res judicata as to the plaintiff's standing to foreclose.<sup>46</sup> To put it another way, standing was treated by the court as a waivable defense, the absence of which does not render a foreclosure judgment subject to later

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<sup>41</sup> See *In re Alcide*, 450 B.R. 526, 536, n.26 (Bankr. E.D. Pa. 2011).

<sup>42</sup> See, e.g., *Harvey v. Deutsche Bank Nat'l Trust Co.*, 69 So.3d 300, 304 (Fla. Dist. App. 2011).

<sup>43</sup> *Id.*; *Bank of New York v. Raftogianis*, 13 A.3d 435 (N.J. Super. Ch. Div. 2010) (judgment denied because BONY could not prove note had been physically endorsed and delivered to it prior to filing suit).

<sup>44</sup> *Mortgage Elec. Registration Sys., Inc. v. Barnes*, 940 N.E.2d 118 (Ill. App. 2010), *appeal denied* 949 N.E. 2d 659 (Ill. 2011).

<sup>45</sup> *Id.*

<sup>46</sup> *Id.*

attack as void.<sup>47</sup>

Likewise, in *Aurora Loan Services, LLC v. Pagano*, the New Jersey Appellate Court refused to set aside a default judgment despite allegations of a defective note transfer.<sup>48</sup> Defendants in that case pointed to the fact that the plaintiff did not have possession of the note at the time of foreclosure and did not record its mortgage assignment until after the foreclosure filing. The court held that the effort to set aside the default judgment was untimely, and also that the foreclosure proceeded with the consent of the proper party, despite the defective note transfer.<sup>49</sup> The clear implication of the decision is that a defective note transfer does not render a default judgment void, and that absent some showing that the plaintiff was a stranger to the transaction, the judgment and foreclosure will not be disturbed.

On the other hand, some post-sale challenges have succeeded. The New Jersey Supreme Court's decision in *Deutsche Bank National Trust v. Mitchell* was in an unusual dual posture, both pre-judgment and post-sale.<sup>50</sup> The court reversed a grant of summary judgment, but also voided a completed foreclosure sale on the grounds that the plaintiff had not provided any evidence that it had possession of the Note when filing the foreclosure. Applying UCC Article 3 without discussing the threshold negotiability coverage issue, the court found that the plaintiff was not a holder or a transferee in possession under UCC §3-301, nor had it offered any evidence meeting the criteria for enforcement of a lost note under 3-309. The court looked past conclusory affidavits from the plaintiff's attorney and the plaintiff's servicer asserting that plaintiff was the holder and owner of the note and mortgage and cited the affidavits' failure to say how and when, if ever, the plaintiff came into possession of the original note.<sup>51</sup> Implicit in the court's reasoning was that the affidavits did not attempt to prove acquisition of the noteholder's rights via some other means such as by a separate sale

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<sup>47</sup> See also *Countrywide Home Loans, Inc. v. Delphonse*, 883 N.Y.S. 2d 135 (N.Y. App. Div. 2009).

<sup>48</sup> *Aurora Loan Serv., Inc. v. Pagano*, 2011 WL 6153634 (N.J. Super. App. Div. 2011).

<sup>49</sup> *Id.*; but see *Bank of New York v. Cupo*, 2012 WL 611849 (N.J. Super. App. Div. 2012) (reversing denial of motion to vacate default judgment for further findings on issue of standing, suggesting that lack of standing might make a judgment void, rather than treating standing as waived by default judgment).

<sup>50</sup> *Deutsche Bank Nat'l Trust Co. v. Mitchell*, 27 A.3d 1229 (N.J. Super. App. Div. 2011).

<sup>51</sup> *Id.* at 1237.

and purchase contract. Strictly speaking, this case was a challenge to standing before judgment because it was a direct appeal from the grant of summary judgment to the plaintiff. However, the foreclosure sale had not been stayed pending the appeal, and the result of the decision was also to undo a completed sale. The court did not analyze separately whether the sale had rendered the standing issue moot.

Strictly speaking, standing and real party in interest are two distinct prerequisites to a judicial foreclosure. For example, MERS may have standing, in the sense that it is, in fact, the agent for the current holder of the mortgage and note; however, MERS may not be the real party in interest if it fails to disclose its agency and the identity of its principal.<sup>52</sup> Even so, as a practical matter, neither of these legal theories is generally available after a default judgment or summary judgment has been entered. As a result, judicial foreclosure sales are unlikely to be set-aside on the basis that the party who started the foreclosure had not received a valid transfer of the mortgage and note.

There are nevertheless occasional exceptions, so that even in judicial foreclosure states, title stability may be affected by note transfer problems.

### c. Non-judicial State Before Sale

In a non-judicial foreclosure state, the borrower must bring an affirmative suit to enjoin the sale in order to assert defenses or defects in the sale process.<sup>53</sup> The California Court of Appeals has held that a borrower cannot challenge a non-judicial sale by filing a lawsuit essentially demanding that the trustee prove it is receiving instructions from the current holder of the note.<sup>54</sup> Thus, while the principle remains the same – *i.e.* that only the present holder or owner of the note may initiate a foreclosure – there is a critical difference between non-judicial and judicial foreclosure states as to how the

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<sup>52</sup> See *In re Alcide*, 450 B.R. 526, 540 (Bankr. E.D. Pa. 2011).

<sup>53</sup> See Timothy Froehle, Note, *Standing in the Wake of the Foreclosure Crisis: Why Procedural Requirements Are Necessary To Prevent Further Loss to Homeowners*, 96 IOWA L. REV. 1719 (2012) (advocating fee-shifting provisions for borrowers challenging nonjudicial foreclosures).

<sup>54</sup> *Gomes v. Countrywide Home Loans, Inc.*, 192 Cal. App. 4th 1149 (Ct. App. 2011); see *Chilton v. Federal Nat. Mortgage Ass'n*, No. 1:09-CV-02187 (E.D. Cal. 2009) (finding there is no requirement under California law that the foreclosing trustee possess the original note, but recognizing that the trustee must have permission to act on behalf of the proper beneficiary of the trust deed, *i.e.* the current note holder or owner).

issue will be raised. In a judicial foreclosure, as the plaintiff, the foreclosing party must come forward with evidence that it is the proper transferee of the note, and the defendant homeowner can essentially put the plaintiff to its proof. In a non-judicial foreclosure state, the objecting homeowner must come forward with a plausible claim that the party giving notice of a foreclosure sale is not the proper transferee.

While non-judicial sales are difficult to challenge because the borrower must come forward with evidence of a note transfer problem, new grounds for such challenges are emerging in non-judicial foreclosure states that have recently adopted foreclosure mediation statutes. Nevada, for example, adopted a pre-foreclosure mediation statute in 2009 that requires a notice to the homeowner and, if the homeowner chooses, a mandatory mediation session at which the deed of trust beneficiary must be present, negotiate in good faith, and must present documents including the deed of trust, the note and all assignments.<sup>55</sup> If a homeowner requests mediation and the foreclosing party fails to comply, the foreclosure sale may not proceed.<sup>56</sup> The District of Columbia, which permits non-judicial foreclosures, has adopted a similar mediation statute, which explicitly provides that a sale conducted in violation of the mediation rules is void, causing great concern among title insurers.<sup>57</sup>

#### d. Note: Non-judicial State after Sale

Because the title transfer by a trustee under a deed of trust usually has no judicial imprimatur,<sup>58</sup> the resulting title may later be

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<sup>55</sup> NEV. REV. STAT. § 107.086(4) (2012).

<sup>56</sup> *Pasillas v. HSBC Bank USA*, 255 P.3d 1281 (Nev. 2011); *Leyva v. Nat'l Default Servicing Corp.*, 255 P.3d 1275 (Nev. 2011) (non-judicial foreclosures could not proceed under Nevada foreclosure mediation statute where party seeking foreclosure was neither the holder of the note nor assignee beneficiary of the deed of trust).

<sup>57</sup> D.C. CODE § 42-815.02(h) (2012); Cezary Podkul, *District Effort to Help Distressed Homeowners could Halt Foreclosure Sales*, WASH. POST, Jul. 7, 2011, available at [http://www.washingtonpost.com/business/economy/district-effort-to-help-distressed-homeowners-could-halt-foreclosure-sales/2011/07/07/gIQABcbn2H\\_story.html](http://www.washingtonpost.com/business/economy/district-effort-to-help-distressed-homeowners-could-halt-foreclosure-sales/2011/07/07/gIQABcbn2H_story.html); see also WASH. REV. CODE ANN. § 61.24.031 (West 2012) (Washington foreclosure mediation statute).

<sup>58</sup> A few states with non-judicial power of sale foreclosures provide for judicial confirmation of the foreclosure title. See, e.g., GA. CODE ANN. § 44-14-161(a) (requiring confirmation of Georgia non-judicial sales as a precondition to seeking a deficiency judgment); OKLA. STAT. tit. 12, § 765 (2011).

challenged based on the trustee's lack of authority to sell.<sup>59</sup> The common law rule allows post-sale challenges when there is unfairness or irregularity in the sale process, presumably including an absence of authority to sell, combined with harm to the former owner, usually meaning a grossly inadequate sales price.<sup>60</sup> On the other hand, some non-judicial foreclosure states have severely limited the ability of homeowners to challenge defective foreclosure sales after the fact.<sup>61</sup> Various impediments to post-sale challenges by former owners mean that, as a practical matter, defective note transfers will not result in title defects in a large number of cases. One key obstacle has been the requirement in many states that a homeowner must show an ability to tender the mortgage debt as a precondition to any post-sale challenge.<sup>62</sup>

Courts in many non-judicial states have also been unreceptive to post-sale challenges based on note transfer issues on the merits. The Michigan Supreme Court in *Residential Funding Co., L.L.C., v. Saurman* recently rejected a challenge to a completed non-judicial sale by the former owner, where the challenge was based on the undisputed fact that MERS initiated the sale, but was never the holder or owner of the note.<sup>63</sup> The court relied on language of the Michigan statute authorizing foreclosure by advertisement and sale:

The party foreclosing the mortgage is either the owner of the indebtedness or of an interest in the indebtedness secured by the mortgage or the servicing agent of the mortgage.<sup>64</sup>

According to the Michigan Supreme Court, MERS owned an "interest in the indebtedness", not by having any interest in the note, but via its bare legal title to the mortgage securing the note.<sup>65</sup>

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<sup>59</sup> Molly F. Jacobson-Greany, *Setting Aside Nonjudicial Foreclosure Sales: Extending the Rule to Cover Both Intrinsic and Extrinsic Fraud or Unfairness*, 23 EMORY BANKR. DEV. J. 139, 154-55 (2006).

<sup>60</sup> *Id.*

<sup>61</sup> *Id.* at 152-53.

<sup>62</sup> See, e.g., *Forbes v. Countrywide Home Loans, Inc.*, No. E051309, 2011 WL 4985965 (Cal. Ct. App. 2011) ("a valid and viable tender of payment of the indebtedness owing is essential to an action to cancel a voidable sale under a deed of trust"); *Saldate v. Wilshire Credit Corp.*, 711 F. Supp. 2d 1126, 1141 (E.D. Cal. 2010); *Arnolds Mgmt. Corp. v. Eischen*, 205 Cal. Rptr. 15 (Ct. App. 1984).

<sup>63</sup> *Residential Funding Co., L.L.C., v. Saurman*, 805 N.W.2d 183 (Mich. 2011), *rev'g* 807 N.W.2d 412 (Mich. Ct. App. 2011).

<sup>64</sup> MICH. COMP. LAWS § 600.3204(1)(d) (2012).

<sup>65</sup> *Saurman*, 805 N.W.2d at 342.

Interestingly, the court did not comment on the appellate court's related holding that if MERS did not have the required interest in the debt, the non-judicial sale would have been void ab initio and thus subject to post-sale legal challenge.<sup>66</sup> In an earlier case, the Michigan Appeals Court voided a sale based on a missing *mortgage* transfer.<sup>67</sup> However, the validity of that decision was called into question by the Appeals Court decision in *Saurman* because of a change in the foreclosure statute that deleted the requirement for the foreclosing party to record a mortgage assignment prior to a notice of sale.<sup>68</sup>

California courts have not been hospitable to post-sale challenges based on note transfer defects either. In *Calvo v. H.S.B.C. Bank, USA, N.A.*, the Court of Appeals held that the trustee under a deed of trust need not record an assignment of the trust deed, and implicitly held that ownership of the note was unnecessary to conduct a foreclosure sale, so long as the original trustee or a properly substituted trustee conducted the sale.<sup>69</sup> The Massachusetts Supreme Judicial Court, on the other hand, has implied that a defective note transfer could void a trustee's deed, although the case was decided based on gaps in the mortgage transfer.<sup>70</sup>

Courts in non-judicial foreclosure states with mediation statutes, like Nevada and the District of Columbia, have not yet addressed the question of whether a trustee's failure to demonstrate a valid note transfer could give rise to a post-sale challenge based on the mediation statutes. That has been the concern expressed by title insurers about the "void" language in the District of Columbia statute, but the outcome of a post-sale challenge based on note transfer gaps and mediation statutes is difficult to predict.<sup>71</sup>

It is not always easy to reconcile the reasoning of these various cases. Often, the precise legal issue, for example, of whether a mortgage assignee in possession of a note payable to someone else with no endorsements can foreclose comes out differently, perhaps as

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<sup>66</sup> *Id.* (dismissing eviction case bought by sale purchaser after non-judicial sale on the grounds that the party conducting the sale did not have any interest in the note, i.e. the "indebtedness," as required by the Michigan statute).

<sup>67</sup> *Davenport v. HSBC Bank*, 739 N.W.2d 383 (Mich. Ct. App. 2007), *appeal denied*, 743 N.W.2d 945 (Mich. 2008).

<sup>68</sup> *Residential Funding Co.*, 807 N.W.2d at 420-21.

<sup>69</sup> *Calvo v. HSBC Bank USA, NA*, 130 Cal. Rptr. 3d 815, 819 (Ct. App. 2011).

<sup>70</sup> *See U.S. Bank Nat'l Ass'n v. Ibanez*, 941 N.E.2d 40 (Mass. 2011) (holding that nonjudicial sale was void based on absence of mortgage assignment, and noting that note transferee has an equitable claim to compel assignment of the mortgage).

<sup>71</sup> *See* note 57, *supra*.



much reflecting the courts' perception of the desirability of speedy and efficient foreclosures on the one hand or of their unhappiness with the industry's shortcuts and shortcomings on the other. Courts in non-judicial states seem reluctant, although not entirely unwilling, to hold up foreclosures based on defective note transfers.

To summarize, there is evidence that a significant number of notes were either not endorsed or not delivered to secondary market purchasers, although less so in the GSE sector than the private securitization sector. Although note ownership can be proven without endorsement and delivery, there are few if any reported court decisions describing and approving alternative proof methods, such as using a pooling and servicing agreement with a loan schedule. Missing notes or endorsements clearly can delay or prevent foreclosures in judicial states where the borrower defends the lawsuit. The delays in New York during 2010 and 2011 in particular have clearly been attributable in part to note transfer failures.<sup>72</sup>

Post-sale challenges to non-judicial sales based on note transfer problems have been less frequent and less successful, in part because the burden is on the homeowner to bring suit rather than on the mortgage assignee to establish its standing to sue. Once a foreclosure sale is completed, note transfer defects have still been raised and may result in the undoing of sales, but statutes and common law favoring finality may tend to limit the number of successful sale challenges. The Massachusetts cases stand out, and a few other states' courts have followed suit, raising potentially serious questions about foreclosure title stability. While most homeowners who wish to contest foreclosures are more likely to do so prior to a foreclosure sale than afterwards, it is conceivable that entrepreneurial attorneys might begin to bring post-sale challenges more frequently as case law develops. At this stage, it is simply too soon to predict the extent of title litigation and foreclosure delays that will result from note transfer failures.

### *B. Transfer (Assignment) of Mortgage*

#### 1. What Legal Methods are Available to Transfer a Mortgage?

Mortgages are transfers of interests in land and, therefore, must be in writing.<sup>73</sup> Likewise, an assignment of mortgage must

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<sup>72</sup> David Streitfeld, *Backlog of Cases Gives a Reprieve on Foreclosures*, N.Y. TIMES, June 19, 2011, at A1, available at <http://www.nytimes.com/2011/06/19/business/19foreclosure.html?pagewanted=all>.

<sup>73</sup> Renuart, *supra* note 12, at 16.

typically be in writing, generally separate from the mortgage itself, and must be recorded in county land records, at least in order to protect the assignee from competing claims to the mortgage.<sup>74</sup> A mortgage assignment document is a conveyance of an interest in land, and therefore must have a grantor and grantee.<sup>75</sup> An assignment that is signed by the mortgagee but does not identify any party to whom the mortgage is being assigned, i.e. an assignment in blank, does not effectively assign the mortgagee's interest and cannot be the basis for a foreclosure by a party who later fills in the missing assignee and attempts to present or record the assignment.<sup>76</sup> The transfer of a mortgage is, therefore, usually executed in a different manner than a note transfer.<sup>77</sup>

## 2. What Methods Were Actually Used to Assign Mortgages Empirically?

As with notes, the document practices for assigning mortgages varied by market sector. Fannie Mae's practice was to have the bank or mortgage company servicing the loan remain the record mortgagee or mortgage assignee or use MERS as the mortgagee of record. The servicer would then transfer the property after foreclosure sale or assign its successful bid to Fannie Mae.<sup>78</sup> When a mortgage loan is first sold to Fannie Mae, the loan seller is instructed either 1) to record the mortgage or an assignment in the name of MERS or 2) to prepare and deliver, but not to record, an assignment from the seller to Fannie Mae.<sup>79</sup> Foreclosures are generally to be filed in the name of the servicer, with a few exceptions. Thus, Fannie Mae avoids appearing as the mortgagee of record in most states. Freddie Mac's procedures are generally similar

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<sup>74</sup> See Christopher Peterson, *Foreclosure, Subprime Mortgage Lending, and the Mortgage Electronic Registration System*, 78 U. OF CIN. L. REV. 1359 (2010); Renuart, *supra* note 12, at 16.

<sup>75</sup> Peterson, *supra* note 8, at 135-37.

<sup>76</sup> U.S. Bank Nat'l Ass'n v. Ibanez, 941 N.E.2d 40, 50-51 (Mass. 2011); Pasillas v. HSBC Bank USA, 255 P.3d 1281, 1285 n.9 (Nev. 2011).

<sup>77</sup> *But see* In re Williams, 395 B.R. 33 (S.D. Oh. 2008) (noting that Ohio statute permits a mortgage assignment to be noted on the margin of the mortgage document).

<sup>78</sup> Fannie Mae Servicing Guide § 105, at 801-29-801-31, § 201 (June 2011) [hereinafter "Fannie Mae Servicing Guide"], available at <https://www.efanniemae.com/sf/guides/ssg/svcg/svc061011.pdf>.

<sup>79</sup> Fannie Mae Seller's Guide § B-8-602, at 936 (2011), available at <https://www.efanniemae.com/sf/guides/ssg/sg/pdf/se1012711.pdf>.

to Fannie Mae's.<sup>80</sup>

In our own survey of foreclosure and land records in six states we found numerous foreclosures filed in the name of a bank, when Fannie Mae held the mortgage, according to MERS.<sup>81</sup> Given the other inaccuracies with MERS, it is difficult to know in a particular case whether the servicer has made an error in reporting ownership information to MERS or the case involves a legitimate Fannie-held mortgage being foreclosed by the servicer as agent for Fannie Mae, its undisclosed principal.

In the private-label securitization market, two methods seem to predominate, although neither accuracy nor consistency seems to have been achieved with either method. One method was for the originator to prepare a blank mortgage assignment to be filled in later in the event that recording the assignment became necessary for foreclosure purposes.<sup>82</sup> Another method was to record the original mortgage, or an assignment, with MERS as the "nominee" or proxy mortgagee and then purportedly have MERS maintain accurate records of the true beneficial owner of the mortgage and any changes in ownership.<sup>83</sup> A third probably unplanned method was to take neither step, so that when foreclosure becomes necessary, the servicer is forced to obtain an assignment (or perhaps fabricate one) from the original lender to the current owner.<sup>84</sup>

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<sup>80</sup> See Freddie Mac Single Family Seller/Servicer Guide, Chapter 16: Documentation Delivery, available at <http://www.freddiemac.com/sell/guide/>.

<sup>81</sup> Data compiled by author from foreclosure and property records in Indiana, Ohio, Pennsylvania, Maryland, Texas, and Iowa. For details on the MERS/foreclosure comparison data, see Appendix 2.

<sup>82</sup> AMERICAN SECURITIZATION FORUM WHITE PAPER, TRANSFER AND ASSIGNMENT OF RESIDENTIAL MORTGAGE LOANS IN THE SECONDARY MORTGAGE MARKET 4 (2010), available at [http://www.americansecuritization.com/uploadedFiles/ASF\\_White\\_Paper\\_11\\_16\\_10.pdf](http://www.americansecuritization.com/uploadedFiles/ASF_White_Paper_11_16_10.pdf); SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION, Q&A REGARDING MORTGAGE LOAN TRANSFERS AND SECURITIZATION (October 20, 2010), available at [http://www.sifma.org/uploadedfiles/issues/capital\\_markets/securitization/securitization/sifma%20mortgage%20transfer%20and%20securitization%20question%20and%20answers.pdf](http://www.sifma.org/uploadedfiles/issues/capital_markets/securitization/securitization/sifma%20mortgage%20transfer%20and%20securitization%20question%20and%20answers.pdf).

<sup>83</sup> Peterson, *supra* note 8, at 116-17

<sup>84</sup> See AEQUITAS COMPLIANCE SOLUTIONS, INC., FORECLOSURE IN CALIFORNIA: A CRISIS OF COMPLIANCE 7 (2012) [hereinafter "AEQUITAS"], available at [http://aequitasaudit.com/images/aequitas\\_sf\\_report.pdf](http://aequitasaudit.com/images/aequitas_sf_report.pdf) (finding that in 27% of sampled foreclosure cases, the mortgage assignment was signed by the servicer or trustee rather than the original lender, 11% of assignments were signed for the assignor by the assignee, and identifying other evidence of doubtful mortgage assignments).

### 3. The Failure of MERS to Accurately Record Mortgage Ownership

MERS was created in order to eliminate the need to record each mortgage assignment in county property records.<sup>85</sup> Participating member mortgage lenders and servicers agree to record mortgages in county property records showing MERS as the proxy mortgagee.<sup>86</sup> MERS purports to be a national database of mortgage ownership and ownership changes.<sup>87</sup> However, prior to 2011 MERS was not regulated by any state or federal agency, and its database was not regularly audited.<sup>88</sup> Because MERS relied on its mortgage industry members – banks and servicing companies – to voluntarily report loan ownership transfers, the MERS database was not a reliable record of those transfers.<sup>89</sup>

Our own survey of 396 foreclosure cases in six judicial foreclosure states found that where MERS was mortgagee of record (fifty percent of cases), the plaintiff asserting the right to foreclose matched an identified “investor” in the MERS public record only twenty percent of the time.<sup>90</sup> Not all mismatches mean that the MERS record is incorrect. For Fannie Mae loans, there will typically be a mismatch because MERS may accurately list Fannie Mae as the investor, while the foreclosure, per the Fannie Mae Servicing Guide, is filed in the name of the servicer as agent.<sup>91</sup> Likewise, the significant number of cases in which the MERS investor is not disclosed could mean either that MERS does not have a record of the current loan owner, or that it does have accurate information but refuses to disclose it.<sup>92</sup>

Based on the survey, there seems to be a general practice among foreclosure attorneys to record a mortgage assignment from MERS to the party bringing the foreclosure action, shortly before or

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<sup>85</sup> See *Hearing on MERS Before the H. Subcomm. on Hous. & Cmty. Opportunity of the H. Comm. on Fin. Servs.*, (Nov. 18, 2010) [hereinafter “Statement of R.K. Arnold”] (statement of R.K. Arnold, Pres. and C.E.O. of MERSCORP, Inc.); Peterson, *supra* note 8.

<sup>86</sup> Peterson, *supra* note 74, at 1370-71.

<sup>87</sup> Statement of R.K. Arnold, *supra* note 85.

<sup>88</sup> INTERAGENCY REVIEW, *supra* note 4, at 10.

<sup>89</sup> One court referred to MERS as the “Wikipedia” of land records. *Culhane v. Aurora Loan Servs. of Neb.*, No. 11-11098-WGY, 2011 WL 5925525 (D. Mass. Nov. 28, 2011).

<sup>90</sup> Data compiled by author from foreclosure and property records in Indiana, Ohio, Pennsylvania, Maryland, Texas, and Iowa. For details on the MERS/foreclosure comparison data, see Appendix 2.

<sup>91</sup> See Fannie May Servicing Guide, *supra* note 78.

<sup>92</sup> Peterson, *supra* note 8, at 130.

after filing the foreclosure, so that the record mortgagee matched the foreclosure plaintiff about ninety percent of the time. Thus, MERS and the mortgage servicer identified different entities as the mortgage owner in the majority of cases. For reasons explained in the Appendix, our sample is one of convenience rather than a representative sample of all judicial foreclosure states. However, our results are consistent with those from other investigators: MERS is not a “nationwide database that tracks changes in . . . ownership interest in mortgage loans”.<sup>93</sup>

Similarly low MERS accuracy rates were reported by an audit for the San Francisco Office of the Assessor-Recorder. California is a nonjudicial foreclosure state, so the audit compared the identity of the deed of trust beneficiary in the sale deed to the investor identified on MERS. The audit found only a 42% match excluding cases where MERS did not disclose the investor.<sup>94</sup>

An example of a MERS mortgage transfer history from the Maine case, *MERS v. Saunders*,<sup>95</sup> appears in Appendix 1. In this case, the MERS transfer history reflected that there was a foreclosure filing in January 2009, purportedly by the originating lender, although the opinion explains that Select Portfolio Servicing (“SPS”) brought the foreclosure, as servicing agent for Deutsche Bank, trustee. The history next reflected the removal of an apparent security interest in favor of warehouse lender Goldman Sachs. The MERS history did not contain any note of Goldman’s initial interest. Next, MERS shows that the beneficial ownership was transferred from the originator to the servicer, SPS. Last, SPS transferred the ownership interest to Deutsche Bank, several months after the foreclosure. Clearly, this particular MERS transfer history is inaccurate. Indeed, the history contained an unnecessary detour through the servicer and an incomplete creation and release of the warehouse lender’s security interest. The true mortgage transfer from the originator to Deutsche Bank was noted years after that change in beneficial ownership supposedly took place, and only after the issue was raised in a disputed foreclosure case.

The MERS transfer method has raised a host of unresolved

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<sup>93</sup> Statement of R.K. Arnold, *supra* note 85. For other findings of MERS’ inaccuracy, see Interagency Review, *supra* note 4; De. vs. MERSCorp, Inc., No. 2011-10-27, Compl. ¶ 8 (De. Ch. 2011). Even in cases where MERS was not used, foreclosure plaintiffs did not uniformly match the mortgage assignee in county property records. However, in those cases the mismatch rate was only 10%.

<sup>94</sup> AEQUITAS, *supra* note 84, at 13.

<sup>95</sup> See *Mortg. Elec. Registration Sys., Inc., v. Saunders*, 2 A.3d 289, 292 (Me. 2010).

legal issues. The first wave of cases concerned the question of whether MERS has standing (or is the real party in interest) so that it can bring a judicial foreclosure suit in its own name.<sup>96</sup> In states where MERS is found not to be the proper plaintiff, a relatively easy fix requires MERS to assign the mortgage back to the true assignee and note holder, who can sue in its own name.

However, this maneuver raises the question of whether a mortgage assignment from MERS to the current holder is valid.<sup>97</sup> These assignments are typically executed by employees of either the current servicer or the attorney filing the foreclosure, essentially purporting to act as agent for the assignor and assigning it to his or her principal (or client). The MERS system of allowing all its members' employees to appoint themselves assistant vice presidents raises important agency law questions regarding the validity of these assignments.<sup>98</sup> This becomes a particular concern when combined with the inaccuracy of the MERS database. If any mortgage servicer or foreclosure attorney belonging to MERS can assign a MERS mortgage to his company or his client relying on incorrect information in the database, the possibilities of error and of competing claims to the right to foreclose arise. More fundamentally, the ability of any MERS member to alter the mortgage ownership information in MERS more or less at will, may lead courts to become increasingly reluctant to recognize MERS assignments as a valid basis for a foreclosure sale.

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<sup>96</sup> Compare *Gomes v. Countrywide Home Loans, Inc.*, 121 Cal. Rptr. 3d 819 (Cal. Ct. App. 2011), *cert. denied*, 132 S. Ct. 419 (2011) (finding MERS may initiate nonjudicial foreclosure), with *Mortg. Elec. Registration Sys., Inc. v. Azize*, 965 So. 2d 151 (Fla. Dist. Ct. App. 2007) (finding that MERS may initiate judicial foreclosure), and *Mortg. Elec. Registration Sys., Inc. v. Barnes*, 940 N.E.2d 118 (Ill. App. Ct. 2010); see *Saunders*, 2 A.3d at 298 (MERS is not proper plaintiff in judicial foreclosure, but may assign mortgage to real party in interest); *Bank of N.Y. v. Silverberg*, 86 A.D.3d 294 (N.Y. App. Div. 2011). The author is not aware of any cases holding that MERS may not initiate a foreclosure sale in a nonjudicial foreclosure deed of trust state.

<sup>97</sup> See *In re Agard*, 444 B.R. 231 (Bankr. E.D.N.Y. 2011) (holding that MERS could not legally assign a mortgage because it was never a proper mortgagee).

<sup>98</sup> See *Peterson*, *supra* note 8; but see *Forbes v. Countrywide Home Loans, Inc.*, No. E051309, 2011 WL 4985965 (Cal. Ct. App. 2011) (rejecting claim that execution of assignment of deed of trust and on behalf of MERS and the trustee's deed on behalf of the beneficiary by the same individual was invalid).

#### 4. When Transfer Was Improper What Are the Consequences?

##### a. Mortgage: Judicial State Before Judgment and Sale

Courts in judicial foreclosure states differ when deciding how a failed mortgage transfer affects a plaintiff's legal right to foreclose. Three related questions do not seem to have a common answer: (1) whether the plaintiff in a foreclosure must hold a valid mortgage assignment, (2) whether the assignment must be recorded, and (3) whether the recording must occur before filing foreclosure.

The Connecticut Court of Appeals has held that the proper holder of the note is entitled to foreclose, even without any assignment of the mortgage.<sup>99</sup> The holding was based on a specific state statute that seemed to provide explicitly for that result.<sup>100</sup> As a result the court found that any problems with MERS as a mortgagee could not serve as the basis to challenge a foreclosure by the note holder, invoking the more general principal that "the mortgage follows the note."<sup>101</sup>

New York and Ohio courts, on the other hand, have consistently held that the foreclosing plaintiff must be the assignee of the mortgage prior to filing judicial foreclosure.<sup>102</sup> Certainly the preferred practice in most judicial foreclosure states is to record a valid assignment from the prior record mortgagee or assignee to the foreclosing entity prior to filing a foreclosure complaint, or at least prior to a judicial sale, to insure a complete record chain of title.

##### b. Mortgage: Judicial State after Judgment and Sale

In a post-judgment case, the Pennsylvania Superior Court voided a judicial foreclosure sale and set aside a default judgment, when the Complaint on its face alleged a mortgage to a different lender and did not even allege any transfer or assignment of the note or mortgage to the plaintiff in the case.<sup>103</sup> The case was unusual because the plaintiff's attorney failed to even allege a chain of mortgage assignments ending with the plaintiff. Nevertheless, the

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<sup>99</sup> Chase Home Finance, LLC v. Fequiere, 989 A.2d 606 (Con. App. Ct. 2010).

<sup>100</sup> CONN. GEN. STAT. § 49-17.

<sup>101</sup> Fequiere, 989 A.2d at 611.

<sup>102</sup> Wells Fargo Bank, N.A. v. Marchione, 69 A.D.3d 204, 887 N.Y.S.2d 615 (App. Div., 2009); Wells Fargo Bank, N.A. v. Byrd, 897 N.E.2d 722 (Ohio Ct. App. 2008); accord Morgan v. HSBC Bank, USA, NA, No. 2009-CA-000597-MR, 2011 WL 3207776 (Ky. Ct. App. July 29, 2011).

<sup>103</sup> Wells Fargo Bank, N.A. v. Lupori, 8 A.3d 919 (Pa. Super. Ct. 2010).

implications of the case are significant: if the complaint itself, presumably including attached mortgages and assignments, demonstrates that the plaintiff was not the mortgage assignee when the foreclosure was filed, the foreclosure sale will be subject to later attack. The case appears to be nearly unique, perhaps because most homeowners have focused their attacks on defective note transfers rather than defective mortgage assignments.

### c. Mortgage: Nonjudicial State before Sale

The California Court of Appeals held in *Gomes v. Countrywide* that a borrower could not assert a legal challenge to a trustee's sale prior to the sale based on asserted defects in the chain of ownership of the loan, namely the invalidity of a MERS mortgage assignment.<sup>104</sup> Other courts in nonjudicial states have followed a similar approach, reasoning that a trustee's sale is presumed to be bona fide, and it is not the obligation of the trustee to prove to anyone that it is authorized to foreclose by the proper beneficial owner of the mortgage.<sup>105</sup> Thus, we see a critical difference between judicial and nonjudicial foreclosure – the borrower cannot simply put the foreclosing party to its proof in a nonjudicial state. As a result, the ability of borrowers generally to assert mortgage transfer issues is considerably diminished in nonjudicial states, simply because of the burden of going forward.

On the other hand, some state statutes prescribing the process for nonjudicial foreclosure require recording of assignments of the beneficial interest in the deed of trust prior to sale, and hence will enjoin or invalidate a sale conducted without a valid, recorded assignment.<sup>106</sup>

### d. Mortgage: Nonjudicial State after Sale

Thus far, courts in nonjudicial foreclosure states have not been hospitable to homeowners bringing post-sale challenges based

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<sup>104</sup> *Gomes v. Countrywide Home Loans, Inc.*, 121 Cal. Rptr. 3d 819 (Cal. Ct. App. 2011), cert. denied, 132 S. Ct. 419 (2011).

<sup>105</sup> See, e.g., *Trotter v. Bank of N.Y. Mellon*, No. 38022, 2012 WL 206004 (Idaho Jan. 25, 2012).

<sup>106</sup> *Burgett v. Mortg. Elec. Registration Sys., Inc.*, No. 09-644-HO, 2010 WL 4282105 (D. Or. Oct. 20, 2010); see also *In re Adams*, 693 S.E.2d 705 (N.C. Ct. App. 2011) (denying judicial approval of a power of sale foreclosure in hybrid judicial/nonjudicial foreclosure where note was not endorsed to the selling party and no other evidence of note ownership was offered).



on allegedly invalid mortgage assignments. A number of legal impediments to such challenges may as a practical matter limit any impact on stability of titles that robo-signing and MERS may have had. First, in many states, a homeowner challenging a nonjudicial sale must plead that she was not in default in payments, or can tender payment in full of the mortgage debt.<sup>107</sup> Second, once a trustee's deed is conveyed to a bona fide purchaser, statutes or common law may preclude further challenges to the validity of the foreclosure sale based on note or mortgage transfer defects.<sup>108</sup> Thus a victim of an improper foreclosure may have a claim for damages, assuming they can establish causation, but finality policies will prevent title from being disturbed by post-sale challenges.

On the other hand, the Massachusetts Supreme Judicial Court, in a pair of 2011 decisions, *U.S. Bank v. Ibanez*<sup>109</sup> and *Bevilacqua v. Rodriguez*,<sup>110</sup> became the first state high court thus far to raise serious doubts about the validity of nonjudicial foreclosure sale titles tainted by gaps in mortgage assignments. Professor Elizabeth Renuart's recent article provides a thorough discussion of the Massachusetts cases, and their possible extension to other nonjudicial foreclosure states including California, Nevada, Arizona and Georgia.<sup>111</sup> Although she concludes that these four states could follow Massachusetts' lead, none of them has thus far. Interestingly, one appellate court in Alabama has followed Massachusetts, and ruled that a homeowner could defend against a post-sale ejectment action on the basis that the party noticing a nonjudicial foreclosure sale was not the mortgage assignee prior to the sale.<sup>112</sup>

The *Ibanez* case arose under somewhat peculiar circumstances. The foreclosing party, U.S. Bank, was in possession of a Note endorsed in blank, and thus had properly completed the Note transfer. However, it did not obtain a written assignment of the mortgage in any form until *after* the foreclosure sale. The title insurance company refused to insure title, and U.S. Bank then brought an action to quiet title to get judicial approval of its sale. Thus, the *Ibanez* holding is that 1) a separate written mortgage assignment (*not* including an assignment with a blank assignee) must

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<sup>107</sup> *In re Mortg. Elec. Registration Sys. (MERS) Litig.*, MDL No. 09-2119-JAT, 2011 WL 4550189 (D. Ariz. Oct. 3, 2011).

<sup>108</sup> *See, e.g.*, *JPMorgan Chase Bank NA v. Pace*, 163 Wash. App. 1017 (2011).

<sup>109</sup> *U.S. Bank Nat'l Ass'n v. Ibanez*, 941 N.E.2d 40 (Mass. 2011).

<sup>110</sup> *Bevilacqua v. Rodriguez*, 955 N.E.2d 884 (Mass. 2011).

<sup>111</sup> *See Renuart, supra* note 12.

<sup>112</sup> *Sturdivant v. BAC Home Loan Servicing, LP*, No. 2100245, 2011 WL 6275697 (Ala. Civ. App. Dec. 16, 2011).

be executed, but not necessarily recorded, before the assignee can foreclose, and 2) proper transfer of the Note is also necessary but not sufficient condition, i.e. the holder of the Note cannot conduct a nonjudicial sale without the written mortgage assignment. The court noted that the mortgage assignment could be proven with a bulk loan sale contract as well as an individual written assignment, but U.S. Bank was unable to produce the written documents showing it had purchased the particular loan at issue.<sup>113</sup>

*Ibanez* is stricter than most cases in nonjudicial states that require only evidence that the deed of trust was transferred, and do not require proof of note transfer, or that simply treat a trustee's deed as conclusive proof that the trustee had authority from the proper party to sell. One Michigan decision also voided a nonjudicial sale when the mortgage was not assigned until after the notice of the foreclosure sale was published,<sup>114</sup> but that case may no longer be good law after the Michigan Supreme Court's decision in *Saurman*.<sup>115</sup>

The impact of defective mortgage transfers on title will depend on definitive judicial resolution of several important issues. Nevertheless, one can see certain trends emerging. First, chain-of-title issues are unlikely to lead to large numbers of post-sale challenges. The *Ibanez* case notwithstanding, most courts have been unwilling to permit former homeowners to challenge a foreclosure sale after the fact based on mortgage transfer problems, whether the homeowners seek equitable relief undoing the sale or money damages. Massachusetts, Michigan, Alabama and Pennsylvania have thus far been the only states with judicial decisions invalidating a foreclosure sale based on transfer defects. The Massachusetts case arose not in the context of a borrower challenge but in a quiet title action brought by the lender and the subsequent purchaser to confirm the foreclosure deed. While there is certainly a theoretical problem with power of sale deeds where the grantor does not have a clear chain of title from the original trust deed beneficiary, the practical consequences of these gaps are limited if parties with an incentive to litigate cannot do so. Clearly, if the gap in mortgage loan transfers resulted from a double sale of the mortgage, or a fraudulent transfer to a thief, then the rightful owner of the mortgage could and would challenge the invalid sale, but these instances are likely to be rare.

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<sup>113</sup> *Ibanez*, 941 N.E.2d at 53.

<sup>114</sup> *Davenport v. HSBC Bank*, 739 N.W.2d 383 (Mich. Ct. App. 2007) (finding foreclosure sale void where foreclosing party received mortgage assignment four days after publishing the notice of the sale, and prior to the sale).

<sup>115</sup> See *supra* notes 63-67 and accompanying text.

Thus, the most likely ongoing impact, and the impact observed to date, has been and will be that homeowners intervening before a foreclosure judgment and sale, especially in judicial states, can prevent or delay foreclosure for extended periods of time, and in significant numbers. In New York State, for example, default judgments in foreclosures have declined from ninety-five percent to fewer than ten percent.<sup>116</sup> New York, along with other states, has also imposed affirmative obligations on foreclosure attorneys to verify the foreclosing party's standing, and those obligations have also slowed down filings.<sup>117</sup> When the validity of a mortgage transfer is raised prior to judgment, there is obviously no cloud on title that lingers after the foreclosure. Either the right party is foreclosing, or the foreclosure sale will be prevented until the mortgage and note transfers are properly completed. At the same time, post-sale challenges are possible, in both judicial and non-judicial foreclosure states, although borrowers face serious hurdles in bringing them. Just how much traction *Ibanez* and its progeny will have and what it will prove to be its legacy on foreclosure titles depends as much on the wherewithal of lawyers and litigants as on the resolution of knotty legal issues.

The political and economic context also matters. The tidal wave of foreclosure litigation around note and mortgage transfers is taking place because millions of delinquent homeowners are seeking workouts and contract modifications from recalcitrant mortgage servicers.<sup>118</sup> The national settlement among federal and state regulators and five major banks resolves regulator claims arising in part from robo-signing and transfer failures, but its remedies call for extensive new efforts to work out troubled mortgage loans. The failures of mortgage servicing are thus directly related to the clouding of foreclosure titles, in the sense that far fewer borrowers would assert transfer failures in litigation if comprehensive renegotiation of defaulted loans could resolve the present foreclosure crisis.

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<sup>116</sup> STATE OF NEW YORK UNIFIED COURT SYSTEM, 2011 REPORT OF THE CHIEF ADMINISTRATOR OF THE COURTS PURSUANT TO CHAPTER 507 OF THE LAWS OF 2009, at 4, available at <http://www.courts.state.ny.us/publications/pdfs/ForeclosuresReportNov2011.pdf>.

<sup>117</sup> *Id.* at 1-2.

<sup>118</sup> Jean Braucher, *Humpty Dumpty and the Foreclosure Crisis: Lessons from the Lackluster First Year of the Home Affordable Modification Program (HAMP)*, 52 ARIZ. L. REV. 727 (2010); Opening Address by FDIC Chairman Sheila C. Bair, Summit on Residential Mortgage Servicing for the 21st Century, Sponsored by the Mortgage Bankers Association; Washington, D.C. (January 19, 2011), available at <http://www.fdic.gov/news/news/speeches/chairman/spjan1911.html>.

## II. WHY IT MATTERS: CONSUMER PROTECTION ISSUES IN MORTGAGE TRANSFERS

While the current wave of litigation of foreclosure standing and note transfer issues will take years to be resolved, it remains important to consider how a better system for tracking mortgage loan ownership might take shape. In moving away from the old paper endorsement and delivery of note plus recorded mortgage assignment system, there are important consumer protection interests at stake. The key consumer protection interests implicated by mortgage transfers are 1) avoiding double payment or double liability, 2) getting a prompt and secure release or satisfaction upon payment in full and 3) having a counter-party with authority to negotiate workouts in the event of payment difficulties.

### A. Double Liability

The endorsement and delivery of a tangible paper note, the reification of a payment obligation, serves to protect borrowers from paying an obligation twice, or paying the wrong creditor. Obviously only one original paper note can be presented for payment by one party.<sup>119</sup> An instance where such a threat becomes real is warehouse-lending fraud, in which a crooked mortgage company sells the same note to multiple parties.<sup>120</sup>

Another example of how competing claims to a mortgage can arise is illustrated in *Diversified Mortgage, Inc. vs. Merscorp, Inc.*<sup>121</sup> A dispute apparently arose among partners or investors in a group of mortgage loans for which MERS was the record mortgagee. The plaintiff sought declaratory and injunctive relief to prevent MERS from permitting any of MERS "assistant vice presidents" to transfer the mortgages to other entities while the ownership of the loans was litigated.

In any such case, the borrower wants to be sure that the servicer delivers all payments they make to the proper party. After full payment, borrowers should not face demands for more money, or

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<sup>119</sup> See U.C.C. § 3-501(b)(2) (requiring the party seeking payment on a negotiable instrument to exhibit the instrument and surrender it if payment in full is made).

<sup>120</sup> See *Provident Bank v. Cmty. Home Mortg. Corp.*, 498 F. Supp. 2d 558 (E.D.N.Y. 2007); Whitman, *supra* note 14, at 768 n. 174.

<sup>121</sup> *Diversified Mortg., Inc. v. MERSCorp, Inc.*, No. 8:09-cv-2497-T-33EAJ, 2010 WL 1793632 (M.D. Fla. May 5, 2010).

worse yet, foreclosure actions on the paid-off debt.<sup>122</sup> Any electronic system for tracking ownership rights in mortgage loans must be sufficiently reliable and authoritative so that consumer borrowers are protected from double liability.

### *B. Availability and Validity of Mortgage Satisfaction*

Borrowers who complete their mortgage loan payments not only wish to avoid further liability, but also are entitled to have the mortgage lien removed from the property records to clear their title and permit future sales, or mortgages. This is usually accomplished by the filing of a separate mortgage release or satisfaction document. One of the asserted benefits of MERS was that it solved the problem that arose when homeowners finished paying a loan but could not get a satisfaction or release document from a defunct lender. Borrowers in some cases may have trouble locating the holder of an old mortgage in order to obtain a release or satisfaction that can be recorded after full payment in order to clear title. This problem could be resolved by adoption of the 2004 Uniform Residential Satisfaction Act, which provides a self-help title clearing mechanism, but that act has been adopted in only two states thus far.<sup>123</sup>

While an accurate and authoritative database of mortgage ownership would in theory solve the problem, the extensive inaccuracy of MERS seems to only compound the difficulty. The New York Attorney General's 2011 suit against MERS alleges that MERS has repeatedly filed erroneous mortgage satisfactions on the wrong property. After discovering its error, MERS (i.e. the servicer) will then file a *lis pendens* against the property, causing the homeowner needless title problems and legal expenses.<sup>124</sup> In early 2012 the Guilford County North Carolina recorder of deeds published extensive documentation on its web site showing mortgage satisfactions filed on behalf of MERS by various banks and securitization trustees, signed by known robo-signers, i.e. by

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<sup>122</sup> Michelle Conlin, *Foreclosure from Old Mortgages 'Most Egregious Manifestation' of Broken Housing Market*, HUFFINGTON POST, Jan. 26, 2012, available at [http://www.huffingtonpost.com/2012/01/26/foreclosure-crisis-old-mortgages-most-egregious-manifestation\\_n\\_1233256.html](http://www.huffingtonpost.com/2012/01/26/foreclosure-crisis-old-mortgages-most-egregious-manifestation_n_1233256.html).

<sup>123</sup> R. Wilson Freyermuth, *Why Mortgageors Can't Get No Satisfaction*, 72 MO. L. REV. 1159 (2007); Uniform Residential Mortgage Satisfaction Act (2004), available at <http://www.law.upenn.edu/bll/archives/ulc/umsa/2004finalact.pdf>.

<sup>124</sup> Complaint by NY Attorney General Schneiderman in *New York v. J.P. Morgan Chase Bank*, No. 2768/2012 ¶ 97 (N.Y. Sup. Ct. Kings Cty 2012) [hereinafter N.Y. Attorney General Complaint].

individuals whose names appear more or less simultaneously as the “assistant vice president” or other officer of multiple financial institutions, and hence whose authority to satisfy the mortgages is questionable.<sup>125</sup> Presumably, these satisfactions were produced at the behest of the servicer acting in the belief that they were authorized by the appropriate assignee. Nevertheless, if another lender, perhaps a debt buyer, sought to enforce the satisfied mortgage, there could be expensive title litigation about the validity of the satisfactions.<sup>126</sup>

### C. Negotiating Workouts

One of the many complaints from homeowners and their advocates about mortgage servicers during the 2007-2012 foreclosure crisis has been the difficulty in negotiating loan modifications and other alternatives to foreclosure. While servicing problems and reforms are beyond the scope of this article, the issue of servicer authority to negotiate workouts is connected to mortgage transfers. In some instances, servicers will refuse to renegotiate mortgage payments, or other workouts such as short sales, invoking a refusal by, or lack of authority from, the “investor”. MERS has made it more difficult for homeowners to identify their mortgage holder. Having this information could permit homeowners to challenge servicer refusal to negotiate, by, among other things, inspecting publicly disclosed servicing contracts governing securitization trusts.<sup>127</sup>

Fannie Mae’s and MERS’ response is that most securitization contracts give the servicer full authority, within some bounds, to renegotiate mortgages, so that the identity of the investor should be irrelevant to the homeowner. Nevertheless, there is a genuine consumer borrower interest in transparency of mortgage assignments so that the identity of the real counterparty is known. These basic consumer protection goals should inform the design of any modernized legal infrastructure for recording mortgage loan transfers.

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<sup>125</sup> See Guilford County, North Carolina, Register of Deeds, *Mortgage Fraud Information From Press Conference*, available at <http://www.co.guilford.nc.us/departments/rod/fraud.html>.

<sup>126</sup> See Conlin, *supra* note 122 (debt buyers seeking to enforce mortgages previously believed to have been paid in full.); see also U.S. Government Accountability Office, *Credit Cards: Fair Debt Collection Practices Act Could Better Reflect the Evolving Debt Collection Marketplace and Use of Technology*, at 29 (Sept. 2009), available at <http://www.gao.gov/products/GAO-09-748>); Fed. Trade Comm’n, *Collecting Consumer Debts: The Challenges of Change*, at 22-23 (Feb. 2009), available at <http://www.ftc.gov/bcp/workshops/debtcollection/dcwr.pdf>.

<sup>127</sup> See N.Y. Attorney General Complaint, *supra* note 124, ¶¶ 107-08.

### III. DESIGNING A RELIABLE ELECTRONIC MORTGAGE AND NOTE TRANSFER SYSTEM WITH FULL CONSUMER PROTECTION

#### *A. Require Full Disclosure of Agency Relationships and Transfer History*

The difficulty in identifying the real party able to negotiate loan workouts and resolve possible errors would be considerably reduced if all principal-agent relationships were required to be disclosed during foreclosure. Two of the biggest sources of confusion about whether and to what extent there are breaks in the chain of title are 1) the Fannie Mae and Freddie Mac policy of filing foreclosures in the name of the servicer while representing that the servicing agent is in fact the principal obligee and 2) the use of MERS as a proxy agent for multiple parties including the assignor, the assignee and the current servicer.

Thus, a foreclosure filed in a judicial foreclosure state, and a notice of sale in a non-judicial sale, should mandatorily identify the original lender, current assignee, current servicer, and any agents or proxies acting on behalf of any of them.<sup>128</sup> For example, a foreclosure complaint might recite that it was filed by MERS, as agent for the servicer, Bank of America, which in turn is the servicing agent for Wells Fargo Bank, trustee for an identified trust, which acquired the loan on a specified date from New Century Mortgage, the original lender.

To deal with contract renegotiations, possible double payment issues and prompt satisfaction issues, a better system design would incorporate transparent and authoritative registration of mortgage loan ownership throughout the life of the loan, and not just at the point foreclosure is initiated. Obviously, a system relying on electronic document images, or on a database, would need adequate safeguards to insure accuracy and to justify its use as an authoritative determinant of mortgage loan ownership.

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<sup>128</sup> A similar proposal for a federal clearinghouse with this information is made in David P. Weber, *The Magic of the Mortgage Electronic Registration System: It Is and It Isn't* (2011) (unpublished manuscript), available at <http://ssrn.com/abstract=1898306>.

*B. Merge the Note and Mortgage into a Single Document and  
Execute Transfers by Single Assignment*

The first and most obvious step in moving to a reliable and authoritative electronic system protecting lenders, borrowers, assignees and other parties to property title is to combine the note and mortgage into a single instrument, with the full image of the instrument and all later modifications to its parties and terms updated in a single electronic registry. Such a system would promptly eliminate the issues created when the note and mortgage travel on different paths, or appear to do so. The details of regulation of such a registry, which could conceivably evolve from the current MERS database, are beyond the scope of this article, but necessarily would include some sort of public audit and methods for interested parties to correct errors, akin to the Fair Credit Reporting Act's provisions for consumer reports.<sup>129</sup>

The primary reason to have separate Note and Mortgage documents has been the need to preserve negotiability of the note and the possibility for a note buyer to become a holder in due course. Article 3 of the UCC protects certain note holders from personal claims and defenses of the borrower in order to promote the easy sale of notes, but only on the condition that the note be stripped of most ancillary contractual promises that are essential to a mortgage transaction, such as promises to insure and maintain the property. The solution to preserve negotiability while gaining the security of real property collateral was to create two separate documents, the negotiable note and the non-negotiable mortgage.

As Dale Whitman, Kurt Eggert and Ronald Mann have all persuasively argued, the relevance of negotiability of mortgage notes has been largely lost over the course of the twentieth century.<sup>130</sup> The secondary market for mortgages is highly liquid, and does not seem to depend on the holder in due course doctrine to any great extent, and in fact borrowers are harmed by the doctrine.<sup>131</sup> The liability of mortgage loan assignees is now governed in many cases by separate consumer protection statutes, like the Truth in Lending Act.<sup>132</sup>

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<sup>129</sup> See 15 U.S.C. § 1681i (providing procedures to correct erroneous credit report information).

<sup>130</sup> Whitman, *supra* note 14; Kurt Eggert, *Held up in Due Course: Codification and the Victory of Form Over Intent in Negotiable Instrument Law*, 35 CREIGHTON L. REV. 363, 368-74 (2002); Ronald J. Mann, *Searching for Negotiability in Payment and Credit Systems*, 44 UCLA L. REV. 951, 969-73 (1997).

<sup>131</sup> Whitman, *supra* note 14.

<sup>132</sup> Kathleen Engel & Thomas James Fitzpatrick IV, *Complexity, Complicity*,



The note/mortgage document could also be greatly simplified, based on consumer testing and research by the Consumer Financial Protection Bureau. To insure the authenticity of the authoritative document, the full document image should be transmitted in a short time after the transaction to the registry, and should be available for free inspection by the lender, the borrower, the title insurer and any other appropriate party. It might still be possible to maintain some minimal degree of privacy by restricting access to parties with a genuine need to inspect the document, or the decision could be made that mortgage/notes should be fully public. Enabling legislation would require that any changes in parties (lender, borrower, or servicer) be promptly submitted to the registry as a condition of their enforcement. To put it another way, no foreclosure of the mortgage could occur except when initiated by and against the currently registered parties to the mortgage/note. There is no particular reason foreclosure could not be initiated in the name of the servicer, on condition that it acted as a disclosed agent for the disclosed investor and principal. Nor would there ever be any reason to bring foreclosures in the name of the registry, a regrettable practice promoted by MERS that has led to nothing but chaos in the courts.

### CONCLUSION

Massive origination of mortgage loans relying on the sell-to-distribute model, followed by massive foreclosures, has led to chaos in the legal processes to track who may foreclose and sell homes. As mortgage industry participants struggled to keep up with the paperwork and resorted to robo-signing, wide gaps appeared in the chains of loan ownership. Some of the paper gaps can be filled and some cannot. Courts have been shocked at bank practices, but are probably unwilling to issue decisions that will void titles on a vast scale. On the other hand, they are perfectly willing to delay foreclosures when homeowners point out the gaps. There are no quick solutions for legislators or regulators to rescue the industry from its mess. While some legal issues are being settled, many other legal questions must wind their way through the courts, including those raised as a result of the widespread use of MERS as a recording proxy. A transition from paper to electronic note/mortgage transfers could solve many problems going forward, but it will not clear the foreclosure backlog, nor will it clarify the muddied titles that are one

of the legacies of the 2007 crisis.

## APPENDIX 1: MERS LOAN OWNERSHIP REPORTING

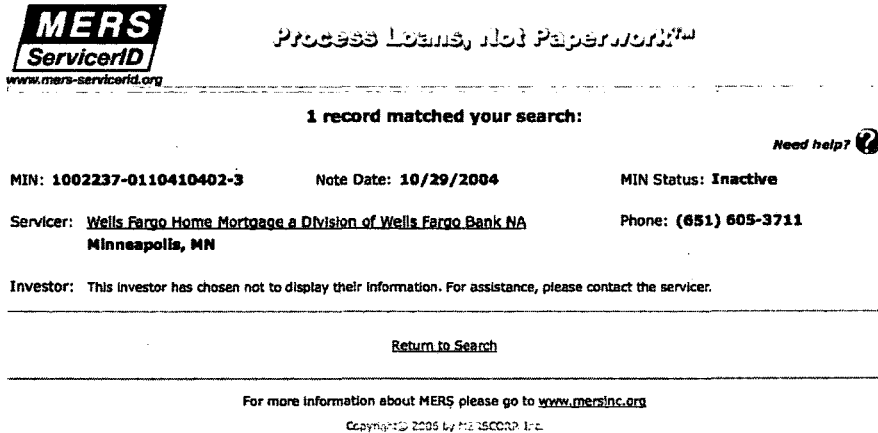
Figure 1: MERS "Milestones" printout tracking ownership of mortgage in *MERS v. Saunders*, 2 A.3d 289 (Me. 2010) (MERS mortgage originated and securitized in 2006, foreclosure filed in February 2009 in the name of MERS, 2009 note allonge endorsed by Accredited produced after foreclosure filed, together with MERS assignment to Deutsche Bank, Deutsche Bank trustee later substituted as plaintiff):

### MILESTONES for 1001761-0606205892-1



Description	Date	Initiating Organization / User	Milestone Information
Transfer Beneficial Rights - Option 2	07/31/2009	1000938 Select Portfolio Servicing Inc  Kim Clark	MIN Status: Active (Registered) New Investor: 1001425 Deutsche Bank National Trust Company as Trustee Old Investor: 1000938 Select Portfolio Servicing Inc Batch Number: 6554789 Transfer Date: 07/31/2009
Transfer Beneficial Rights - Option 2	06/26/2009	1001761 Accredited Home Lenders  Batch	MIN Status: Active (Registered) New Investor: 1000938 Select Portfolio Servicing Inc Old Investor: 1001761 Accredited Home Lenders Batch Number: 6459094 Transfer Date: 06/26/2009
Warehouse Origination Lender Removed	03/06/2009	1001761 Accredited Home Lenders  Jennifer Markowitz	MIN Status: Active (Registered) Old : 1001383 Goldman Sachs Mortgage Company Batch Number: 6112327 Transfer Date: 03/01/2009
Transfer Seasoned Servicing Rights	03/06/2009	1001761 Accredited Home Lenders  Jennifer Markowitz	MIN Status: Active (Registered) New Servicer: 1000938 Select Portfolio Servicing Inc Old Servicer: 1001761 Accredited Home Lenders Batch Number: 6112327 Sale Date: 03/01/2009 Transfer Date: 03/01/2009
Foreclosure Status Update	01/13/2009	1001761 Accredited Home Lenders  Carla Gangozza	MIN Status: Active (Registered) Foreclosure Status: Foreclosure Pending (option 2), retained on MERS Quality Review: N
Registration	07/05/2006	1001761 Accredited Home Lenders  Batch	MIN Status: Active (Registered) Servicer: 1001761 Accredited Home Lenders

Figure 2: MERS loan search web page screenshot (May 26, 2011), in response to query based on MERS identification number (“MIN”), no investor disclosed:



**MERS**  
ServicerID  
www.mers-servicerid.org

Process Loans, Not Paperwork™

**1 record matched your search:**

[Need help?](#)

MIN: **1002237-0110410402-3**      Note Date: **10/29/2004**      MIN Status: **Inactive**

Servicer: **Wells Fargo Home Mortgage a Division of Wells Fargo Bank NA**      Phone: **(651) 605-3711**  
**Minneapolis, MN**

Investor: This investor has chosen not to display their information. For assistance, please contact the servicer.

[Return to Search](#)

For more information about MERS please go to [www.mersinc.org](http://www.mersinc.org)  
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## APPENDIX 2 – THE MERS/COURT RECORD SURVEY

Between April and August 2011 we searched on-line court dockets for judicial foreclosures filed in the name of Deutsche Bank, Bank of New York and Wells Fargo Bank, primarily but not exclusively filed as trustee for securitization trusts. These three banks served as trustee in a large number of non-GSE securitizations of mortgages prior to the 2008 foreclosure crisis, and thus we would expect to see multiple mortgage transfers in those cases. We examined court dockets, and where available, complaints, to determine the identity of plaintiff and alleged chain of mortgage ownership. Records were obtained from fourteen counties in six states (Indiana, Iowa, Maryland, Ohio, Pennsylvania, Texas). Sixty percent of the records were from Cuyahoga County Ohio (Cleveland.)

We then searched on-line county property records to identify the original mortgagee and any recorded assignments. (The sample counties were selected based on the availability of electronic court and property records.) In any case where MERS had a record interest (forty-nine percent of all cases), we searched the MERS ID public web page and recorded the investor and servicer. To match the foreclosure to a MERS ID, we used the MERS loan identification number when available from the property record (the image of the

original mortgage, typically) or attachments to the foreclosure complaint; otherwise we searched MERS for the property owner/defendant name and property address. Because of differences in address designations, common names, and other typical searching problems, MERS IDs may in a small number of instances have produced erroneous results, for example by locating a second mortgage or other unrelated mortgage in the MERS system that was not the same as the mortgage involved in the foreclosure.

During the study period it was possible to search MERS records to identify both the servicer and the “investor” at <https://www.mers-servicerid.org/sis/search>. At some point in August or September 2011 MERS stopped permitting public searches for the mortgage investor, restricting access to individual mortgage borrowers by requiring entry of borrower personal identifying information for each query. As a result our sampling was cut short and is unbalanced in the ways previously mentioned. It can best be described as a convenience sample.

Out of 396 cases, 357, or ninety percent, had matching foreclosure plaintiffs and record mortgagees or assignees. Thus, the county property records and foreclosure filings seemed to be generally consistent, albeit with a significant ten percent error rate. It appears that in most of the counties we studied, courts required the plaintiff to be the mortgage assignee of record, and that foreclosure firms were relatively diligent in getting facially compliant assignments recorded, although some were recorded after the foreclosure filing, and may have been signed by MERS assistant vice presidents, improperly notarized, or had other defects.

The MERS records, on the other hand, showed a match between the “investor” in the MERS database and the foreclosure plaintiff in only twenty-three of 195 cases, i.e. twelve percent of the MERS cases. The MERS database identified the investor as “not disclosed” in 105 of those cases, Fannie Mae in twenty-four cases, and another non-matching investor in the remaining forty-four cases.

Case summaries from court and deed recorder records often truncate the plaintiff’s name, so that for example Bank of New York Trust Co., Trustee for First Franklin Mortgage Loan Trust 2005-FF-5 may appear as BANK OF NEW YORK. We treated any designation of the correct trustee as a match, despite the failure to identify the specific trust in either the foreclosure complaint or the MERS records. As a result we probably overestimate the match rates. We also disregarded differences between different subsidiaries of the same bank holding company, so that for example we treated a case with Wells Fargo Bank, NA as the plaintiff and Wells Fargo Home

Mortgage, Inc. as the record mortgage assignee as a match, although strictly speaking it is not. MERS allowed its members the option whether or not to disclose the “investor”, and in fifty percent of the cases the investor was “not disclosed.” Those cases were treated as not matching. The twenty-four cases in which Fannie Mae is the MERS identified investor may be correct, because the bank plaintiff may in fact have been servicing those loans for Fannie Mae. We did not take the extra step of checking the loans on the Fannie Mae lookup site because of the lapse of time from many of the foreclosures.

We found only eight cases in which MERS was the current record mortgage holder or assignee. Of course the selection criteria were that foreclosures were filed in the name of the trustee bank and not in the name of MERS. Generally speaking in the counties we examined plaintiffs were obtaining assignments from MERS to the foreclosure plaintiff and recording those assignments, usually but not always prior to the foreclosure.

Table 1 – Current Mortgage “investor” According to MERS

<b>MERS “Investor:” FC Plaintiff = Wells Fargo, Deutsche Bank or Bank of New York</b>			
	<b>Frequency</b>	<b>Percent</b>	<b>Valid Percent</b>
AHM Acceptance, Inc.	1	0.3	0.5
Aurora Bank FSB	1	0.3	0.5
BAC Home Loan Servicing LP	2	0.5	1
BAC Home Loans Servicing LP	1	0.3	0.5
Bank of America, NA	2	0.5	1
Bank of America, National Association	1	0.3	0.5
Bank of New York Mellon NA	6	1.5	3.1
Barclays Bank PLC	2	0.5	1
Countrywide Bank FSB	1	0.3	0.5
Credit Suisse First Boston LLC	1	0.3	0.5
Deutsche Bank National Trust Company as Trustee	1	0.3	0.5
Deutsche Bank National Co as Trustee	1	0.3	0.5
Deutsche Bank National Trust Co as Trustee	4	1	2.1

Deutsche Bank National Trust Company	1	0.3	0.5
Deutsche Bank National Trust Company as Trustee	4	1.1	2.0
EMC Mortgage Corporation	1	0.3	0.5
EMC Mortgage LLC	1	0.3	0.5
Encore Credit Corp.	1	0.3	0.5
Fannie Mae	24	6.1	12.3
FDIC as Receiver for Washington Mutual Bank	2	0.5	1
Federal Home Loan Bank of Chicago, as MPF	1	0.3	0.5
Home Vest LLC	1	0.3	0.5
HSBC Mortgage Services	2	0.5	1
Impac Mortgage Holdings, Inc.	1	0.3	0.5
JP Morgan Chase Bank as Trustee	5	1.3	2.6
JP Morgan Chase Bank NA	1	0.3	0.5
MetLife Home Loans, a Division MetLife Bank, N.A.	1	0.3	0.5
Morgan Stanley Mortgage Capital Holdings, LLC	2	0.5	1
Not disclosed	105	26.5	53.8
Novastar Mortgage, Inc.	1	0.3	0.5
Ocwen Loan Servicing, LLC	1	0.3	0.5
PHH Mortgage Corporation	1	0.3	0.5
The Bank of New York Mellon	1	0.3	0.5
The Bank of New York Mellon, N.A.	3	0.8	1.5
The Bank of New York Mellon, N.A. as Trustee	2	0.5	1
UBS Real Estate Securities, Inc	1	0.3	0.5
Universal American Mortgage Company, LLC	1	0.3	0.5
Unknown	4	1	2.1
Vericrest Financial, Inc.	2	0.5	1
WMC Mortgage Corporation	1	0.3	0.5
Total MERS cases	195	49.2	100
Not MERS mortgage	201	50.8	
Total cases	396	100	

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