

SERVICING MANAGEMENT[®]

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New Rules Toughen Servicers' Foreclosure Procedures

Recent court decisions have dictated that ownership of a loan must be proven before foreclosure can rightfully be pursued.

A Connecticut court recently joined what is becoming a national trend of road-blocking foreclosure of mortgages that have been traded in the secondary market, and the implications for mortgage servicers could be significant.

In April, the Connecticut Superior Court in New Haven dismissed a foreclosure action that Mortgage Electronic Registration Systems Inc. (MERS), as nominee for Finance America LLC, had commenced against Anna M. Miller because MERS did not prove that it owned the note.

Generally speaking, only the institution that owns the note can foreclose the mortgage if there is a default. It may sound like a simple idea, but the defect that was fatal to the lender in the Miller case exists in many other foreclosure cases and could be a dramatic problem for servicers.

Here's why: As every servicer knows, mortgage loans change hands frequently and rapidly in the secondary market. The supporting paperwork, which is evidence of the transfer, follows either slowly or not at all. Similarly, sometimes nonperforming loans return to the seller, and sometimes they do not.

The result of this system is that the servicer is often left in the dark as to who actually owns the loan. What the servicer does know - and knows first - is when there is a default.

Though it is typically the servicer's job to do something about the default, under the Miller case, the servicer is hamstrung. It cannot

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commence a foreclosure because it does not own the loan and, regardless of what its servicing agreement might say, it cannot commence a foreclosure in the owner's name because it cannot be sure who the owner is.

Lest the servicer think that it is only what happens in the end that counts, the court in the Miller case disagreed. Namely, the court rejected MERS' argument that it does not matter who owned the loan when the action commenced as long as it is sorted out before the action concludes.

The court was very definite in its ruling that only the true owner of the loan can start a foreclosure, while imposters will be dismissed. MERS learned the lesson the hard way, pursuing the foreclosure for over three years and coming away empty.

Confusion and sloppiness?

Even more recently, a bankruptcy court in Massachusetts imposed a stiff fine on a servicer, among others, for what it described as the "confusion and lack of knowledge, or perhaps sloppiness" as to the roles of the players in the residential mortgage industry.

In an April 25 decision in *Nosek v. Ameriquest Mortgage Co.*, the federal bankruptcy court ruled that the frequent buying and selling of mortgage loans "imposes a responsibility to know and correctly represent the status of the loan." The court fined Ameriquest, the servicer, \$250,000 for misrepresenting to the court that it owned the loan.

The court in the *Nosek* case also observed that the current system of keeping track of mortgages has some basic problems. In its ruling, the court stated that "the link between lender and borrower in the current residential mortgage industry is a multilayered, tightly - if not hopelessly entangled - 'assembly line,' the purpose of which seems to be the avoidance of responsibility" to the court and borrower.

Because the owner of the loan ordinarily does not dirty its hands in a foreclosure, the evidence for the foreclosure comes from the servicer.

The problem, however, is that the servicer usually does not have the knowledge necessary to provide the evidence. This issue played out in a New York court in *Deutsche Bank National Trust Co. v. Maraj*. Here, the New York court said it was "concerned" that Deutsche Bank may have committed fraud or malfeasance with the evidence it provided.

In this case, the court refused to grant foreclosure and demanded an explanation of some matters that "perplexed" the court. These concerns included why one person who claimed to be a vice president of MERS, the assignor of the loan (for IndyMac Bank), also claimed to be a vice president of Deutsche Bank, the assignee of the loan.

There was also a question of why that person executed the assignment in Texas when she claimed to be an officer of companies - MERS and Deutsche Bank - whose offices were purportedly in the exact same place in Missouri.

Of course, the “vice president” was probably an employee of the servicer, with a claim to authority to act for the assignor, MERS and the assignee, Deutsche Bank. The court’s point is that it this sort of “self-dealing” (the same person on both sides of a



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transaction) may be improper, particularly when the transaction occurs, as this one did, in the midst of a mortgage crisis.

Loan ownership

Though a borrower represented by an attorney is substantially more likely to benefit from these decisions, the foreclosing entity is not necessarily safe if the borrower does not have a lawyer. Courts are taking it upon themselves to make sure that the party seeking foreclosure has the right to seek that foreclosure and behaves properly in presenting its case to the court.

As a federal court in Ohio noted in foreclosure cases, “unchallenged by underfinanced opponents, the institutions worry less about [the legal]

requirements and more about maximizing returns. Unlike the focus of financial institutions, the federal courts must act as gatekeepers, assuring that only those who [prove they are entitled] are allowed to pass through.” In short, an unrepresented borrower is not a ticket to foreclosure.

Every legal and factual detail in a foreclosure action is under tremendous scrutiny. Courts are declining foreclosure to those who do not play by the rules. Servicers need to understand that these decisions will make it harder for any servicer or mortgage loan owner to collect if and when the loan goes into default.

It may be a monumental task, but servicers will have to do their homework to identify the loan’s true owner and secure its cooperation. **SM**