

'Standing' on Shifting Ground

BY SHAUN RAMEY

A landmark verdict was reached in February 2011 upholding a securitized trust's right to foreclose. It was a major victory for securitized lenders on the issue of standing.

It must have been a curious sight to the presiding judge of Jefferson County (home to Alabama's largest city, Birmingham) when he took the bench in June 2010 to preside over a "routine" eviction trial. But like many matters in the modern mortgage litigation world, there was nothing routine about this eviction trial. ■ To start, the courtroom gallery housed an array of interested people, including other attorneys (both from Alabama and neighboring Florida), consumer-rights advocates and bloggers. They came because they'd heard that the issue of "standing" was going to be tried for the first time in any court in the country, and they hoped for an outcome they could use to support their own cases and causes. ■ The parties spent three days analyzing and questioning documents outside the normal eviction process, including Pooling and Servicing Agreements (PSAs), related prospectuses, mortgage loan schedules (MLSes) and the original collateral file. ■ The borrower's counsel retained and presented expert testimony from two experts—one in structured finance, the other a professor of New York trust law. The borrower's counsel attacked virtually every aspect of the precedent non-judicial foreclosure sale, focusing heavily on the securitization of the loan. ■ The borrower's counsel claimed, among other things, that 1) the note was not timely transferred to the securitized trust; 2) the trust did not "own" the note; 3) the endorsements on the note were allegedly forged; 4) another entity, other than the foreclosing trust, could own the loan; and (5) New York trust law, which was the choice of law specified in the securitization documents, voids any sale or conveyance in contravention of the trust.

As the judge had denied the borrower's motion for counterclaims prior to trial, there were no money damages at stake. Rather, from the viewpoint of the securitized trust, it sought possession of a property secured by a \$104,400 loan.

From the viewpoint of the borrower's counsel, however, they sought something much larger than a verdict in this one case. They sought a verdict they could use to challenge nationwide the standing of securitized trusts to foreclose.

The trial judge did not issue a hasty decision in what had become a very non-routine eviction action.

Following the trial, the parties submitted lengthy post-trial briefs analyzing the issues on a nationwide basis, so the court would be well equipped to make a decision. Furthermore, while waiting for the verdict, the borrower's trial counsel taught other borrowers' counsel at nationwide "boot camps" the techniques and theories they had employed at trial so these other counsel could launch the same attacks in their respective jurisdictions.

A landmark verdict

On Feb. 23, 2011, some nine months after the trial, the court issued a 21-page order upholding the securitized trust's right to foreclose, signifying a landmark victory for securitized lenders on the issue of standing.

The decision was *U.S. Bank NA v. Congress*, pending in the Circuit Court of Jefferson County, Alabama. In its order, the court issued several findings, many of which should have nationwide application.

First, the court found that the trustee affirmatively proved its case for eviction (technically, referred to as an "ejectment" in Alabama), holding that the borrower's allegations against the trustee were affirmative defenses for which she bore the burden of proof. The court specifically rejected the notion that the borrower's allegations raised issues of standing, noting that the trust proved standing by virtue of being named in the foreclosure deed.

Second, the court rejected the borrower's claim that the mortgage was not transferred to the trust prior to the closing date listed in the PSA. The court stated that the listing of the borrower's mortgage in the MLS to the PSA along with various representations made in the PSA was evidence that the loan was transferred into the trust prior to the trust's closing date.

Third, the court rejected the borrower's claim that the foreclosure was invalid because the trust lacked the authority to own the note at the time of the foreclosure. The court cited long-established commercial law that provides a party does not have to own a note, but must merely "hold" the note in order to be a party entitled to enforce the note. The court found the trustee or its custodian held the note, and therefore had the legal right to foreclose.

Fourth, the court dismissed the borrower's claims of forgery by stating that the signatures on the note and

alonge (a piece of paper affixed to the note, on which to place additional endorsements) are presumed admissible under the rules of evidence and the Alabama Commercial Code (which is identical to the Uniform Commercial Code [UCC]) and digital signatures and stamps are sufficient. Noting the serious nature of such claims, the court held that allegations of forgery must be proven by "clear and convincing evidence."

Fifth, the court dismissed the borrower's claim that some other entity might enforce her note by holding that the borrower failed to present any evidence that any entity other than the plaintiff trust has an interest in the mortgage. Observing that the borrower admittedly had not been contacted by any other party about the debt, the court stated that "[i]n the remote possibility that some other entity should someday claim an interest in the note, such a claim could be thwarted by the judgment in this case."

Sixth, the court rejected the borrower's claims that New York trust law applied to the foreclosure that was conducted in Alabama because the borrower could not invoke the New York choice of law provisions because she was not a party to the PSA.

Finally, in closing, the court classified in simple terms what had turned into a very complicated case, stating, "Laying sympathy aside, the thrust of the case is that [the borrower] borrowed \$104,400 and put up her residence as security for repayment of the loan. She failed to make the required payments. Plaintiff is entitled to possession of the security."

On issues of standing

While a landmark victory for lenders, the *Congress* decision is not the final say on issues of standing. A month later, two more opinions were handed down by trial judges in Alabama with some bearing on this topic.

The first was issued by the presiding judge of the state's capital in the case of *Wells Fargo Bank NA v. Thomas* (March 2011), pending in the Circuit Court of Montgomery County, Alabama. *Thomas*, like *Congress*, upheld the securitized trust's right to foreclose in a nine-page opinion on competing motions for summary judgment.

The second opinion, however, issued from a rural county entitled *Horace v. LaSalle Bank* (March 2011), pending in the Circuit Court of Russell County, Alabama, enjoined the securitized trust from foreclosing.

In its one-page opinion, the court first stated, "The court is surprised to the point of astonishment that the defendant trust did not comply with the terms of its own pooling and servicing agreement and further did not comply with New York law in attempting to obtain assignment of plaintiff [borrower's] note and mortgage." Further, the court stated that the borrower "is a third-party beneficiary of the pooling and servicing agreement . . . without such . . . [the borrower] and other mortgagors similarly situated would never have been able to obtain financing."

Consequently, three trial opinions—none of which is binding on the others—have been issued in Alabama,

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putting the state of the “standing” issue in question in this state. Consequently, a binding decision is needed by the state’s appellate courts in order to resolve this apparent conflict, and such a decision might be forthcoming soon as the *Congress* order has recently been appealed.

While no one can predict exactly what an appellate court will do with any specific set of facts, the Alabama Supreme Court did recently make the following proclamation in a securitized trust case—*Ware v. Deutsche Bank National Trust Co.* (June 2011)—that upheld the foreclosure sale, but on what appeared to be predominantly procedural grounds: “However, the trustee argues that [the borrower] does not have standing’ to invoke the provisions of the PSA, because ‘she is neither a party nor a third-party beneficiary of the PSA.’ Indeed, [the borrower] is neither a party to the PSA nor a ‘certificateholder’ . . . [the borrower] does not respond to this argument and fails to cite any authority for the proposition that one who is neither a party to, nor an intended beneficiary of, a contract has standing to enforce its provision.”

Although these opinions may have no binding effect in other jurisdictions, the opinions and the issues raised in them do carry persuasive authority and are of national significance. At stake are the ability of securitized trusts to foreclose on non-performing assets and investors in those trusts to recapture some value from their investments. Indeed, should these entities not be able to take such actions, it would jeopardize a large portion of the world’s financial economy. By way of example, the trust that contained the *Congress* loan was made up of loans with a total principal balance exceeding \$690 million. Some other securitized trusts’ principal balances exceed \$1 billion. An attack to any one loan in such a trust could affect all the other loans in that trust.

Only 11 days after the issuance of the *Horace* opinion, the case was raised to and rejected by a federal court in West Virginia. In *Wittenberg v. First Independent Mortgage Co.* (April 2011), the court rejected the borrower’s claim that she was a third-party beneficiary to a PSA and thus could not raise failure to comply with the terms thereof as a defense to foreclosure.

The court stated it was not persuaded by the borrower’s claim that she was a third-party beneficiary to a PSA just because the lender reduced its underwriting standards based upon its plan to sell her note and mortgage on the secondary market. Indeed, the court rejected the borrower’s claim to be a third-party beneficiary to the PSA—which, like most PSAs, did not even exist at the time the loan was made to the borrower.

On a securitized trust’s right to foreclose

Additional opinions issued in the spring of 2011 from various jurisdictions upheld a securitized trust’s right to foreclose. In *Sarmiento v. Bank of New York Mellon* (March 2011), the Hawaii federal court granted the trust’s motion

to dismiss the borrower’s claim and stated that the “court further rejects that securitization in general somehow gives rise to a cause of action.”

In *Reyes v. GMAC Mortgage LLC* (April 2011), the Nevada court rejected the borrower’s claim that securitization affects the trust’s right to foreclose in the event of default. Citing previous cases from Utah and Virginia, the court stated, “[S]ince the securitization ‘merely creates a separate contract, distinct from plaintiffs’ debt obligations under the note and does not change the relationship of the parties in any way, plaintiffs’ claims arising out of the securitization fail.’”

Likewise, in *Anderson v. Countrywide Home Loans* (April 2011), the Minnesota federal court rejected the borrower’s securitization argument. In so holding, the court stated, “an assignment’s compliance with the chain of assignment mandated by a PSA was not relevant to the validity of the assignee’s interest under the Minnesota Recording Act. Plaintiffs have cited no authority that an assignment made in contravention of a PSA is invalid. Moreover, plaintiffs do not have standing to challenge the validity of an assignment to the trust because they are not parties to the PSA.”

Perhaps the highest court that has issued an opinion on this issue is the U.S. Court of Appeals for the Fourth Circuit, whose opinions are binding on the federal courts in Maryland, West Virginia, Virginia, North Carolina and South Carolina. In *Hovarth v. Bank of New York* (May 2011), the appellate court upheld a lower court’s opinion dismissing the borrower’s lawsuit based on the theory that only the original lender had authority to foreclose the property.

The note in question had changed hands several times as a natural consequence of the securitization process, although the deed of trust had not changed. The deed of trust named Reston, Virginia-based MERS as nominee for the original lender and that lender’s successors and assigns.

The borrower claimed that the securitization of his note voided anyone else’s claim to title over the property except for the original lender, meaning that he now owned the property free and clear despite having defaulted on the loan.

The note in question had been endorsed in blank which, per the court, “allows the parties to avoid thorny disputes about who has to pay whom, and when, in favor of a simple rule: Possession permits enforcement.” Hence, per the court, “The old adage about possession being nine-tenths of the law is, if anything, an understatement.”

Indeed, the court recognized that the parties, per the language in the note and mortgage, intended to allow the documents in question to be freely transferred. Likewise, the court recognized the doctrine that the “mortgage follows the note” and thus, a transfer of the note thus necessarily involved a transfer of the underlying security.

As noted by the court, “[If the borrower] were correct in asserting that the transfer of a note splits it from the deed of trust, there would be little reason for notes to exist in the first place. One of the defining features of notes is their transferability, but [in the borrower’s] view,

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transferring a note would strip it from the security that gives it value and render the note largely worthless. This cannot be—and is not—the law.”

Finally, in closing, the court noted that, per Virginia law, there was no requirement that an assignment of the deed of trust be recorded in the probate records.

Opinions favoring borrowers

While there probably have been more opinions supporting the standing of a securitized trust to foreclose, there also have been opinions that favor borrowers. Perhaps the first championed by the consumer’s bar was *U.S. Bank NA v. Ibanez* (January 2011), in which the Massachusetts Supreme Court rejected two securitized trust’s claims that they had clear title to the properties at issue.

In *Ibanez*, the court took issue with the trusts’ ownership based upon the timing of the assignments: One trust recorded the assignment more than one year after the foreclosure sale, and the other trust recorded an assignment 10 months after the foreclosure sale.

The court rejected the trusts’ claims that the PSAs were evidence of an assignment of the mortgages at issue. It should be noted, however, that neither trust identified the specific loan in the relevant MLSes that accompany the PSAs, and thus, the court could not determine from the record if the loans at issue were included within the pooled mortgages held by the trusts.

Also distinguishable was the fact that Massachusetts has a specific statute that says the power of sale can only be exercised by “the mortgagee or his executors, administrators, successors or assigns.”

Most other states, like Alabama, have statutes that allow the power of sale to be exercised by “any person, or the personal representative of any person who, by assignment or otherwise, becomes entitled to the money thus secured.” (Emphasis added.) This foreclosure statute works in concert with the language from the UCC (which Alabama has adopted) regarding the enforceability of negotiable instruments.

The UCC provides that a “holder” of an instrument endorsed in “blank” or specifically endorsed to that person, is the “person entitled to enforce” the instrument. The “person entitled to enforce the instrument” is, therefore, the “person . . . entitled to the money thus secured” by the mortgage.

Consequently, in other states like Alabama or Virginia (as recognized by *Hovarth*), there is no requirement that a mortgage or deed of trust be recorded in the probate office in order for the holder of the note to exercise the power of sale (although assignments are typically recorded to clarify the status of title and satisfy title insurers post-foreclosure).

This requirement of a recorded assignment, however, does not necessarily mean that Massachusetts does not follow the doctrine that the “mortgage follows the note.” Rather, as claimed by a Massachusetts federal court in *Kiah v. Aurora Loan Services LLC* (March 2011), this doctrine is indeed followed in Massachusetts.

In *Kiah*, the court dismissed a plaintiff’s claims that the mortgage in question was null and void because the assignment of mortgage was not recorded as of the day the foreclosing lender claimed the note had been assigned to it (although, unlike *Ibanez*, it was recorded prior to foreclosure). In so holding, the court focused on the date the note was assigned and not the date the mortgage assignment was recorded.

The court stated, “[b]y law, the transfer of the note automatically transfers an equitable interest in the underlying mortgage, even without a formal assignment. An equitable right to the mortgage was therefore transferred to [the foreclosing lender] along with the note. Plaintiff’s theory that the note and the mortgage somehow became disconnected from one another, and that the mortgage should disappear as a result, is therefore not tenable as a matter of law.”

Consistent with *Ibanez*, however, the court noted that in Massachusetts, “the mere equitable right to the mortgage is not enough to foreclose on a property.” Thus, unlike most states, in Massachusetts,

you must record an assignment of mortgage in the probate office prior to foreclosing.

A bankruptcy court in California recently made some statements on securitization and New York trust law that might assist both borrowers and lenders with the standing debate.

In *In re Doble* (April 2011), the court dismissed the borrower’s securitization claims, but primarily because the claims were too flawed for interpretation. “Based on the allegations of the complaint, the court cannot determine whether the loan was validly conveyed to the trust, whether the trust is invalid, or what effect such an invalidation would have.”

Nevertheless, before making this statement, the court found that while the borrower did not have standing to interfere with the securitized trust’s administration, the borrower did have standing to challenge the trust’s assertion that it had standing to file a claim in the bankruptcy court seeking to foreclose the loan. Thus, it was unclear what challenges a borrower could and could not legally assert to a foreclosure.

In addition, the court stated that New York trust law had no applicability because a securitized trust constitutes a “business trust” that is exempt from the New York Estate Powers and Trusts law. Such a holding, if followed by other courts, could thus dispose of borrowers’ arguments that a securitized trust’s claims to ownership can be challenged irrespective of the borrower’s relationship to the transaction because they are void transactions per New York trust law.

Finally, there have been several other decisions, mostly in bankruptcy courts, that have favored borrowers—but most of these opinions have been based on a lack of sufficient evidence that the foreclosing trust was the holder of the promissory note at the time the trust sought to take some action with respect to the note and the supporting security. For example, see *In re Veal* (June

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2011), issued by the Ninth Circuit Bankruptcy Appellate Panel; *In re Densmore* (March 2011), issued by a Vermont bankruptcy court; and *In re David A. Simpson PC* (May 2011), issued by the Court of Appeals of North Carolina. It is also notable that there was no discussion in any of these cases as to whether a PSA, MLS or other securitization documents, and an original note could be used in concert to establish the right to foreclose in the same manner as had been done in the *Congress* case.

The outlook

Consequently, the “standing” argument is on shifting ground with numerous courts weighing in on different aspects of the debate, and will likely continue to shift in the coming months.

While many of the issues will turn on state-specific requirements, as evidenced by the Massachusetts statute cited in *Ibanez*, or the specific facts of a particular case (i.e., what evidence was offered in support of noteholder status), many issues should apply on a nationwide basis. These include whether a borrower has standing to challenge a securitization as an intended third-party beneficiary to the securitization and whether New York trust law has any applicability to a borrower’s dispute.

This is precisely why the borrower’s counsel poured their resources and effort into the *Congress* case in 2010—because they recognized that these issues can have nationwide effect. Indeed, the final effects of that case, and its potential persuasive effect, are still to be determined on appeal.

Thus, it is incumbent upon lenders to stay apprised of these issues and recognize the challenges that can be posed even by the most routine case. After all, there no longer appears to be anything routine in the world of mortgage litigation. **MB**

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