

Legal analysis to guide the mortgage industry and protect its interests.

Massachusetts Bankruptcy Court Invalidates Sale Where Lender Held Original Note

R. Ryan Daugherty

In re Schwartz, AP No. 07-04098, 2011 WL 3667494 (D. Mass. Aug. 22, 2011) – The United States Bankruptcy Court in Massachusetts has held that a foreclosing trust must have an actual Assignment of Mortgage prior to publishing notice of sale and initiating foreclosure, regardless of whether the trust can show its acquisition of the mortgage loan pursuant to the securitization documents, if the subject loan was originally in the name of Mortgage Electronic Registration Systems, Inc.

In this case, Deutsche Bank National Trust Company, as Trustee (“Deutsche”) foreclosed on the property owned by Sima Schwartz. Schwartz signed the mortgage and note on July 22, 2005, and the trust containing Schwartz’s loan was formed on November 29, 2005. Schwartz defaulted on the loan and foreclosure on Schwartz’s loan was initiated on May 3, 2006, when notice of the foreclosure was published pursuant to Mass. Gen. Laws Ann. ch. 244, § 14. The original mortgagee named in Schwartz’s mortgage was Mortgage Electronic Registration Systems, Inc. (“MERS”). MERS executed an assignment to Deutsche on May 23, 2006, and the non-judicial foreclosure was completed on May 24, 2006.

After the foreclosure, Schwartz filed bankruptcy and filed an adversary proceeding against Deutsche. The Bankruptcy Court construed Schwartz’s adversary complaint as a request to have the foreclosure sale held invalid and conducted a trial on the issues. At the trial, Deutsche introduced ample evidence proving every step of the securitization chain, and showing that Schwartz’s mortgage loan was indisputably included in the trust through the Mortgage Loan Schedule. Deutsche also established that it was in possession of the original note executed by Schwartz, which was indorsed in blank, and that Deutsche had been in possession of the note since before the trust was formed. Regardless, Schwartz contended that the foreclosure sale was invalid because Deutsche did not have an actual Assignment of Mortgage from MERS at the time the first publication notice was advertised.

The Bankruptcy Court agreed with Schwartz, holding the foreclosure sale invalid because MERS continued to hold legal title at the time the first notice was published. The Court based its decision on the Massachusetts Supreme Judicial Court’s holding in *U.S. Bank Nat’l Ass’n v. Ibanez*, 941 N.E.2d 40 (2011), which the Bankruptcy Court held as requiring “that a foreclosing mortgagee must hold the mortgage as of the date that the first notice of sale is published.” The Bankruptcy Court acknowledged that *Ibanez* appeared to allow for an exception where the foreclosing trust could show that it had acquired the mortgage through the securitization process, even if the trust did not have an actual Assignment of Mortgage from the original mortgagee. In an unexpected twist, however, the Bankruptcy Court held that because MERS retained legal title to the mortgage on the date of publication, Deutsche was incapable of exercising the power of sale in the mortgage regardless of the securitization documents it submitted proving its ownership of the loan in question. In other words, where MERS is named as the original mortgagee, the trust cannot foreclose until it receives an actual Assignment of Mortgage from MERS.

In doing so, the Bankruptcy Court upheld the MERS system and MERS's authority to hold title to the mortgage on behalf of the lender, and later assign that interest for foreclosure purposes as the need arises. The same court issued the opinion earlier this year in *In re Marron*, 2011 WL 2600543 (Bkrtcy. D. Mass. Jun. 29, 2011), which also affirmed the MERS system. This holding, while outstanding for MERS's ability to act on behalf of the lender in assigning the mortgage, is extremely concerning for trust related loans that have foreclosed in Massachusetts without first obtaining an Assignment of Mortgage. As pointed out by the Supreme Judicial Court in *Ibanez*, Massachusetts is one of the few states in the country where an assignment of the mortgage does not follow a transfer of the note, and a separate assignment of mortgage is needed. Consequently, *Schwartz*, like *Ibanez*, should be easily distinguishable in most jurisdictions. In Alabama, for example, the statutory authority provides that the power of sale "may be executed by any person, or the personal representative of any person who, **by assignment or otherwise**, becomes entitled to the money [] secured" by the mortgage. See Ala. Code § 35-10-12 (emphasis added).