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# Why Mortgage "Formalities" Matter

David A. Dana

*Northwestern University School of Law*, [d-dana@law.northwestern.edu](mailto:d-dana@law.northwestern.edu)

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# WHY MORTGAGE “FORMALITIES” MATTER

*David A. Dana* \*

## INTRODUCTION

**B**efore the current foreclosure crisis, legal commentators and academics, not to mention the news media, paid almost no attention to the law surrounding residential foreclosures and foreclosure actions. But in the recent crisis, precisely because foreclosing parties quite often seem to violate them, such laws have become the subject of substantial attention. While the extent of unlawful behavior remains unknown, it appears that “robo-signing” of notice and certification documents has been a common practice on the part of servicers and their law firms for years. Foreclosing parties have instituted actions even before they acquire the mortgage and/or the note that is allegedly in default. Sometimes the foreclosing parties cannot even say who owns the mortgage that is being foreclosed.<sup>1</sup>

One reaction to this noncompliance with the law has been to dismiss it as a matter of mere formalities – “mortgage formalities,” if you will. In this account, there is no good reason to insist on adherence to the various procedural requirements for effecting a valid foreclosure as long as the economic substance behind the foreclosure is what it should be in a foreclosure action – namely, that the borrower is in default and cannot cure the default, and that the parties that are legally due proceeds from the foreclosure sale eventually get them. Jamie Dimon, CEO of JP Morgan Chase, expressed the view, “[w]e’ve known about these issues for a while [but] [w]e’re not

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\* Stanford Clinton and Zylpha Kilbride Clinton Professor of Law, Northwestern University School of Law. The author would like to thank Susan Koniak for her very helpful suggestions and guidance.

<sup>1</sup> See, e.g., Tim Reid, *The U.S. Foreclosure Crisis, Beverly Hills-Style*, REUTERS.COM (Feb. 16, 2012), <http://www.reuters.com/article/2012/02/16/us-usa-housing-hills-idUSTRE81F0B520120216>.

evicting people who deserved to stay in their house.”<sup>2</sup> Or as another commentator put it, “these homeowners [who ask banks to follow proper procedures] are staying in their homes based on a technicality.”<sup>3</sup> There is rarely any dispute over whether or not they have stopped paying their mortgage.<sup>4</sup> Indeed, according to this formalities-don’t-matter account, insisting that procedural and legal requirements are met is actually socially counter-productive because it serves only to slow down the foreclosure process and delay the elimination of the huge backlog of mortgages in default.<sup>5</sup> If defaulting borrowers cannot afford to stay in their homes under their current mortgages, as the story goes, better to get them out of there sooner rather than later so that the housing market can clear. As one industry commentator argued, “[t]he banks loose [sic] because they can’t get the bad assets off their books, the real estate industry loses [sic] because they can’t sell property, and most of all society loses [sic] not only because of the blight of vacant homes in our neighborhoods, but because . . . we need a strong housing sector, and that is not going to happen until we get through these foreclosures.”<sup>6</sup>

But mortgage formalities (I will adopt that term, albeit ironically) do matter, and they should matter. Arguably, we need more of them. Hence, courts err in disregarding them as they have sometimes done. Similarly, state legislatures err in eliminating formalities from substantive law, as Florida did in its experiment with

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<sup>2</sup> Colin Barr, *Dimon Downplays Foreclosure Mess*, CNNMONEY (Oct. 13, 2010), <http://finance.fortune.cnn.com/2010/10/13/dimon-downplays-foreclosure-mess/>.

<sup>3</sup> Les Christie, *Foreclosure free ride: 3 years, no payments*, CNNMONEY (Jan. 1, 2012), [www.money.cnn.com/2011/12/28/real\\_estate/foreclosure/index.htm](http://www.money.cnn.com/2011/12/28/real_estate/foreclosure/index.htm).

<sup>4</sup> *Id.*

<sup>5</sup> *See id.* Many people undergoing foreclosure who remain in their homes for years do not maintain their properties, further lowering the property values in the neighborhood.

<sup>6</sup> Bob Willett, *What’s up with stopping foreclosures?*, SACRELENDER, (Oct. 12, 2010), [www.sacre lender.com/?p=110](http://www.sacre lender.com/?p=110). The hostility toward taking mortgage law seriously also may reflect less a view about what the housing market needs to recover and more pure resentment on the part of some Americans toward those they perceive as “deadbeats” or recipients of special favors. Consider, in this regard, how commentator’s Rick Santelli’s rant against borrowers who might avoid foreclosure with the help of a proposed federal program went viral and even, according to some, helped spawn the politically important Tea Party movement. *See* Eric Etheridge, *Rick Santelli: Tea Party Time*, N.Y. TIMES (Feb. 20, 2009), <http://opinionator.blogs.nytimes.com/2009/02/20/rick-santelli-tea-party-time/?scp=1&sq=Eric%20Etheridge,%20Rick%20Santelli:%20Tea%20Party%20ime&st=cse>.

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“foreclosure courts.”<sup>7</sup> Additionally, state legislatures err by not considering adding more mortgage formalities to the law than traditionally have been in place – something no state is apparently even considering doing (with the notable exception of new mandatory mediation requirements).<sup>8</sup> Further, state attorneys general err in embracing a settlement that largely frees the banks from liabilities for robo-signing and similar practices that, though large in absolute terms, are paltry in the scheme of the mortgage market.<sup>9</sup> In sum, mortgage formalities have been largely ignored and should not be considered “formalities” at all.

Why, then, do mortgage formalities matter? The answer has three distinct parts. First, they matter because, in at least some cases, they may help a homeowner rightfully stay in his home over the long term rather than having to relocate. There is no way of knowing how many homeowners genuinely would be helped by strict adherence to the formalities; nevertheless, to build on the Jewish proverb that saving one life is the same as saving the whole world, if even one homeowner retains his home, that is significant.

The second reason mortgage formalities matter lies in what they express about society. Adherence to the formalities expresses the significant value that the home serves in people’s lives and the vitality of communities.<sup>10</sup> Moreover, adherence to the formalities sends an important message about equality before the law, which is

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<sup>7</sup> See Tami Luhby, *Florida pulls plug on rocket-docket foreclosure courts*, CNNMONEY (May 25, 2011, 1:31 PM), [www.money.cnn.com/2011/05/24/news/](http://www.money.cnn.com/2011/05/24/news/). It is worth noting that, although the foreclosure courts drew criticism from the ACLU and others, the Florida state legislature apparently de-funded them primarily for budgetary reasons. *Id.*

<sup>8</sup> See, e.g., Douglas S. Malan, *Foreclosure Mediation Becomes Mandatory*, CONN. L. TRIB. (June 8, 2009), [www.ctlawtribune.com/getarticle.aspx?id=33993](http://www.ctlawtribune.com/getarticle.aspx?id=33993). It remains unclear whether mediation, whether voluntary or mandatory, has benefits that justify its costs.

<sup>9</sup> See, e.g., Gretchen Morgenson, *The Deal Is Done, but Hold the Applause*, N. Y. TIMES, February 11, 2012, <http://www.nytimes.com/2012/02/12/business/mortgage-settlement-leaves-much-to-be-desired-fair-game.html?scp=1&sq=The%20Deal%20Is%20Done,%20But%20Hold%20The%20Applause&st=cse>. Some information regarding the settlement is available at <http://www.nationalmortgagesettlement.com/>. There is a great deal of uncertainty over who will bear the costs provided for in the settlement, and, in particular, how much any financial hit will be borne by the settling banks and how much instead will be borne by investors in mortgages or by the federal taxpayer.

<sup>10</sup> Indeed, many areas of our law, such as the mortgage interest deduction to the homestead exemption from bankruptcy, reflect recognition of the home as an especially important form of property. See 11 U.S.C. § 522(o)(4) (2010).

one of our constitutive and constitutional values. Because the mortgage formalities addressed herein are all designed to provide some protection to borrowers/homeowners, disregarding these formalities communicates this message: the law will hold the “little people” to strict compliance regarding their legal obligations under mortgages and notes, while it excludes large financial institutions like Chase and Citibank from their legal obligations when they are inconvenient. There should be normative discomfort with the message that corporations are treated more favorably than the men, women, and children subject to residential foreclosures.<sup>11</sup>

The third and perhaps most important way in which mortgage formalities matter is that insistence upon following them – as well as embracing more of them – might help prevent a repeat of the foreclosure crisis that is currently wreaking havoc on most parts of this country. There are substantial reasons to believe that the aggressive practices of pooling, securitizing, and re-securitizing mortgages has created a landscape in which many significant loan modifications are not occurring, even though the modifications would benefit both the owner(s) of the mortgage and the borrower/homeowner.<sup>12</sup> Strict adherence to mortgage formalities may not prevent future aggressive securitization. However, it may create an incentive for more care in the securitization process, which may translate into fewer impediments to loan modifications. Moreover, mortgage formalities, precisely because they increase the cost of foreclosure, may make it less attractive for a lender to lend or a mortgage pool investor to invest where there is a significant risk that the borrower(s) will not be able to make the mortgage payments. We should want lenders and investors to think hard about that significant risk and attempt to avoid it. Increasing the cost of foreclosure is at least one way to encourage this.<sup>13</sup> The current crisis

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<sup>11</sup> See David A. Dana, *The Law and Expressive Meaning Of Condemning The Poor After Kelo*, 101 NW U. L. REV. 365 (2011) (addressing the expressive meaning of permitting blight takings affecting low-income households while permitting economic development takings affecting middle-class households).

<sup>12</sup> See David A. Dana, *The Foreclosure Crisis and the Antifragmentation Principle in State Property Law*, 77 U. CHI. L. REV. 97, 102 (2010). For very good descriptions of precisely how servicer incentives can disfavor modifications and favor foreclosure, see also Diane E. Thompson, *Foreclosing Modifications: How Servicer Incentives Discourage Loan Modifications*, 86 WASH. L. REV. 755 (2011); Adam J. Levitin & Tara Twomey, *Mortgage Servicing*, 28 YALE J. ON REG. 1 (2011).

<sup>13</sup> From an economic efficiency perspective, however, we might want foreclosure to be a relatively low-cost procedure if underwriting standards and loan

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has demonstrated that families and the communities they live in are better off with somewhat higher costs of borrowing and less access to financing if the result is that families avoid the trauma of losing homes and, in many cases, the lives they had built around those homes.<sup>14</sup> Making home loans as cheap and attractive as possible should not be an overriding social goal if the loans carry a significant risk of default.<sup>15</sup>

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origination practices were such that unaffordable or otherwise excessively risky loans were not made and there were strong incentives for loan modifications when housing prices substantially dropped. Where there are inadequate underwriting standards and skewed incentives that work against reasonable modifications, there is a case for costly foreclosures as a means of providing borrowers transitional relief in the form of time in the residence and as a means of encouraging modifications of loans. For a proposal for reforming the residential mortgage market along these lines, see David A. Dana, *A Simple Approach To Preventing The Next Housing Crisis*, HUFFINGTONPOST.COM (Dec. 31, 2010), [www.huffingtonpost.com/david-a-dana/a-simple-approach-to-prev\\_b\\_803092.html](http://www.huffingtonpost.com/david-a-dana/a-simple-approach-to-prev_b_803092.html); see also George Soros, *Denmark Offers A model Mortgage Market*, WALL ST. J. (Oct. 10, 2008), available at [online.wsj.com/article/SB122360660328622015.html](http://online.wsj.com/article/SB122360660328622015.html).

<sup>14</sup> As Levitin & Twomey, *supra* note 12, at 5-6, explain:

Foreclosures increase housing supply and push down housing prices, affecting neighboring homeowners' property values and eroding property tax bases. This effect, in turn, hurts neighbors who have to bear either higher taxes or reduced services. Foreclosures also force families to relocate. Because many social ties are geographically based, foreclosures sever these ties. Children have to change schools, severing friendships; congregants are cut off from their houses of worship; even medical care and employment relationships are affected, as relocation can render commutes impracticable. And foreclosures contribute to urban blight and public health problems. Foreclosed properties often become centers of crime and arson, and mosquitoes breeding in stagnant water in untended swimming pools on foreclosed properties have even been linked to the spread of the West Nile virus.

<sup>15</sup> If mortgage formalities do and should matter in the “real world,” then they should also matter in the world of law schools, where, traditionally, first-year required Property classes devoted almost no attention to them. If nothing else, legal academics have it within their power to remedy that omission. A good place to start would be the leading Property casebooks, which have not yet engaged with what the foreclosure crisis has taught us about the importance of so-called mortgage formalities. For example, the topic of foreclosures and foreclosure procedures is not extensively addressed in the leading casebook, JESSE E. DUKEMINIER, JAMES KRIER, GREGORY ALEXANDER & MICHAEL SCHILL, *PROPERTY*, (Wolters Kluwer, 7th ed. 2010).

### THREE STORIES OF THE COURTS AND MORTGAGE FORMALITIES

#### *The Context for the Stories*

To better understand what is meant by “mortgage formalities,” it may be helpful to distinguish between (1) the falsification question, i.e., whether the foreclosing party made false representations in required documents or pleadings; and (2) the standing question, which is whether the foreclosing party has met the procedural requirement for standing to foreclose. The standing question inquires whether the foreclosing party has identified and obtained, by assignment or otherwise, the mortgage and/or note for the property that is the subject of the foreclosure. The questions of falsification and standing become entwined when the foreclosing entity implicitly or explicitly falsely represents that it has the note or mortgage that gives it proper standing to foreclose.

In spite of the vast number of recent foreclosures and the suspected high percentage of some kind of failure to follow mortgage formalities in these foreclosures, relatively few judicial opinions have addressed the issue of mortgage formalities and the consequences of noncompliance. This is likely because getting the courts to take foreclosed homeowners seriously has been so difficult, even if the homeowners have the money and resources to fight foreclosure. For example, a recent New York Times story chronicled how one homeowner with resources battled falsehoods by the foreclosing entity for seven years, only to have the court resolutely ignore him.<sup>16</sup> Opinions that do exist regarding the falsification question focus on whether the foreclosing entity and/or its lawyers should be subject to court sanctions, such as payment of fees.<sup>17</sup> The courts also have been compelled by a relatively few determined foreclosed-upon parties to confront the question of whether the standing requirement for foreclosing parties will be strictly enforced or glossed over in the interest of allowing litigation (and by extension the market) to move forward. Three standing decisions, which in effect are three stories of

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<sup>16</sup> Gretchen Morgenson, *A Mortgage Tornado Warning Unheeded*, NYTIMES.COM (Feb. 4, 2012), <http://www.nytimes.com/2012/02/05/business/mortgage-tornado-warning-unheeded.html?ref=gretchenmorgenson>.

<sup>17</sup> See, e.g., *Fed. Nat'l Mortg. Ass'n v. Bradbury*, 32 A.3d 1014 (Me. 2011) (upholding trial court's decision not to hold loan servicer in contempt and not to award attorneys fees, despite the court's recognition that the servicer's attorney intentionally made false statements in its pleadings).

property owners, help illustrate the range of judicial responses to the standing question and provide a basis for reflecting further on why mortgage formalities matter. These three cases are *U.S. Bank National Association v. Ibanez*,<sup>18</sup> *JPMorgan Chase Bank v. Harp*,<sup>19</sup> and *Tina v. Countrywide Home Loans, Inc.*<sup>20</sup>

Before analyzing these three cases, one should consider some background legal concepts: (1) the differences among judicial and non-judicial power of sale and strict foreclosure; (2) the difference between a mortgage and a note, as well as the corresponding difference between chain-of-title in a mortgage and chain-of-title in a note; and (3) the role of the pooling and servicing agreements (“PSA”) in the servicing of mortgages that have been pooled as part of securitization.

A large number of states allow “power of sale” foreclosures, which are non-judicial foreclosures that are essentially bank-conducted. In these jurisdictions, the foreclosing entity need not file a complaint in court and wade through the litigation of a case before the foreclosure sale actually happens. The power of sale refers to a clause in the mortgage and note documents in which the borrower agrees ahead of time to a private, non-judicial foreclosure. Homeowners can sue to stay or set aside a foreclosure in these jurisdictions, but they must take the initiative to bring an action in court.<sup>21</sup>

In judicial foreclosure and strict foreclosure jurisdictions, the foreclosing entity must bring a court action to foreclose upon a property. These forms of foreclosure involve a host of procedural requirements associated with filing court papers and appearing before a judge. As a result, judicial foreclosure is widely perceived to be slower and more expensive for foreclosing entities.<sup>22</sup> From the

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<sup>18</sup> *U.S. Bank Nat’l Ass’n v. Ibanez*, 941 N.E.2d 40 (Mass. 2011).

<sup>19</sup> *JPMorgan Chase Bank v. Harp*, 10 A.3d 718 (Me. 2011).

<sup>20</sup> *Tina v. Countrywide Home Loans, Inc.*, No. 08 CV 1233 JM (NLS), 2008 WL 4790906 (S. D. Cal. Oct. 30, 2008).

<sup>21</sup> GRANT S. NELSON & DALE A. WITMAN, *REAL ESTATE FINANCING LAW*, (West Group, 2001).

<sup>22</sup> *See id.*; *see also* DUKEMINIER ET AL., *supra* note 15. In fact, foreclosures are taking longer on average during this foreclosure crisis in judicial foreclosure states, as compared to non-judicial ones. *See* Steve Cook, *Happier Days On The Way For Judicial States*, BIGGERPOCKETS.COM (Feb. 1, 2012), [http://www.biggerpockets.com/renewsblog/2012/02/01/foreclosure-update-happier-days-on-the-way-for-judicial-states/?utm\\_source=feedburner&utm\\_medium=feed&utm\\_campaign=Feed%3A+RealEstateNewsForReal+%28Real+Estate+News+For+Real+|+A+BiggerPockets+Blog%29](http://www.biggerpockets.com/renewsblog/2012/02/01/foreclosure-update-happier-days-on-the-way-for-judicial-states/?utm_source=feedburner&utm_medium=feed&utm_campaign=Feed%3A+RealEstateNewsForReal+%28Real+Estate+News+For+Real+|+A+BiggerPockets+Blog%29) (explaining that foreclosures have taken the longest in judicial foreclosure

perspective of “clearing the backlog of mortgages in default,” it would make sense to advocate for non-judicial foreclosure in jurisdictions that currently do not allow it. But from the formalities-matter perspective, quite the opposite is true: judicial foreclosure is preferable because it provides borrowers more protections and sends a message that the law considers dislocation from the home an important enough action that it always deserves some overt “due process” in a court.<sup>23</sup> Moreover, judicial foreclosure is preferable because it *ex ante* discourages investments where there is a significant risk of foreclosure by *ex post* increasing the costs of foreclosure. For instance, San Francisco County, which is in the power-of-sale state of California, recently completed an audit of foreclosures and found that “clear violations of law” were not just commonplace but were considered the norm. Indeed, the report cast doubt on “the validity of almost every foreclosure it examined.”<sup>24</sup> At the same time, we do not have similarly rigorous reviews of foreclosures in judicial foreclosure states, so we cannot assume that the pervasiveness of “clear violations of law” is less in those states than it is in power-of-sale states. As the three cases discussed below show, the courts’ attitudes toward procedural requirements can matter enormously in ascertaining whether the requirements really have meaning in practice. Thus, the effective protections for homeowners in judicial sale jurisdictions may be no greater than they are in power-of-sale jurisdictions. However, because judicial foreclosure brings every foreclosure into the system, and non-judicial foreclosure leaves the bulk of foreclosures involving non-litigating borrowers outside the scope of judicial review, the potential for meaningful judicial review – assuming a willing and resource-equipped judiciary – is greatest in judicial foreclosure states.

When one buys property with third-party financing, they invariably sign a mortgage and a note, both of which may create rights of recovery against the property in the event of default. Both mortgages and notes are assignable interests. Since both the mortgage and note are at issue in a foreclosure and in theory should be

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states, with New York properties taking “an average of 1,019 days to complete foreclosure – the longest of any state.”).

<sup>23</sup> There is precedent for the proposition that non-judicial foreclosure, as opposed to judicial foreclosure, does not implicate the constitutional guarantee of due process. *See, e.g.,* Apao v. New York, 324 F.3d 1091 (9th Cir. 2003).

<sup>24</sup> Gretchen Morgenson, *Audit Uncovers Extensive Flaws In Foreclosures*, N.Y. TIMES, (Feb. 15, 2012), <http://www.nytimes.com/2012/02/16/business/california-audit-finds-broad-irregularities-in-foreclosures.html>.

extinguished by the foreclosure (unless there is a separate claim for a deficiency judgment), the standing requirement would seem to compel the foreclosing party to hold both the mortgage and note. However, as a result of the housing boom, the rise in more complicated securitization, sloppy servicing, and the embrace of the now somewhat infamous Mortgage Electronic Registration Service by financial institutions,<sup>25</sup> the servicers of mortgages in default sometimes cannot identify who owns the mortgage or the note at any given point in time, including the point at which the power-of-sale foreclosure process or the foreclosure judicial action commences. As commentators have observed, the unresolved chain-of-title problem in both notes and mortgages appears to be immense.<sup>26</sup>

In the “old days” of residential mortgage financing, the relevant players with respect to the secured credit on a home were simply “the bank” and “the borrower.” The bank originated the mortgage, serviced it, and owned it. The bank rationally would agree to significant loan modification, even principal reduction, in order to avoid foreclosure where housing prices had dropped substantially since the origination of the mortgage. That has all changed. Now, with respect to the secured credit on a single home, there are a host of actors with an economic interest in whether, or how, the loan is paid back, modified, or both. Mortgages now are most often pooled and then serviced by an entity that holds no direct or indirect interest in the mortgage or mortgages in the pool. The nexus between a servicer (most often a major bank) and the owners of interest in the pool of mortgages that back various forms of securities is the pooled servicer agreements of PSA.

The number and variety of investors in pools of first mortgages can make identifying who has a stake in any given mortgage quite challenging. In recent years, the securities in each pool have been divided into different “tranches” with different credit-risk ratings and different rights to payments from the borrowers. Tranching has occurred in a dizzying variety of approaches, but typically, for each pool, there are senior, intermediate or mezzanine, and junior tranches. The lower tranches, moreover, typically have been re-securitized through the use of collateralized mortgage

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<sup>25</sup> See Nolan Robinson, *The Case Against Allowing Mortgage Electronic Registration Systems, Inc. (MERS) To Initiate Foreclosure Proceedings*, 32 CARDOZO L. REV. 1621 (2011) (exploring the division in the case law between courts that recognize MERS as having standing and those that do not, and arguing for the latter approach).

<sup>26</sup> See, e.g., Adam Levitin, *Ibanez and Securitization Fail*, CREDIT SLIPS (Jan. 10, 2012), <http://www.creditslips.org/creditslips/2011/01/ibanez.html>.

obligations (CMOs) or collateralized debt obligations (CDOs). CMOs and CDOs then often have been tranching and securitized in the form of a CMO2 or CDO2, and then sometimes these instruments in turn have been tranching and securitized, and on and on. By virtue of the financial alchemy of Wall Street, a single mortgage could be – and often has been – transformed into tens, hundreds, or even thousands of distinct investment interests. Finally, for many properties, a second mortgage was originated at the same time as the first mortgage in order to allow the borrower to avoid mortgage insurance requirements.

### *Three Cases*

The first of the cases highlights how easy it is for standing and other questions about the foreclosing party's case go ignored, especially in power-of-sale jurisdictions where foreclosure generally is finalized without any court involvement. In *U.S. Bank National Association v. Ibanez*, U.S. Bank foreclosed on two residential mortgages, invoking the power of sale clauses in the mortgages. As often happens, the foreclosing party bought the two homes at the foreclosure sale. Because U.S. Bank had published its foreclosure notice in a Boston paper rather than the paper for the city where the properties were located (Springfield, a working-class city in central Massachusetts), U.S. Bank filed an action seeking a declaration of valid title to the properties. The homeowners whose homes had been sold at foreclosure did not appear. But the judge then surprised U.S. Bank, *sua sponte* finding that it lacked title to the mortgages at the time of foreclosure and that the sales therefore were invalid.<sup>27</sup> If U.S. Bank had not felt that it had made an error in its publication choice and had not gone to court for a confirmation of good title, or had the judge passively issued a default judgment, the chain-of-title problems with these mortgages never would have come to light.

The Supreme Judicial Court of Massachusetts found that U.S. Bank had indeed failed to establish it had been assigned the mortgages at issue *prior* to issuing the foreclosure notice and conducting the foreclosure sale. The Court took very seriously what might be dismissed as a mortgage formality, the statutory requirement that the notice of foreclosure and the sale be undertaken only by the “the mortgagee or his executors, administrators, successors or assigns.”<sup>28</sup> U.S. Bank's argument boiled down to (1)

<sup>27</sup> *U.S. Bank Nat'l Ass'n v. Ibanez*, 941 N.E.2d 40, 55 (Mass. 2011).

<sup>28</sup> “Statutory power of sale” in mortgage, MASS. GEN. LAWS ANN. ch. 183, § 21 (West 2011).

the assertion that its documentation was close enough to show that it had been assigned the mortgage by the time the foreclosure notices were published, and, in the alternative, that (2) any prior defect was cured when the mortgages were assigned to U.S. Bank after the foreclosure sales. The Court rejected the “close enough” assertion, explaining that neither an unexecuted private placement memorandum nor an unsigned PSA sufficed to establish that U.S. Bank held the mortgages when it noticed the foreclosures. The Court noted that U.S. Bank could not point to any specific mention of either mortgage in the schedules attached to either document.<sup>29</sup> Moreover, there was a lack of documentation for previous alleged assignments of the mortgages in the alleged chains of title.<sup>30</sup> With respect to the post-foreclosure assignments to U.S. Bank, the Court explained that “postforeclosure assignment be treated as a preforeclosure assignment simply by declaring an ‘effective date’ that precedes the notice of sale and foreclosure.”<sup>31</sup> The concurring justices bemoaned “the utter carelessness with which the plaintiff banks documented the titles to their assets.”<sup>32</sup>

The next two cases are in contrast to *Ibanez*, in which the trial court judge on his own insisted that the foreclosing entity prove ownership of the mortgage even in the absence of a complaining homeowner. *JP Morgan Chase v Harp* and *Tina v. Countrywide Home Loans* involved property owners who battled foreclosing entities without the assistance of a lawyer and who found the courts essentially uninterested in the standing question. The courts in these cases paid little heed to the arguments that the *pro se* plaintiffs tried to articulate and dismissed the foreclosing entities’ inability to establish chain-of-title as substantively important. Because *Harp* involved a strict foreclosure state, and another, *Tina*, a non-judicial foreclosure state, the two cases again illustrate that the form of foreclosure may matter less than the attitude of the courts.

In *Harp*, Chase filed a foreclosure action on a home, but at the time the foreclosure complaint was filed, Chase had not yet been assigned the mortgage. The Maine Supreme Judicial Court reasoned that because Chase was assigned the mortgage by the time it filed summary judgment, and because Harp did not raise the standing/assignment issue before that time in the litigation, Chase’s lack of ownership of the mortgage when it filed for foreclosure was

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<sup>29</sup> *Ibanez*, 941 N.E.2d at 52.

<sup>30</sup> *Id.*

<sup>31</sup> *Id.* at 54.

<sup>32</sup> *Id.* at 55.

essentially unimportant: “JP Morgan’s late acquisition of the mortgage did not change the cause of action or prejudice Harp.”<sup>33</sup> The Court seemed unconcerned that it was making the case turn on a *pro se* litigant’s delay of raising the standing issue. Indeed, the Court explained that “[w]e do not afford Harp special consideration as a *pro se* litigant.”<sup>34</sup>

In *Tina*, property owners sued after their property was sold at foreclosure pursuant to a power-of-sale provision. Countrywide did not provide a copy of the original note at the time of the foreclosure notice or sale, and as far as one can tell from the opinion, it had not been assigned the note prior to foreclosure. Nonetheless, the Court held that under California law, proof that the foreclosing entity holds the note is unnecessary for a power of sale foreclosure.<sup>35</sup> Read literally, the opinion seems to sanction foreclosures by entities that never have and never will acquire the original note related to the property. The Court swept away *Tina*’s other arguments as unsupported by statutory authority or adequate factual allegations.

### WHAT DO THE STORIES MEAN?

On one account, these three cases just involve technicalities about assignment of notes and mortgages, and so they mean nothing. The property owners in all three cases had defaulted, so what difference do the technicalities make? This view was expressed in a reader comment to a New York Times story on the mortgage mess:

Did the Bank mess it up? Yes. Does that change the fact that the homeowner is in fact not paying their mortgage and came to foreclosure regardless of the paperwork? Nope . . . This is like beating a speeding ticket because the officer’s handwriting made the State look like NV instead of NY.<sup>36</sup>

One thing wrong with this view is that one does not truly know whether the property owners owed what the servicers claim they did. The Harps and the Tinas, at least, seemed to dispute this, and for all anyone knows, the defaulting property owners in *Ibanez* would also have disputed the amount owed if they had resources to fight the foreclosure themselves. That servicers would play so fast

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<sup>33</sup> JPMorgan Chase Bank v. Harp, 10 A.3d 718, 721 (Me. 2011).

<sup>34</sup> *Id.* at 721 n.6.

<sup>35</sup> *Tina v. Countrywide Home Loans, Inc.*, No. 08 CV 1233 JM (NLS), 2008 WL 4790906, at \*8 (S. D. Cal. Oct. 30, 2008).

<sup>36</sup> Source on file with author.

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and loose with the assignment of notes and mortgages does not inspire confidence in the overall servicing of the mortgages, including the proper accounting of what is owed. Insistence on strict compliance of servicers with procedural requirements might give leverage to homeowners who need a reasonable modification of their loans but who, literally, cannot get their phone calls returned or answered by anyone with proper training or an incentive to be helpful.

Still, for many instances of foreclosures that are completed without the “mortgage formalities,” the foreclosures eventually would have happened even if there had been judicial insistence on strict compliance. That does not mean, however, that insistence on strict compliance lacks meaning. One clear meaning of strict compliance would be that the legal system takes seriously not just the interests of wealthy corporations but also, and equally, those of struggling homeowners. Another related meaning would be that the legal system demands as much from lawyers for major financial institutions as it does for lawyers for “regular” people. When a lawyer files a foreclosure complaint in a judicial or strict foreclosure state that contains or implies a falsehood, such as suggesting that the filing party owns the note and mortgage at issue when that may not be true or is unknown, that lawyer is breaching a basic professional duty and should be sanctioned. Federal Rule of Civil Procedure 11 and corresponding state rules provide for sanctions for lying to the court, either through direct misstatement or omission. Nevertheless, courts are hesitant to impose sanctions even in cases of falsification. This hesitation implies a relative de-valuation of the foreclosed-upon homeowners and the norm of legal equality. Consider a relatively recent report from Florida, a hotbed of foreclosure abuse:

Florida courthouses are rife with evidence of errors and fabrications made by attorneys handling foreclosure cases, and yet so far no lawyers have been disciplined.

With pressure mounting to police its own members, the Florida Bar established a special category of complaints listed as “foreclosure fraud.”

But in 20 complaints investigated in that category, the Bar has not found cause to discipline anyone—even lawyers who admitted to breaking ethical rules.

Some observers say that early track record of ignoring misdeeds by its members raises questions about whether

the system of self-policing for lawyers can handle the depth of wrongdoing in the foreclosure crisis.

The complaints have been filed by judges, lawyers, homeowners and the Florida Bar itself, and reflect the issues seen in courtrooms almost daily for the past two years, including forged signatures and backdated documents used to improperly seize homes in foreclosures.

In addition, attorneys for lenders have filed false motions, left out important information that would hurt their case, or skipped mandatory mediations and court hearings.

The state Attorney General's Office has investigated and found the same evidence of wrongdoing. But with no known criminal investigations launched into the behavior, the public and the court system must rely on the Florida Bar to stop bad behavior by attorneys.<sup>37</sup>

Courts (not to mention state bar authorities) are often hesitant to wade into the arena of sanctions. But contrast the lax attitude toward slipshod and deceptive, lawyering on behalf of major financial institutions with the attitude embodied in the Private Securities Litigation Act ("PSLA"), which is a statute addressing instances when it is major financial institutions (as well as other major corporations) that are being sued. Under the PSLA, sanctions are mandatory when a lawyer for aggrieved shareholders files a fraudulent or frivolous pleading.<sup>38</sup> Moreover, the courts have taken the mandate to sanction very seriously and have broadly construed it. In the securities litigation context, close enough is not treated as good enough.

The broader meaning of *Ibanez*, too, may be that the aggressive securitization of residential mortgages comes at a cost, and that cost may not be worth the social benefit, at least with respect to most categories of residential mortgages. The facts of *Ibanez* suggest that, in the complex dance of transferring, pooling, dividing, re-dividing and retransferring interests in mortgages, no one may be able to coherently speak for the "owner" or "owners" of the mortgage. Servicers may have the freedom to proceed serving their

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<sup>37</sup> Todd Ruger, *Foreclosure lawyers' misdeeds ignored in Fla.?*, HERALD-TRIB., (Jan. 18, 2011), <http://www.heraldtribune.com/article/20110118/ARTICLE/101181061>.

<sup>38</sup> Private securities litigation, 15 U.S.C. § 78u-4 (c)(2).

own parochial interests, which may include not hiring the necessary staff to handle loan modifications and also may include resisting the only kind of loan modification that could save the loan from foreclosure – namely, principal reduction.<sup>39</sup> But to be fair to servicers, the confusion engendered by the aggressive securitization of the sort witnessed during the housing boom also may make it harder for a faithful-agent servicer to discern exactly who would have to be contacted and give permission to a loan modification at any given point in time.<sup>40</sup> In this view, the carelessness the Justices criticized in *Ibanez* may not be an aberration but rather a systemic attribute of aggressive securitization. Indeed, the San Francisco County report found that almost half the properties claimed at foreclosure by beneficiaries of the deeds of trusts were in fact “a ‘stranger’ to the deed of trust.”<sup>41</sup> By penalizing servicers as well as investors in mortgages for such carelessness, the courts can push the industry away from its current form and practices of securitization and encourage the holding of loans or a greater part of each loan by

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<sup>39</sup> See Dana, *supra* note 12, at 104 (“Because the servicer of a mortgage does not own any part of the mortgages it services, its only source of revenue related to the mortgages is a fee it obtains from investors in the pool of securitized mortgages, and these fees are generally based on the principal of the serviced mortgages. Servicers thus have a strong interest in not modifying loans in such a way as to reduce principal and hence reduce fees, even when doing so might be the only way to avoid foreclosures and might be exactly what economically rational servicers would do if they also owned the mortgages they serviced. Because PSA contracts also generally provide that servicers must cover payments to investors in the mortgage pool after the mortgages go into default and up until the properties are foreclosed upon, cash-strapped servicers also have an incentive to push mortgages in default to foreclosure. The fact that servicers are compensated for all expenses of foreclosure, including whatever various fees they tack on, also may lead them to proceed readily to foreclosure.”).

<sup>40</sup> See *id.* (“Even when servicers want to aggressively pursue meaningful loan modifications, including ones involving principal, the inability to coordinate and obtain consent from all the relevant investors may result in paralysis or at best halfway measures. Many PSA contracts require a supermajority or even unanimous consent of all interest holders in a mortgage in order to allow a modification of the loan. Even when that is not the case, servicers reasonably may fear liability if they act without broad consent. Investors in senior-most tranches have no reason to support loan modification because they have priority and will recover on their investment even with foreclosure, while those in the most junior tranches have no reason to support modification because they will receive nothing once a schedule of significantly reduced payments is in place. Of course, some “in the middle” investors may benefit from meaningful modifications but that hardly makes for unanimity or a supermajority of investors.”).

<sup>41</sup> See Morgenson, *supra* note 24.

the originating financial institution. In the least, the courts may encourage more thoughtful mechanisms for use in securitization, including better PSAs, and more investments in maintaining a reliable system of mortgage and note registration and their assignments.

A final implication of *Ibanez* and other decisions insisting on adherence to mortgage formalities may be that a significant tradition in Anglo-American property law remains alive, if not dominant. When courts insist on mortgage formalities and thereby create a disincentive for the intense fragmentation of interests in mortgages, they operate within Anglo-American law's tradition of combating excessive fragmentation of property interests. There is no "anti-fragmentation principle" as such in our estate law tradition, but there are a number of doctrines that have been justified on the basis of enhancing the alienability and especially the efficient market alienability of land. These doctrines enhance alienability precisely by limiting fragmentation of interests in land. The implicit premise of these doctrines – as they have come to be justified, however obscure and contested their historical origins may be – is that private actors may not splinter property into so many fragments that they preclude value-maximizing decision making regarding the use and disposition of land.

The first such doctrine is that ambiguous grants or devises should be read as creating a fee simple in land. Another doctrine that is consistent with an anti-fragmentation principle is the doctrine of worthier title. The final estate doctrine that advances an anti-fragmentation principle is the common law rule against perpetuities. This rule operates to override even a clear expression of intent on the part of the grantor when the grant fragments the interest in property so as to create distant, uncertain contingent remainders. Interests that violate the rule are simply "crossed out," with the result that the overall fragmentation of property in land is reduced and alienability increased.<sup>42</sup>

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<sup>42</sup> See Dana, *supra* note 12, at 111-12 ("State property law, via statutes, has expressed an antifragmentation principle most clearly in the context of oil and gas field development. Indeed, in this arena the law has overridden firm property rights expectations and contracts in the name of preventing a socially important asset from being inefficiently developed. The state and federal courts, in this context, have accepted that where existing property rights rules and private ordering result in too many parties with an interest in the same resource, the law has a legitimate role in coercing the multiple interest holders to act in a more unified, and hence (from an overall return on private investment perspective) rational, manner.").

## WHY DO SOME COURTS TAKE MORTGAGE FORMALITIES SERIOUSLY AND OTHERS NOT?

One obvious lesson from reflecting on the *Ibanez*, *Harp*, and *Tina* cases is that courts vary in how seriously they take mortgage formalities. This raises the interesting question of why? It does not appear that positive state law, namely precedents and statutes, determines the level of seriousness of mortgage formalities, as witnessed by the fact that in California and elsewhere, courts within the same state have taken seemingly opposite approaches.<sup>43</sup> Variables that might be factors in enforcing mortgage formalities include the local housing market and default levels and judicial ideology. In states with crushing default rates, perhaps judges are more likely to ignore formalities. There is no doubt that avoiding crushing workloads would be a rational (although in my view, undesirable) reason for why courts would ignore devoting energy to mortgage formalities. For that reason, one might expect that jurisdictions with the most extreme default levels (such as Florida and Nevada) would be ones where the courts disregard mortgage formalities. A recent report in New York, for example, explains New York courts adopted a new rule in 2010 to try to repair what its chief judge called “a deeply flawed process.”<sup>44</sup> The rule required lawyers who pursued foreclosure suits to file a certification stating that they had personally checked the accuracy of the claims concerning a homeowner’s loan. The New York courts are struggling to process a backlog of tens of thousands of foreclosures that have been filed with such certifications and are striving to do so in a way that holds the certifying lawyers accountable. At the same time, thousands of “shadow” foreclosure actions have been initiated. In shadow foreclosure actions, borrowers are intimidated into reaching a deal with the bank before the process reaches the point at which certification is required. Thus, the New York courts must struggle with what to do about shadow foreclosures. The judges in some other states may conclude that they simply cannot bear the cost of policing compliance with mortgage formalities.

Judicial ideology also may play a part in the different

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<sup>43</sup> See David R. Greenberg, *Neglecting Formalities In The Mortgage Assignment Process And The Resulting Effects On Residential Foreclosures*, 83 *TEMPLE L. REV.* 253, 275 (2010) (discussing the tensions in California law).

<sup>44</sup> William Glaberson, *Push To Avert Foreclosures Hits Court Logjam*, *N.Y. TIMES* (Feb. 9, 2012), <http://www.nytimes.com/2012/02/09/nyregion/push-to-avert-foreclosures-hits-court-logjam.html?pagewanted=all>.

responses. Perhaps Democratic-leaning judges behave differently than Republican-leaning ones. Or perhaps party affiliation does not capture the important ideological divides. Another possible variable is whether the relevant judges are elected or appointed. Another reason that courts have varied may be because the judges in different states have different conceptions of themselves relative to the other branches and levels of government. Some judges may well say to themselves, figuratively if not literally, that other institutions of government are better equipped to address the foreclosure crisis and ensure it will not be repeated. But other judges, in a more activist tradition, might feel that they should not tolerate wrong behavior and that their role is, in effect, to lead if no other institution is taking responsibility. Thus, one might expect that courts more generally deemed “activist” might behave differently than those thought not to be “activist.”

From a social scientific perspective, in the realm of the sociology of courts, the foreclosure crisis can be envisioned as a natural experiment in why courts differ in their response to the same social phenomenon. A tremendous amount of social science in the legal academy is now devoted to how differences in ideology and background lead judges – and especially federal appellate judges – to rule differently in the same kinds of cases. Trial level courts have received less attention, as by-and-large have the state courts, even though state courts have greater involvement than federal courts in the lives of most individuals and households. The housing crisis and the judicial response would be a good place to address this imbalance in social science research.

#### A THOUGHT EXPERIMENT (OR WHY THE COURTS CAN MAKE A REAL DIFFERENCE)

Finally, I would like to address the “why us?” objection to my claim that state courts should take mortgage formalities seriously. The essence of this objection is that other institutions – Congress, the federal Executive, state attorneys general – are better equipped to address the structural problems at the heart of the foreclosure crisis, of which the failure to follow mortgage formalities is only one component. Constrained to taking one case at a time, the state judiciary may be too weak an actor to make any real difference, according to this view.

It is certainly true that federal legislative and regulatory initiatives could have a major impact, and there has been no shortage of thoughtful, and, in some cases, bold, proposals. The state

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attorneys general also have been active in this arena. But no legislation has emerged or seems likely to emerge from Congress. The Obama Administration efforts have been widely seen as too little, too late. Moreover, it remains unclear whether state attorney generals, in a nationwide settlement or additional actions, will impose really meaningful penalties on servicers and provide them with a strong enough incentive to change their behavior.

State courts have some advantages relative to the other institutions of government in addressing the foreclosure crisis. In contrast to federal actors, state courts are on the front lines. Hence, they are well-positioned to observe and blow the whistle on deceptive and slipshod foreclosure practices and the harms they entail. Furthermore, judges, even those who face periodic election, have greater political insulation from interest groups' lobbying than more overtly political actors at the state or federal level. To the extent that the federal legislative or regulatory response to the foreclosure crisis has been too tepid because of the outsized political power of the major banks, state courts, for all their limitations, have greater freedom to act.

A simple thought experiment illustrates the potential power of state courts. Imagine that every state judge in each state had acted like the trial court in *Ibanez*, who demanded proof that the foreclosing entity owned the mortgage and set aside the foreclosure because there was no proof. What if every judge who had reason to believe that foreclosure mills were filing false certifications had simply blocked every foreclosure until evidence was provided that the foreclosures were proper? What would have happened? In effect, there would have been a partial mortgage moratoria. A tremendous amount of news stories and television coverage would have followed, and state attorney generals, not wanting to be left out of the limelight, would have launched or stepped up investigations. Moreover, the major servicers, the major banks, would have been under pressure to strike a reform deal with the state attorney generals and federal regulators as a way of both appeasing and circumventing the state judges. As a result, there might have been a swifter and stronger response to the servicers' disregard for “mortgage formalities,” and society, especially struggling homeowners, might have been better off as a result. In sum, state judges might have made a real difference. Moreover, they still could if, when faced with the many foreclosure actions that the banks will surely bring in the next few years, they insist, like the trial judge in *Ibanez*, that borrowers and banks alike must enjoy the full protections afforded by law.