

# NEGLECTED FORMALITIES IN THE MORTGAGE ASSIGNMENT PROCESS AND THE RESULTING EFFECTS ON RESIDENTIAL FORECLOSURES\*

## I. INTRODUCTION

At the height of the housing boom in 2004, homeownership reached a record high of 69.2%.<sup>1</sup> Just eight years later, 8.1 million homes—or sixteen percent of all mortgages—are expected to be in foreclosure.<sup>2</sup> The mortgage securitizations and assignments, which allowed Wall Street to push America's housing market towards the peak reached in 2004,<sup>3</sup> were often hastily completed and are now creating problems for the financial institutions attempting to bring those 8.1 million foreclosures. These foreclosure problems first appeared in the courts, but have since garnered national attention as a result of the widespread use of questionable evidence to establish the elements of a foreclosure.

In 2007, in the U.S. District Court for the Northern District of Ohio, Judge Boyko dismissed fourteen foreclosure cases because none of the plaintiffs presented the notes associated with the mortgages or established that they had standing to foreclose on those mortgages.<sup>4</sup> Since then, numerous state and federal courts have dealt with the problems created by the improper, untimely, or non-existent assignments associated with securitized mortgages.<sup>5</sup> The level of neglect for the assignment formalities falls on a spectrum. Untimely assignments and

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1. JAMES R. BARTH ET AL., MILKEN INST., A SHORT HISTORY OF THE SUBPRIME MORTGAGE MARKET MELTDOWN 1 (2008), available at <http://www.milkeninstitute.org/publications/publications.taf?function=detail&ID=38801038&cat=Papers> (follow "view PDF" hyperlink; creation of free account required).

2. ROD DUBITSKY ET AL., CREDIT SUISSE, FORECLOSURE UPDATE: OVER 8 MILLION FORECLOSURES EXPECTED 1 (2008), available at <http://www.chapa.org/pdf/ForeclosureUpdateCreditSuisse.pdf>.

3. See *infra* Part II.A.2 and accompanying text for a discussion of how securitization led to the housing boom.

4. See generally *In re Foreclosure Cases (Boyko Foreclosure Cases)*, Nos. 1:07CV2282, 07CV2532, 07CV2560, 07CV2602, 07CV2631, 07CV2638, 07CV2681, 07CV2695, 07CV2920, 07CV2930, 07CV2949, 07CV2950, 07CV3000, 07CV3029, 2007 WL 3232430 (N.D. Ohio Oct. 31, 2007) (denying standing because—although plaintiffs in question were presumably holders of securitized notes and mortgages—subject notes and mortgages still identified original lending institutions as holders without any evidence of assignment to plaintiffs or otherwise mentioning plaintiffs in chains of title or interest).

5. See Samuel L. Bufford & R. Glen Ayers, Am. Bankr. Inst., *Where's the Note, Who's the Holder: Enforcement of Promissory Note Secured by Real Estate* 5–8 (Apr. 3, 2009) (unpublished report), [http://www.ce9.uscourts.gov/jc2009/references/bjep/UCC\\_Paper\\_L0325086.PDF](http://www.ce9.uscourts.gov/jc2009/references/bjep/UCC_Paper_L0325086.PDF) (presenting list of recent cases dealing with foreclosure problem which served as starting point for this Comment's research).

poorly documented assignments fall relatively low on the spectrum, and courts are split on the effect of these less severe forms of neglected formalities.<sup>6</sup> However, as the financial institutions' neglect for the traditional assignment formalities increases in severity, all courts should begin to recognize that foreclosures based on those severely neglected assignments must be prevented.

In deciding if and when problem mortgages can be foreclosed upon, courts have wrestled with several factors. In federal courts, the main question has been about the federal standing doctrine.<sup>7</sup> In state courts, there have been similar standing analyses, but through the lens of state law.<sup>8</sup> With the recent revelations regarding the use of improper evidence and "robo-signers" to prove the elements of a foreclosure, all courts should be increasingly concerned with the evidence used to establish a bank's right to foreclose.<sup>9</sup>

Several state and federal courts have expressly acknowledged two public policies at play when making their decisions.<sup>10</sup> These two constant and countervailing policies are (1) the interest in protecting families and communities by not allowing financial institutions to foreclose on homes without the legal authority to do so, and (2) preventing further harm to an economy dependent on the mortgage industry's ability to recoup debt.<sup>11</sup> While several courts have expressly considered the two interests above, other courts have disregarded these policies either by allowing foreclosures to go through with inadequate documentation or by wiping clean the entire debt on a mortgage when no proof of assignment was presented at the initial filing.

This Comment argues that when disregard for the assignment process rises to the level of bringing a foreclosure without a legal assignment, on behalf of an undisclosed third party, or with inadequate evidence, standing should never be afforded to the foreclosing financial institution regardless of the court, governing state law, or countervailing public policies.<sup>12</sup> To ensure that banks do not foreclose when they are unable to adequately prove their standing to do so, while at the same time preventing further damage to the global economy, this Comment concludes that all courts should consider the relevant public policies and that cases reaching the higher levels of neglect should always be dismissed without prejudice or, in bankruptcy, claims should always be given leave to amend.

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6. See *infra* Part III.A.2 for a discussion of the consequences of an untimely or unproven assignment.

7. See, e.g., *Boyko Foreclosure Cases*, 2007 WL 3232430.

8. See, e.g., *U.S. Bank N.A. v. Mallory*, 982 A.2d 986, 993-94 (Pa. Super. Ct. 2009).

9. See Gretchen Morgenson, *Banks' Flawed Paperwork Throws Some Foreclosures into Chaos*, N.Y. TIMES, Oct. 4, 2010, at A1 (explaining how Bank of America, GMAC Mortgage, and JP Morgan Chase voluntarily halted foreclosures after realizing that a significant percentage of their foreclosure documents had been improperly prepared, signed, and filed).

10. See, e.g., *Boyko Foreclosure Cases*, 2007 WL 3232430, at \*3 n.3 (stating court's feelings on how banking entities were taking advantage of homeowners); *In re Hwang*, 396 B.R. 757, 765 (Bankr. C.D. Cal. 2008) (considering both markets' reliance on foreclosures and need to prevent banks from using neglectful assignments to foreclose), *rev'd*, 438 B.R. 661 (C.D. Cal. 2010).

11. See *infra* Part III.B for a further discussion of these competing policies.

12. See *infra* Part III.A.3 and accompanying text for a discussion of how courts deal with severe deficiencies in assignment formalities.

To begin, Part II.A lays out some of the significant changes in the mortgage industry which contributed to the financial crisis. Parts II.B and II.C then discuss mortgage assignment requirements and departures from the assignment recording process. To lay a foundation for the judicial reaction to the foreclosure crisis, Parts II.C, II.D, and II.E detail the emergence of the foreclosure crisis, the different types of foreclosure, the role of bankruptcy in foreclosure, the emergence of bank reliance on questionable evidence, and the standing requirements. Part II.F then presents several ways courts have reacted to the foreclosure crisis and the neglected formalities in mortgage assignments.

Part III.A discusses how federal courts should apply the standing doctrine to mortgage assignments. Finally, Part III.B places recent cases in the context of the two opposing public policies: (1) protecting consumers from improper foreclosures based on neglected assignments and questionable evidence and (2) preventing further damage to the economy. Part III.B concludes that the individual consumer and the economy as a whole will best be protected if courts always consider these two policies and (1) strictly hold banks accountable to the standing requirements, while (2) giving banks an opportunity to correct mistakes in foreclosure filings through dismissals without prejudice or through opportunities to amend proofs of claim in bankruptcy. This proposal will ensure that banks adequately prove all elements of a foreclosure, but will give banks a second chance to prove those elements if a bank's first filing was inadequate.

## II. OVERVIEW

In order to effectively analyze the cases dealing with these issues—cases which began to appear in 2007 in the Northern District of Ohio<sup>13</sup>—it is important to understand the causes and scope of the dramatic increase in residential foreclosures. The increase in subprime mortgages, the securitization of these mortgages, and the foreclosure of significant numbers of these mortgages all contributed to the current financial crisis.<sup>14</sup>

### A. *Recent Changes in the Mortgage Industry*

#### 1. Subprime Lending

Between 1994 and 2006, subprime mortgages grew from five percent to over twenty percent of all new mortgages.<sup>15</sup> Subprime mortgages target individuals who do not qualify for credit in the prime market.<sup>16</sup> While the primary reason an

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13. *Boyko Foreclosure Cases*, Nos. 1:07CV2282, 07CV2532, 07CV2560, 07CV2602, 07CV2631, 07CV2638, 07CV2681, 07CV2695, 07CV2920, 07CV2930, 07CV2949, 07CV2950, 07CV3000, 07CV3029, 2007 WL 3232430 (N.D. Ohio Oct. 31, 2007).

14. Gerald Korngold, *Legal and Policy Choices in the Aftermath of the Subprime and Mortgage Financing Crisis*, 60 S.C. L. Rev. 727, 728–31 (2009) (detailing causes of financial crisis).

15. BARTH, *supra* note 1, at 3.

16. TREASURY TASK FORCE ON PREDATORY LENDING, DEP'T OF HOUSING & URBAN DEV., CURBING PREDATORY HOME MORTGAGE LENDING 27 (2000), available at <http://www.huduser.org/publications/pdf/treasrpt.pdf>.

individual would not qualify for a prime-rate mortgage is a poor credit history, other factors such as limited assets, self-employment, and variable income are considered as well.<sup>17</sup> Targeting individuals who do not qualify for prime mortgages increases the risk that the mortgagor will eventually default on the mortgage, thereby making subprime mortgages a riskier investments for banks.<sup>18</sup>

To entice riskier borrowers while ensuring lenders would receive payment on the loans, lenders began to target subprime borrowers with adjustable rate mortgages.<sup>19</sup> These adjustable rate mortgages enticed borrowers by starting with a low interest rate.<sup>20</sup> After the first two or three years, however, the rates increase significantly, often to above-market rates.<sup>21</sup> Between 1980 and 2006, adjustable rate mortgages jumped from five percent to sixty-four percent of all originations.<sup>22</sup> Such a rapid increase in subprime adjustable rate mortgages—coupled with the fact that most foreclosures on subprime loans occur in the first few years after the loans are made—created a situation where, in March 2008, 16.7% of individuals with subprime mortgages had fallen behind in their payments while 6.8% were in foreclosure.<sup>23</sup>

## 2. Securitization

Securitization of the subprime mortgage market was a significant contributing factor in the rapid increase in subprime lending.<sup>24</sup> By 2006, 80.5% of all subprime loans were packaged into mortgage-backed securities.<sup>25</sup> Mortgage brokers found subprime loans “attractive because they could earn fees while passing along any credit risk”<sup>26</sup> to those who purchased the securities. Additionally, because the housing market was booming and home prices were increasing between 2000 and 2006 at an average of nine percent per year, lenders, borrowers, and investors were extremely optimistic about the benefits of subprime lending.<sup>27</sup>

The mortgage securitization process begins with the relationship between the mortgagor and the mortgage broker, or originator, and ends with several

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17. *Id.*

18. See Korngold, *supra* note 14, at 730–31 (stating that many subprime borrowers were financially unsound and quickly became unable to pay their mortgages).

19. *Id.* at 730.

20. Rayth T. Myers, Comment, *Foreclosing on the Subprime Loan Crisis: Why Current Regulations Are Flawed and What Is Needed to Stop Another Crisis from Occurring*, 87 OR. L. REV. 311, 314 (2008).

21. *Id.*

22. BARTH, *supra* note 1, at 2.

23. Edmund L. Andrews, *Relief for Homeowners Is Given to a Relative Few*, N.Y. TIMES, Mar. 4, 2008, at C7.

24. TREASURY TASK FORCE ON PREDATORY LENDING, *supra* note 16, at 30. Other factors include: “the strength of the housing market; relatively low interest rates; [and] deregulation that led to innovations in mortgage products making loans available with less money down and fewer documentation requirements.” Raymond H. Brescia, *Beyond Balls and Strikes: Towards a Problem-Solving Ethic in Foreclosure Proceedings*, 59 CASE W. RES. L. REV. 305, 327–28 (2009).

25. BARTH, *supra* note 1, at 3.

26. *Id.*

27. *Id.*

entities between the mortgagor and the individuals benefiting from the mortgage payments.<sup>28</sup> Once the originator underwrites the mortgage and the mortgagor has received the money, the mortgage generally gets sold to an issuer or arranger.<sup>29</sup> The issuer or arranger then pools thousands of mortgages together and sells them as securities to the investors.<sup>30</sup> The investor receives a fractional interest, or tranche, in a bankruptcy-remote trust's<sup>31</sup> pool of mortgages.<sup>32</sup>

This securitization process has completely shattered the traditional borrower-lender relationship.<sup>33</sup> No longer are neighborhood savings and loans banks the ones holding the mortgage, servicing the mortgage, or making themselves available to discuss the mortgage.<sup>34</sup> Rather, a mortgagor's contact for all payments and problems is generally the mortgage servicer<sup>35</sup>—an entity interested only in the profits from servicing and the corresponding default fees.<sup>36</sup>

The mortgage servicer takes on all the responsibility for contact with the mortgagor and for collection of payments, which are then passed onto the investors.<sup>37</sup> In return for handling these responsibilities, the servicers earn revenue in three ways:

First, they receive a fixed fee for each loan. Typical arrangements pay servicers between 0.25% and 0.50% of the note principal for each loan. Second, servicers earn "float" income from interest accrued between when consumers pay and when those funds are remitted to investors. Third, servicers often are permitted to retain all, or part, of any default fees, such as late charges, that consumers pay.<sup>38</sup>

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28. Brescia, *supra* note 24, at 329–31.

29. Adam B. Ashcraft & Til Schuermann, Fed. Reserve Bank of N.Y., Understanding the Securitization of Subprime Mortgage Credit 5 (Mar. 2008) (unpublished staff report), [http://www.newyorkfed.org/research/staff\\_reports/sr318.pdf](http://www.newyorkfed.org/research/staff_reports/sr318.pdf).

30. *Id.* at 5–6 (describing pooling process in much greater detail, including use of bankruptcy-proof trusts, responsibilities of capitalization of mortgages, and frictions created by disparity in information about individual mortgages and pools being bought and sold).

31. A bankruptcy-remote trust holds the mortgages as a special-purpose vehicle that issues debt to investors. This bankruptcy-remote trust protects the investors from the bankruptcy of the arrangers and protects the arrangers from losses on the mortgages. *Id.* at 6–7.

32. Katherine Porter, *Misbehavior and Mistake in Bankruptcy Mortgage Claims*, 87 TEX. L. REV. 121, 126 (2009).

33. Brescia, *supra* note 24, at 329.

34. See BARTH, *supra* note 1, at 1–3 (detailing decline of savings and loans industry in conjunction with rises in adjustable rate securitized mortgages).

35. See Porter, *supra* note 32, at 126–27 (describing servicers' role as intermediaries between borrowers and beneficiaries of payments); LAUREN K. SAUNDERS ET AL., NAT'L CONSUMER LAW CTR., DESPERATE HOMEOWNERS: LOAN MOD SCAMMERS STEP IN WHEN LOAN SERVICERS REFUSE TO PROVIDE RELIEF 4–5 (2009).

36. Porter, *supra* note 32, at 127 (detailing three ways servicers earn revenue).

37. See Ashcraft & Schuermann, *supra* note 29, at 7 (describing mortgage servicers' duties as including: "collection and remittance of loan payments, making advances of unpaid interest by borrowers to the trust, accounting for principal and interest, customer service to the mortgagors, holding escrow or impounding funds related to payment of taxes and insurance, contacting delinquent borrowers, and supervising foreclosures and property dispositions").

38. Porter, *supra* note 32, at 127 (footnotes omitted).

Because servicers have neither a vested interest in the losses or gains associated with individual loans nor a vested interest in the communities where homes are located, servicers often act in their own best interest as opposed to the interests of either the mortgagor or the mortgagee.<sup>39</sup>

*B. The U.C.C. and the Assignment Process*

In one of the first articles dealing with how the securitization process created significant standing issues in foreclosure cases, the authors focused primarily on the United Commercial Code (U.C.C.) and how it applies in this situation.<sup>40</sup> As the U.C.C. has been adopted in some fashion by every state,<sup>41</sup> the U.C.C. analysis is important to a multi-state analysis of the standing debate. According to U.C.C. section 3-309, a missing note—without more—does not prohibit enforcement of the note in question.<sup>42</sup> However, “[e]nforcement of [the] note always requires that the [financial institution] seeking to collect show that it is the holder. A holder is an entity that has acquired the note either as the original payor or transfer<sup>43</sup> by endorsement of order paper or physical possession of bearer paper.”<sup>44</sup> So, while a financial entity does not need to produce the note, in order to enforce a note through a mortgage foreclosure, a financial institution which was not the original lender must establish that it (1) acquired the note through assignment or (2) show physical possession of the note.<sup>45</sup>

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39. See Manuel Adelino et al., Fed. Reserve Bank of Bos., *Why Don't Lenders Renegotiate More Home Mortgages? Redefaults, Self-Cures, and Securitization 4* (July 6, 2009) (unpublished paper), <http://www.bos.frb.org/economic/ppdp/2009/ppdp0904.pdf> (“[B]ecause servicers do not internalize the losses on a securitized loan, they may not behave optimally.”).

40. See generally Bufford & Ayers, *supra* note 5.

41. *Id.* at 2.

42. *Id.* While the note is not an absolute requirement, the presence of the note lays out the terms of the loan, is helpful in establishing chain of title, and is decisive in establishing the presence of the debt. Despite the importance of the note, a study analyzing chapter 13 bankruptcies found that 41.1% of proofs of claim for mortgages were not accompanied by the note. Porter, *supra* note 32, at 146–48.

43. “A transfer of intangible property [such as a note and the attached mortgage] is most often characterized as an assignment.” 2 FREDERICK M. HART ET AL., *NEGOTIABLE INSTRUMENTS UNDER THE UNIFORM COMMERCIAL CODE* § 3.01(2) (2010).

44. Bufford & Ayers, *supra* note 5, at 2 (footnote added).

45. The exact requirements to assign or transfer a note, however, differ depending on whether the note is negotiable or nonnegotiable. See 1 GRANT S. NELSON & DALE A. WHITMAN, *REAL ESTATE FINANCE LAW* § 5.28 (5th ed. 2009), available at 1 *Real Estate Finance Law* § 5.28 (Westlaw).

If the note is nonnegotiable, it can be transferred by assignment; the term ‘negotiation’ has no significance with respect to a nonnegotiable note. An assignment may be carried out in any of several ways: by indorsement on the note by the original payee-mortgagee; by the use of a separate document which the payee-mortgagee executes, stating that rights under the note are transferred to the assignee; or even by an oral statement to the assignee that a transfer is being made. To assign a nonnegotiable note, it is not necessary that possession of the note itself be given to the transferee, although a transfer of possession can be used to assign ownership if the parties elect that method.

On the other hand, if a negotiable note is involved, the mode of transfer is much more narrowly constrained. The note *must* be physically transferred into the hands of the person who is gaining the right to enforce it. The use of a separate document of assignment is not necessarily objectionable, but it cannot substitute for delivery of the note. If the delivery is

When these assignment processes are not followed and not recorded, three problems can occur.<sup>46</sup> The first problem, and the main focus of this Comment, is that many states require a record of the assignment chain in order to foreclose.<sup>47</sup> Second, without a recorded assignment, the current mortgage holder is not protected from fraudulent actions, such as foreclosure or discharge, taken by prior holders of the note and mortgage.<sup>48</sup> Third, the mortgagor will have a difficult time getting a legitimate discharge when they do not know who owns the mortgage at the time of discharge.<sup>49</sup>

C. *The Rise of the Foreclosure Crisis*

The burst of the housing bubble in 2006 led to three waves of foreclosures. The first wave came when speculators gave up on properties whose value fell below that of the respective mortgages; the second wave came when subprime mortgagors could no longer afford interest payments after their loans reset to a higher rate; and the third came in the wake of widespread job loss resulting from the economic impact of the first two waves.<sup>50</sup>

While the housing market was booming and the value of borrowers' homes were increasing, people were able to refinance before the higher rates of the adjustable rate mortgages kicked in.<sup>51</sup> When the housing market declined in 2006, borrowers were not able to refinance to avoid the higher rates.<sup>52</sup> This inability to avoid the higher rates caused the second wave of foreclosures.<sup>53</sup> As a result of the inability to refinance, the borrowers who "entered into such subprime loans with either little regard for their ability to make . . . payments upon reset or little understanding of the impact of such resets on their monthly mortgage"<sup>54</sup> were forced to confront the realization that they were no longer able to make their mortgage payments.<sup>55</sup>

When subprime borrowers began defaulting on their mortgages, lenders started the second wave of foreclosures on houses they could not resell in the "depressed and saturated market."<sup>56</sup> With the mortgagees not receiving payments

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accompanied by an endorsement of the note, the transfer is known as a "negotiation" and the transferee (if otherwise qualified) may become a holder in due course. If there is no endorsement, the transfer will still vest the right of enforcement in the transferee, but he or she cannot be a holder in due course. In all events, delivery is absolutely essential to a transfer of the right to enforce a negotiable note.

*Id.* (footnotes omitted).

46. *Id.*

47. *Id.*

48. *Id.*

49. *Id.*

50. Peter S. Goodman & Jack Healy, *Work Losses Hit Mortgages Seen As Safe*, N.Y. TIMES, May 25, 2009, at A1.

51. Brescia, *supra* note 24, at 330.

52. *Id.* at 330-31.

53. See Goodman & Healy, *supra* note 50 (discussing cause of second foreclosure wave).

54. Brescia, *supra* note 24, at 330.

55. *Id.* at 331.

56. Korngold, *supra* note 14, at 730-31.

from the borrowers, and not able to squeeze any money out of the houses used to back those mortgages, the value of the mortgage-backed securities quickly plummeted, causing a disastrous chain of events affecting the secondary mortgage markets, the broader financial sector, and the entire United States—and global—economy.<sup>57</sup>

The economic impact of the first two waves of foreclosures caused the country to shed more than five million jobs.<sup>58</sup> With this increase in unemployment, mortgagors who qualified for and received the previously stable prime mortgages, and who have since lost their jobs as a result of the declining economy, were expected to account for sixty percent of the mortgage defaults in 2009.<sup>59</sup> In fact, according to the chief economist for the Mortgage Bankers Association, the number of adjustable rate mortgage foreclosures decreased significantly during the second quarter of 2009.<sup>60</sup> However, there was such an increase in prime-rate foreclosures that the total foreclosure numbers for the first and second quarters of 2009 remained relatively unchanged.<sup>61</sup> As a result of the increase in this third wave of foreclosures, “percentages of loans ninety days or more past due and loans in foreclosure [during the second quarter of 2009] both set new record highs, breaking records set [in the previous] quarter.”<sup>62</sup> As of February 2009, there were over four million loans, worth more than \$717 billion, in some form of distress as a result of one of these three waves of foreclosure.<sup>63</sup> As a result of the impact this crisis continues to have on individual families and communities at large,<sup>64</sup> both state and federal governments have attempted to create legislation and other programs aimed at decreasing the foreclosure rate.<sup>65</sup> These programs, however, have been largely unsuccessful.<sup>66</sup>

57. *Id.*

58. Peter S. Goodman & Jack Healey, *660,000 More Jobs Lost; Total Tops 5 Million*, N.Y. TIMES, Apr. 4, 2009, at A1.

59. *Id.*

60. Press Release, Mortgage Bankers Ass'n, *Delinquencies Continue to Climb, Foreclosures Flat in Latest MBA National Delinquency Survey* (Aug. 20, 2009), available at <http://mortgagebankers.org/NewsandMedia/PressCenter/70050.htm>.

61. *Id.*

62. *Id.*

63. Goodman & Healey, *supra* note 50.

64. See Roger Lowenstein, *Just Walk Away*, N.Y. TIMES, Jan. 10, 2010, at MM 15 (stating that foreclosures cause decreases in neighborhood home values); Aline van Duyn, *US Housing Market Hit by 'Walkaways'*, FIN. TIMES (Feb. 22, 2010, 22:13), <http://www.ft.com/cms/s/0/a93abcea-1fe7-11df-8deb-00144feab49a.html> (free registration required) (“The high level of foreclosures in the US—the handing over of homes to banks that lent people money to buy them—has been a huge burden on the economy, has kept house prices on a downward spiral and has resulted in misery and anxiety for millions of people. In some areas so many homes have been abandoned that the entire community has fallen apart as schools close, public services are cut and homes are ransacked for fittings or taken over by criminals. That has also sent property values plunging for those people still in their homes and paying mortgages.”).

65. See generally GEOFFREY WALSH, NAT'L CONSUMER LAW CTR., STATE AND LOCAL FORECLOSURE MEDIATION PROGRAMS: CAN THEY SAVE HOMES? 4–10 (2009).

66. See Diane E. THOMPSON, NAT'L CONSUMER LAW CTR., WHY SERVICERS FORECLOSE WHEN THEY SHOULD MODIFY AND OTHER PUZZLES OF SERVICER BEHAVIOR: SERVICER COMPENSATION AND ITS CONSEQUENCES 1 (2009) (arguing that mortgage modification and mediation programs run counter to servicers' financial interest



#### D. Types of Foreclosure

Foreclosure proceedings are governed by state law and, as one might imagine, differences exist among states regarding the necessary procedure to foreclose. The two main types of procedures are judicial foreclosures and non-judicial foreclosures.<sup>67</sup>

##### 1. Judicial Foreclosures

In a judicial foreclosure, the lender files a court action in the county where the property is located in an attempt to obtain judicial approval for a foreclosure sale.<sup>68</sup> Generally, the lender must prove that there is a valid mortgage between the parties, the borrower is in default on the mortgage, and the proper procedures have been followed.<sup>69</sup> While judicial foreclosure is one of the predominant foreclosure procedures used today, it presents numerous complications, costs, and other disadvantages.<sup>70</sup> In addition to these complications, there are a number of established defenses utilized to further slow the process or achieve dismissals in judicial foreclosure actions.<sup>71</sup>

##### 2. Non-Judicial Foreclosures

Non-judicial foreclosures—or power of sale foreclosures—are the typical method of foreclosure in thirty states.<sup>72</sup> These foreclosures are generally based on a clause in the original mortgage stating that upon default, the mortgagee may conduct a foreclosure sale pursuant to the terms of the mortgage and applicable state law.<sup>73</sup> All non-judicial foreclosure states require an element of notice, but the actual notice requirements differ from state to state. Most states require both a

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and this financial disincentive is one reason programs are failing).

67. WALSH, *supra* note 65, at 2. The following states primarily use judicial foreclosures: Colorado, Connecticut, Delaware, Florida, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, New Jersey, New York, North Dakota, Ohio, Pennsylvania, South Carolina, Vermont, and Wisconsin. *Id.* The following states primarily use non-judicial foreclosures: Alabama, Alaska, Arizona, Arkansas, California, Georgia, Hawaii, Idaho, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, Oklahoma, Oregon, Rhode Island, South Dakota, Tennessee, Texas, Utah, Virginia, Washington, West Virginia, and Wyoming. *Id.* The District of Columbia also uses the non-judicial foreclosure procedure. *Id.*

68. NAT'L CONSUMER LAW CTR., CONSUMER CREDIT LAW MANUAL § 13.02[2] (2009).

69. *Id.*

70. 1 Grant S. Nelson & Dale A. Whitman, Real Estate Finance Law § 7.11 (5th ed. 2010) ("Judicial foreclosures are complicated, costly, and time-consuming. A typical action in equity to foreclose and sell involves a long series of steps: a preliminary title search to determine all parties in interest; filing of the foreclosure bill of complaint and lis pendens notice; service of process; a hearing, usually by a master in chancery who then reports to the court; the decree or judgment; notice of sale; actual sale and issuance of certificate of sale; report of the sale; proceedings for determination of the right to any surplus; possible redemptions from foreclosure sale; and the entry of a decree for a deficiency." (footnote omitted)).

71. Procedural and substantive defenses include "tender of the payments due, the lender's fraud, usury, invalidity of the mortgage, . . . Truth in Lending Act ("TILA") violations[,] . . . lack of jurisdiction, lack of joinder of necessary parties, insufficiency of service of process, and improper pleading." *Id.*

72. See *supra* note 67 for a list of non-judicial foreclosure states.

73. CONSUMER CREDIT LAW MANUAL, *supra* note 68, § 13.02(3).

public notice through legal advertisement, newspaper, or posting in another public place, and private notice to the mortgagor through registered or certified mail.<sup>74</sup> Additionally, some states require that notice be given to other parties with an interest in the property.<sup>75</sup> Like in judicial foreclosures, there are several established defenses, but because this is an out-of-court process, there are far fewer available.<sup>76</sup>

### 3. Bankruptcy as a Last Defense

In both judicial and non-judicial foreclosures, if the homeowner files for bankruptcy, the foreclosure process stops. However, bankruptcy has traditionally been a last resort.<sup>77</sup> The filing of a bankruptcy petition triggers the automatic stay, which prevents almost all creditor actions against the debtor, including foreclosure actions.<sup>78</sup> The filing of the petition also brings the case to federal bankruptcy court.<sup>79</sup> While bankruptcy offers a last chance for the mortgagor to save their property, the requirements to prevent foreclosure and keep the property are fairly difficult to meet.<sup>80</sup> When these requirements are not met, a creditor can bring a motion to obtain relief from the automatic stay and proceed with the foreclosure.<sup>81</sup> Additionally, the debtor has the option to reaffirm a debt, which then places the debtor and creditor back to where they were prior to bankruptcy.<sup>82</sup>

### 4. Banks' Use of Questionable Evidence to Prove Elements of a Foreclosure

It has recently come to light that several large national banks have been using improper and potentially fraudulent documentation to prove the elements of their foreclosures.<sup>83</sup> The affidavits being used to prove the balances owed on loans, the banks' ownership of particular mortgages, and the relevant assignments of the

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74. *Id.*

75. *Id.*

76. To contest a non-judicial foreclosure, a homeowner must file for injunctive relief or else there is no judicial involvement. Possible bases of relief include improper notice and a claim that the foreclosure is time barred, although the time-barred claim will only work in a few courts. *Id.*

77. See Porter, *supra* note 32, at 123 (stating that bankruptcy offers "families one last chance to save their homes").

78. See 11 U.S.C. § 362 (2006) (outlining actions to which automatic stay does and does not apply).

79. See Porter, *supra* note 32, at 123 (stating federal court system and uniform bankruptcy rules provide defaulting mortgagors protection from "vagaries of state foreclosure law").

80. See *id.* (stating defaulting mortgagor must pay mortgage company's proofs of claims filed with bankruptcy court or lose his home).

81. 11 U.S.C. § 362(d).

82. 11 U.S.C. § 524(c); see also *Chapter 7: Liquidation Under the Bankruptcy Code*, U.S. COURTS, <http://www.uscourts.gov/FederalCourts/Bankruptcy/BankruptcyBasics/Chapter7.aspx> (follow "The Chapter 7 Discharge" hyperlink) (last visited Oct. 26, 2010) ("A reaffirmation is an agreement between the debtor and the creditor that the debtor will remain liable and will pay all or a portion of the money owed, even though the debt would otherwise be discharged in the bankruptcy. In return, the creditor promises that it will not repossess or take back the automobile or other property so long as the debtor continues to pay the debt.").

83. Morgenson, *supra* note 9.

mortgages, were being signed by individuals who never verified the information.<sup>84</sup> Documentation problems also appeared with improper notarizations, forged signatures, and multiple banks claiming the rights to foreclose on the same property.<sup>85</sup> As a result of this widespread use of questionable documentation, several national banks temporarily halted all foreclosure proceedings in both judicial and non-judicial foreclosure states.<sup>86</sup> Such document problems have further called into question whether banks bringing the foreclosures are, in fact, the proper parties to foreclose.

*E. Standing to Bring a Foreclosure Motion*

Article III, Section 2 of the U.S. Constitution limits access to federal courts to “cases or controversies.”<sup>87</sup> The standing doctrine allows federal courts to determine which suits meet the case or controversy requirements.<sup>88</sup> Standing doctrine attempts to determine if the plaintiff bringing a suit is the correct party to bring the suit and if the relief sought would redress the injuries caused by the defendant to the plaintiff.<sup>89</sup> Therefore, “when standing is placed in issue in a case, the question is whether the person whose standing is challenged is a proper party to request an adjudication of a particular issue and not whether the issue itself is justiciable.”<sup>90</sup>

In *Lujan v. Defenders of Wildlife*,<sup>91</sup> the Court held that to prove standing, a plaintiff must establish three elements making up “the irreducible constitutional minimum of standing”:

First, the plaintiff must have suffered an injury in fact—an invasion of a legally protected interest which is (a) concrete and particularized . . . and (b) actual or imminent, not conjectural or hypothetical. . . . Second, there must be a causal connection between the injury and the conduct complained of—the injury has to be fairly . . . trace[able] to the challenged action of the defendant, and not . . . th[e] result [of] the independent action of some third party not before the court. . . . Third, it must be likely, as opposed to merely speculative, that the injury will be redressed by a favorable decision.<sup>92</sup>

In addition to the constitutional standings laid out in *Lujan*, the Supreme Court has established three prudential standing requirements which must also be met before a plaintiff has standing to bring a case in federal court.

[T]he plaintiff generally must assert his own legal rights and interests, and cannot rest his claim to relief on the legal rights or interests of third

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84. *Id.*

85. *Id.*

86. See, e.g., Nelson D. Schwartz, *Foreclosures Had Errors, Bank Finds*, N.Y. TIMES, Oct. 25, 2010, at B1.

87. *E.g.*, *Whitmore v. Arkansas*, 495 U.S. 149, 154–55 (1990) (internal quotation marks omitted).

88. *Id.*

89. *DaimlerChrysler Corp. v. Cuno*, 547 U.S. 332, 342 (2006).

90. *Flast v. Cohen*, 392 U.S. 83, 99–100 (1968).

91. 504 U.S. 555 (1992).

92. *Lujan*, 504 U.S. at 560–61 (alterations in original) (footnote omitted) (citations omitted) (internal quotation marks omitted).

parties. In addition, even when the plaintiff has alleged redressable injury sufficient to meet the requirements of Art. III, the Court has refrained from adjudicating abstract questions of wide public significance which amount to generalized grievances, pervasively shared and most appropriately addressed in the representative branches. Finally, the Court has required that the plaintiff's complaint fall within the zone of interests to be protected or regulated by the statute or constitutional guarantee in question.<sup>93</sup>

In *Sprint Communications Co. v. APCC Services, Inc.*,<sup>94</sup> the Court dealt with the issue of whether or not an assignee receives all the rights of the assignor, including the ability to bring a suit for injuries sustained before the assignment. In its decision, the Court analyzed the three standing requirements laid out in *Lujan* and determined that an assignment, even with a promise "to remit the proceeds of the litigation [back] to the assignor," does not preclude standing for a suit to redress such injuries.<sup>95</sup> The Court stated that "where assignment is at issue, courts . . . have always permitted the party with legal title alone to bring suit."<sup>96</sup> The Court further stated that "[l]awsuits by assignees, including assignees for collection only, are 'cases and controversies of the sort traditionally amenable to, and resolved by, the judicial process.'"<sup>97</sup>

#### 1. Failure to Prove Standing in Federal Court

When a party brings a case to federal court without standing, the federal courts have no jurisdiction over the suit.<sup>98</sup> With no jurisdiction, the court must dismiss the case.<sup>99</sup> A dismissal for lack of jurisdiction will generally be without prejudice,<sup>100</sup> thereby allowing the party to refile their case after establishing standing.<sup>101</sup> Because a case dismissed without prejudice is not decided on its merits, curing the lack of standing allows the plaintiff to file another complaint alleging the same facts or to refile in state court if they cannot correct the federal standing issues.<sup>102</sup>

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93. *Valley Forge Christian Coll. v. Ams. United for Separation of Church & State, Inc.*, 454 U.S. 464, 474–75 (1982) (footnotes omitted) (citations omitted) (internal quotation marks omitted). If the courts were to allow third parties to assert the legal rights of others, courts would create potential double liability for defendants having to defend against the third party and then against the actual owner of the legal right. See Martin H. Redish & William J. Katt, Taylor v. Sturgell, *Procedural Due Process, and the Day-in-Court Ideal: Resolving the Virtual Representation Dilemma*, 84 *Notre Dame L. Rev.* 1877, 1901–03 (2009) (stating that allowing multiple suits against defendants for rights to indivisible property creates potential for defendants to have double liability).

94. 128 S. Ct. 2531 (2008).

95. *Sprint Commc'ns*, 128 S. Ct. at 2533, 2535–36, 2538–42.

96. *Id.* at 2541.

97. *Id.* at 2542 (quoting *Vt. Agency of Natural Res. v. United States ex rel Stevens*, 529 U.S. 765, 777–78 (2000)).

98. 8 JAMES WM. MOORE ET AL., *MOORE'S FEDERAL PRACTICE* § 41.50 (3d ed. 2010).

99. *Id.*

100. *Id.*

101. *Id.*

102. *Id.*

## 2. The Role of Standing in State Courts

Whereas federal courts are constrained by Article III of the Constitution, the federal case-or-controversy requirement does not extend to state courts. Even when state courts are adjudicating questions of federal law, the Supreme Court has gone out of its way to say that state courts are not bound by the same standing requirements that bind federal courts.<sup>103</sup> A state's constitution establishes the limiting factors on who may bring a suit in that state's courts. In granting judicial power, some state constitutions do not impose any express limits on the courts, while others provide for "broad court jurisdiction unencumbered by injury requirements."<sup>104</sup> States generally have more relaxed requirements to get into state court than what Article III requires of plaintiffs to gain access to federal court.<sup>105</sup>

### F. Judicial Reaction to Foreclosure Crisis

As a result of the foreclosure crisis and the breakdown of the traditional mortgage-assignment process, courts have been confronted with the question of whether a sloppy mortgage assignment or an unassigned mortgage can be a plaintiff's basis for standing in a foreclosure case.<sup>106</sup> Some courts—such as in Ohio, Massachusetts, and New York—have prevented banks from foreclosing on informal, untimely, or non-existent assignments, while other courts—such as in Pennsylvania, Illinois, and California—have allowed defective foreclosures to proceed.<sup>107</sup>

#### 1. Courts Preventing Banks from Foreclosing Based on Untimely Assignments

##### a. Ohio

The question of whether an untimely assignment can confer standing began to gain momentum and press coverage<sup>108</sup> in October 2007, following Judge Boyko's decision in *In re Foreclosure Cases* ("*Boyko Foreclosure Cases*").<sup>109</sup> In the decision, Judge Boyko combined fourteen foreclosure cases and dismissed them

103. ASARCO Inc. v. Kadish, 490 U.S. 605, 620 (1989).

104. Christopher R. Leslie, *Standing in the Way of Equality: How States Use Standing Doctrine to Insulate Sodomy Laws from Constitutional Attack*, 2001 WIS. L. REV. 29, 58–59 (surveying non-exhaustive list of state standing requirements).

105. William A. Fletcher, *The "Case or Controversy" Requirement in State Court Adjudication of Federal Questions*, 78 CALIF. L. REV. 263, 286 (1990).

106. See Bufford & Ayers, *supra* note 5, at 5–8 (discussing recent case law on this issue).

107. This is by no means an exhaustive survey of the states which have dealt with neglected formalities. It is simply a collection of several states which have dealt with the situation in an instructive manner.

108. See Gretchen Morgenson, *Judge Demands Documentation in Foreclosures*, N.Y. TIMES, Nov. 17, 2007, at C8 (detailing reasoning and implications of Judge Boyko's decision).

109. *Boyko Foreclosure Cases*, Nos. 1:07CV2282, 07CV2532, 07CV2560, 07CV2602, 07CV2631, 07CV2638, 07CV2681, 07CV2695, 07CV2920, 07CV2930, 07CV2949, 07CV2950, 07CV3000, 07CV3029, 2007 WL 3232430 (N.D. Ohio Oct. 31, 2007).

without prejudice because the various plaintiff-lenders were unable to prove that—at the time the foreclosure complaints were filed—the plaintiffs had properly been assigned the mortgages in question.<sup>110</sup> Before dismissal, Judge Boyko issued an order requiring all plaintiff-lenders to file a copy of the executed assignment.<sup>111</sup> The dismissal without prejudice was ordered after none of the plaintiff-lenders were able to file an executed assignment demonstrating they were the assignees before the complaints were filed.<sup>112</sup> Without proper and timely assignments, the court determined that the plaintiff-lender was not the owner or holder of the note or mortgage and therefore did not have standing to bring the foreclosure complaints in federal court.<sup>113</sup>

In response to the plaintiff's comment, "Judge, you just don't understand how things work,"<sup>114</sup> Judge Boyko admonished the mortgage industry for its poor treatment of the mortgagors, its "condescending mindset[,] and [the] quasi-monopolistic system where financial institutions have traditionally controlled, and still control, the foreclosure process."<sup>115</sup> The judge then further stated that the industry's attitude that a proper assignment was not necessary to foreclose would no longer be tolerated even though the industry claimed it was common practice.<sup>116</sup> Through these and other comments, Judge Boyko demonstrated that his decision to dismiss without prejudice, while clearly within the law, was heavily influenced by the policy against allowing unchecked foreclosures.<sup>117</sup>

In addition, the *Boyko Foreclosure Cases* cited to the Ohio Revised Code (O.R.C.) and stated that "the unique nature of real property requires contracts and transactions concerning real property to be in writing."<sup>118</sup> Judge Boyko noted that before an assignee is entitled to receive distribution from the sale of a property, the assignment must meet the recording requirements imposed under O.R.C. section 5301.25.<sup>119</sup> According to section 5301.25, assignments "shall be recorded

110. *Boyko Foreclosure Cases*, 2007 WL 3232430, at \*1.

111. *Id.*

112. *Id.*

113. *Id.* at \*2-3.

114. *Id.* at \*3 n.3 (internal quotation marks omitted).

115. *Id.*

116. *Id.*

117. While Judge Boyko acknowledged the right of a financial institution to foreclose when they meet the standing requirements, he stated:

Typically, the homeowner who finds himself/herself in financial straits, fails to make the required mortgage payments and faces a foreclosure suit, is not interested in testing state or federal jurisdictional requirements, either *pro se* or through counsel. Their focus is either, "how do I save my home," or "if I have to give it up, I'll simply leave and find somewhere else to live."

In the meantime, the financial institutions or successors/assignees rush to foreclose, obtain a default judgment and then sit on the deed, avoiding responsibility for maintaining the property while reaping the financial benefits of interest running on a judgment. The financial institutions know the law charges the one with title (still the homeowner) with maintaining the property.

*Id.*

118. *Id.* at \*2 (citing Ohio Rev. Code Ann. § 1335.04 (LexisNexis 2010)).

119. *Id.*

in the office of the county recorder of the county in which the premises are situated.”<sup>120</sup> Judge Boyko dismissed the cases without prejudice, holding that, because the assignments in question had not been assigned and recorded before the complaint was filed, the plaintiffs were not entitled to receive a distribution from the foreclosure at the time of the complaint, and therefore did not have standing to foreclose on the properties.<sup>121</sup> In doing so, Boyko stated that courts “need not, and will not, be forgiving in this regard.”<sup>122</sup>

Approximately a month later, Judge Holschuh of the Southern District of Ohio also considered a similar situation in *In re Foreclosure Cases* (“*Holschuh Foreclosure Cases*”).<sup>123</sup> Judge Holschuh, after consideration of the applicable standing requirements and state law, determined that assignments made within days after filing the complaints were not adequate to confer standing.<sup>124</sup> This holding came as a complete shock to the lender’s counsel who stated that he had “brought ‘hundreds’ of these foreclosures cases, and that ‘[u]ntil recently, no judge . . . had questioned’ his practice of bringing such cases without filing the required documents, such as an affidavit, with the complaint.”<sup>125</sup> In a second opinion by Judge Holschuh, all of the combined cases—except one involving a bankruptcy—were dismissed without prejudice for their inability to show that the mortgages were assigned legally or equitably before the foreclosure complaints were filed.<sup>126</sup>

While Judge Holschuh of the Southern District of Ohio came to the same result achieved in the *Boyko Foreclosure Cases*, Judge Holschuh’s analysis of Ohio state law was more forgiving than that of Judge Boyko. In addition to analyzing the standard assignment and recordation process, albeit through slightly different statutes, Judge Holschuh stated that Ohio “recognizes an equitable assignment of a mortgage . . . that may transfer legal title in the absence of a formal assignment.”<sup>127</sup> This allowance of equitable assignments is in sharp contrast to Judge Boyko’s adamant declaration that the courts will not be forgiving in this regard. Additionally, equitable assignments do not appear in the Ohio statutes. Judge Holschuh cited to a treatise which, in turn, cited to cases from the 1890s and 1920s.<sup>128</sup> While differing on the exact standard, Judge Boyko and Judge Holschuh

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120. OHIO REV. CODE ANN. § 5301.25(A) (LexisNexis 2010).

121. *Boyko Foreclosure Cases*, 2007 WL 3232430, at \*1–2.

122. *Id.* at \*3 (internal quotation marks omitted).

123. *In re Foreclosure Cases* (*Holschuh Foreclosure Cases I*), Nos. 07-cv-166, 07-cv-190, 07-cv-226, 07-cv-279, 07-cv-423, 07-cv-534, 07-cv-536, 07-cv-642, 07-cv-670, 07-cv-706, 07-cv-714, 07-cv-727, 07-cv-731, 07-cv-963, 07-cv-999, 07-cv-1047, 07-cv-1091, 07-cv-1119, 07-cv-1150, 2007 U.S. Dist. LEXIS 90812 (S.D. Ohio Nov. 27, 2007). In a similar opinion, by Judge Rose, twenty-seven foreclosure cases were combined and dismissed without prejudice. *In re Foreclosure Cases* (*Rose Foreclosure Cases*), 521 F. Supp. 2d 650 (S.D. Ohio 2007).

124. *Holschuh Foreclosure Cases I*, 2007 U.S. Dist. LEXIS 90812, at \*9–11.

125. *In re Foreclosure Cases* (*Holschuh Foreclosure Cases II*), Nos. 07-cv-166, 07-cv-190, 07-cv-226, 07-cv-279, 07-cv-423, 07-cv-534, 07-cv-536, 07-cv-642, 07-cv-706, 07-cv-727, 07-cv-731, 07-cv-963, 07-cv-1047, 07-cv-1119, 07-cv-1150, 2007 U.S. Dist. LEXIS 95673, at \*16 (S.D. Ohio Dec. 27, 2007) (alteration in original) (omission in original).

126. *Id.* at \*18–19.

127. *Holschuh Foreclosure Cases I*, 2007 U.S. Dist. LEXIS 90812, at \*8–9.

128. *Id.* (citing 69 GLENDA K. HARNAD, OHIO JUR. § 461 (3d ed. 2009) (citing *Edgar v. Haines*, 141 N.E. 837 (Ohio 1923); *Kernohan v. Manss*, 41 N.E. 258 (Ohio 1895); *Holmes v. Gardner*, 33 N.E. 644 (Ohio

agreed on the fact that either the recordation of the assignment or the equitable assignment must be completed before the filing of the complaint to achieve standing.<sup>129</sup>

*b. Massachusetts*

Massachusetts, unlike Ohio, is a non-judicial foreclosure state. As a result, the statute at issue in *U.S. Bank National Ass'n v. Ibanez*<sup>130</sup> involved the pre-foreclosure notice requirements, not the requirements for the actual foreclosure.<sup>131</sup> The statute at issue in *Ibanez* was chapter 244, section 14 of the Massachusetts General Laws, which details the notice requirements prior to a foreclosure sale.<sup>132</sup> The court in *Ibanez* stated that the statute "requires 'strict compliance' with its notice provisions," including the provisions "that the notice identify 'the holder of the mortgage'" and that "[f]ailure to do so renders the 'sale void as a matter of law.'"<sup>133</sup> Because the bank listed itself in the notices as the mortgage holder, but had not yet been assigned two of the three mortgages, the court determined that the two foreclosures had not complied with chapter 244, section 14 and were therefore invalid.<sup>134</sup> In a separate decision, the court later rejected the bank's argument in its motion to vacate the judgment that a contractual right to a mortgage assignment was enough to establish that it was the holder at the time in question.<sup>135</sup>

The line drawn in Massachusetts between permissible and impermissible foreclosure processes is further defined in a series of bankruptcy cases all of which deal with some aspect of improper assignments.<sup>136</sup> In *In re Schwartz*,<sup>137</sup> the court determined that chapter 244, section 1 of the Massachusetts General Laws only allows a mortgagee to foreclose if an assignment was completed prior to the foreclosure.<sup>138</sup> There, the bank foreclosed on the property in May 2006, but had not been assigned the property until June 2006.<sup>139</sup> Furthermore, the power of attorney used to foreclose on the property was not signed until September 2006.<sup>140</sup> The court, therefore, determined that a foreclosure sale was improper because the bank (1) was not the mortgagee at the time of the foreclosure<sup>141</sup> and

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1893))).

129. See *supra* notes 119–21 and accompanying text for a discussion of the recordation requirement.

130. 17 LCR 202 (Mass. Land Ct. 2009).

131. *Ibanez*, 17 LCR at 203–07.

132. MASS. GEN. LAWS ch. 244, § 14 (2009).

133. *Ibanez*, 17 LCR at 204 (citing *Bottomly v. Kabachnick*, 434 N.E.2d 667, 669 (Mass. App. Ct. 1982)).

134. *Id.* at 207.

135. *U.S. Bank Nat'l Ass'n v. Ibanez*, 17 LCR 679, 688 (Mass. Land Ct. 2009).

136. See, e.g., *In re Schwartz*, 366 B.R. 265 (Bankr. D. Mass. 2007).

137. 366 B.R. 265 (Bankr. D. Mass. 2007).

138. *Schwartz*, 366 B.R. at 269.

139. *Id.* at 268–69.

140. *Id.*

141. *Id.* at 269.



(2) “had not yet authorized the attorneys to act on its behalf when the foreclosure sale was conducted.”<sup>142</sup>

However, a few months later in *Saffran v. Novastar Mortgage, Inc.*,<sup>143</sup> the U.S. District Court for the District of Massachusetts stated that a bank could foreclose without an assignment because the bank established that it had a financial interest in the property.<sup>144</sup> The *Saffran* court found that, although Mortgage Electronic Registry System (“MERS”) was the bank’s nominee through assignment, the mortgage itself left the statutory power to sell in the hands of the bank.<sup>145</sup> While the mortgage at issue had been partially assigned to MERS, and while MERS was the holder of the note, the bank “technically had ‘ownership’ of the mortgage” and the authority to foreclose on the property.<sup>146</sup> Because the bank retained these interests, the court determined that the bank met the requirements for standing and therefore denied the homeowner’s motion to reinstate the automatic stay.<sup>147</sup> A month later in *In re Maisel*,<sup>148</sup> the Bankruptcy Court for the District of Massachusetts limited the holding in *Saffran*.<sup>149</sup> The *Maisel* court stated that *Saffran* only applied to situations where the foreclosing entity was already the holder of the note and already had a financial interest in the property.<sup>150</sup> *Maisel* thereupon held that an entity which had no prior interest in the property is not able to foreclose unless it can bring evidence that it is the current holder of the instrument or that it had obtained a financial interest in the mortgage before the motion for relief was filed.<sup>151</sup>

The following year, in *In re Hayes*,<sup>152</sup> the Bankruptcy Court for the District of Massachusetts denied a motion for relief from the automatic stay, and granted leave to amend a proof of claim, because a bank was unable to trace the mortgage

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142. *Id.*

143. No. 4:07-CV-40257-PBS, 2007 U.S. Dist. LEXIS 96306 (D. Mass. Oct. 18, 2007).

144. *Saffran*, 2007 U.S. Dist. LEXIS at \*6.

145. *Id.* at \*5–7. MERS is an electronic database which tracks who owns a given mortgage at any given time. The owner of a mortgage registers or assigns its mortgage with/to MERS, and MERS then records itself as either the holder of record or as a nominee of the holder of record on a particular county’s office of the recorder. The mortgage industry created MERS to allow for the easy transfer and tracking of mortgages throughout the financial sector without the hassle of rerecording every transfer in a county record office. As a result, the MERS system has saved the mortgage industry over a billion dollars. Currently, over 60 million loans are registered for which MERS is the holder or nominee of the holder. See generally Christopher L. Peterson, *Foreclosure, Subprime Mortgage Lending, and the Mortgage Electronic Registration System*, 78 U. CIN. L. REV. 1359 (2010) (detailing transition from traditional recordation processes to MERS-based recording).

146. *Saffran*, 2007 U.S. Dist. LEXIS at \*6.

147. *Id.* at \*6, \*8.

148. 378 B.R. 19 (Bankr. D. Mass. 2007).

149. *Maisel*, 378 B.R. at 21–22.

150. *Id.*

151. *Id.* at 22. Because the debtor in *Maisel* intended to surrender the property, motion for relief from the stay was granted despite the lack of standing. *Id.* In light of the debtor’s desire to surrender the property, it is notable that the court chose to write this opinion, limit *Saffran*, and take its shots at the mortgage industry, when the opinion was ultimately unnecessary to resolving the dispute between the parties.

152. 393 B.R. 259 (Bankr. D. Mass. 2008).

at issue from the original lender to itself.<sup>153</sup> In doing so, the court stated that “reliance upon back-dated, unrecorded assignments, have confounded the identity of the current holder of the mortgage for the purpose of filing the Motion for Relief from Stay, as well as the proof of claim.”<sup>154</sup> While the court stated that “a mortgagee or an entity with a valid assignment may foreclose on real estate in Massachusetts and seek relief from the automatic stay to do so,”<sup>155</sup> the court determined that the assigning entity in question could not prove that it ever had the authority to assign the mortgage.<sup>156</sup> Further, the mortgage was assigned “seven months after the filing of the Motion for Relief from Stay.”<sup>157</sup>

*c. New York*

As in Massachusetts and Ohio, New York courts have determined that an untimely assignment will prevent a foreclosure. In *Countrywide Home Loans, Inc. v. Taylor*,<sup>158</sup> the New York Supreme Court of Suffolk County used a standing requirement, similar to that of federal courts,<sup>159</sup> to determine that a foreclosure claim should be dismissed when there is no evidence of an assignment, or delivery of the note and mortgage, prior to the filing of the complaint.<sup>160</sup> Countrywide’s assignment was executed March 6, 2007, but the foreclosure complaint was filed on February 6, 2007.<sup>161</sup> The court, therefore, dismissed the case without prejudice, allowing Countrywide to refile and prove a timely assignment.<sup>162</sup> In a similar opinion in 2009, the Supreme Court of Kings County held that because the assignor neither assigned nor delivered the mortgage and note before the assignee attempted to foreclose, the bank’s motions of reference for the property were denied without prejudice.<sup>163</sup>

However, in a drastic departure from the allowances for refilling seen above, a bankruptcy judge in the Southern District of New York responded to an inadequate proof of claim by wiping clean the entire debt on the relevant mortgage.<sup>164</sup> The judge based his decision on the fact that there was no evidence that the bank received an assignment, and on his belief that—if the debtor paid the claim—the debtor may be paying the wrong party.<sup>165</sup>

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153. *Hayes*, 393 B.R. at 261.

154. *Id.* at 269.

155. *Id.* at 267.

156. *Id.* at 268.

157. *Id.*

158. 843 N.Y.S.2d 495 (N.Y. Sup. Ct. 2007).

159. *See Hayes*, 393 B.R. at 261 (holding that bank lacked standing to obtain relief from stay since it failed to provide evidence of assignment).

160. *Countrywide Home Loans*, 843 N.Y.S. at 497.

161. *Id.*

162. *Id.* at 496.

163. *See generally Deutsche Bank Nat’l Trust Co. v. Bailey*, No. 3747/08, 2009 WL 294688 (N.Y. Sup. Ct. Feb. 9, 2009).

164. Gretchen Morgenson, *If Lenders Say ‘The Dog Ate Your Mortgage’*, N.Y. TIMES, Oct. 25, 2009, at BU1 (explaining decision with no published opinion where judge wiped clean \$461,263 in mortgage debt).

165. *Id.*

In Ohio, Massachusetts, and New York, the courts have all been fairly consistent when dealing with the timing of an assignment. In all three states, some level of assignment is necessary before a foreclosure can occur.<sup>166</sup> In Ohio, if one goes by the *Hulschuh Foreclosure Cases*, a bank will be able to foreclose as long as there is an equitable assignment.<sup>167</sup> In Massachusetts, the bank will need to prove either that there was a proper assignment or that it was the holder with a significant financial interest in the property at the time the complaint or motion for relief was filed.<sup>168</sup> Finally, in New York, courts require either a proper written assignment or a delivery of the mortgage and note.<sup>169</sup> Thus, while the courts in Massachusetts, New York, and Ohio have developed slightly different standards, they all agree that an assignment must have been completed before the complaint, or proof of claim, was filed.

## 2. Courts Allowing Banks to Foreclose Based on Neglected Assignment Formalities

### a. *Pennsylvania*

In striking contrast to the decisions in Ohio, Massachusetts, and New York, the Superior Court of Pennsylvania in *US Bank N.A. v. Mallory*<sup>170</sup> held that the plaintiff had standing to foreclose even though an assignment was neither executed nor recorded before the complaint was filed.<sup>171</sup> In *Mallory*, the defendant attempted to open up a default judgment against herself from a foreclosure complaint filed in November 2007.<sup>172</sup> The mortgage and note were not assigned to the plaintiff until December 2007. However, because the plaintiff bank claimed that in November it was the legal owner of the note and mortgage, and in the process of formalizing the assignment, the court allowed the default judgment to stand.<sup>173</sup> In the opinion, the court analyzed both the recording and assignment requirements.<sup>174</sup> The court began by determining that recording the assignment

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166. See *Holschuh Foreclosure Cases I*, 07-cv-166, 07-cv-190, 07-cv-226, 07-cv-279, 07-cv-423, 07-cv-534, 07-cv-536, 07-cv-642, 07-cv-670, 07-cv-706, 07-cv-714, 07-cv-727, 07-cv-731, 07-cv-963, 07-cv-999, 07-cv-1047, 07-cv-1091, 07-cv-1119, 07-cv-1150, 2007 U.S. Dist. Lexis 90812, \*8 (S.D. Ohio, Nov. 27, 2007) (holding that either equitable or proper assignment is required to foreclose); *In re Maisel*, 378 B.R. 19, 21–22 (Bankr. D. Mass. 2007) (holding that without previous financial interest in property, acquiring interest in property through assignment after motion for relief is filed does not confer standing); *Countrywide Home Loans*, 843 N.Y.S.2d at 497 (holding that plaintiff did not have standing to foreclose because it did not receive assignment of mortgage before filing complaint).

167. See *Holschuh Foreclosure Cases I*, 2007 U.S. Dist. Lexis 90812, at \*8–9 (holding that either equitable assignment or proper assignment is required to foreclose in Ohio).

168. *Maisel*, 378 B.R. at 21–22.

169. *Bailey*, 2009 WL 294688, at \*3 (holding that assignments are made by either written instrument or by physical delivery of note and mortgage).

170. 982 A.2d 986 (Pa. Super. Ct. 2009).

171. *Mallory*, 982 A.2d. at 992–93.

172. *Id.* at 988–89.

173. *Id.* at 992–93. The court additionally stated that even if the defendant could have proven the foreclosure judgment was improper, the judgment would have been left alone because her petition to strike/open the judgment was not timely. *Id.* at 995.

174. *Id.* at 992–94.

was not a requirement to foreclose and quoted two cases stating that, “Pennsylvania recording laws . . . do not render invalid an unrecorded interest in land,”<sup>175</sup> and “the fact that [an] assignment was unrecorded [does] not disprove that there had been a valid assignment.”<sup>176</sup> These cases directly support the proposition that a failure to record an assignment does not prevent a foreclosure.

While Pennsylvania law clearly states that failure to record an assignment does not prevent foreclosure, Pennsylvania law is less clear as to the legal position of a bank that purchased a mortgage but never executed the assignment. The *Mallory* court held that an unexecuted mortgage assignment was enough to make one a real party in interest.<sup>177</sup> However, the court never provided authority for the proposition that this unexecuted assignment is equivalent to an actual assignment and sufficient to gain legal rights to enforce a mortgage.<sup>178</sup> The court stated that the Pennsylvania Rules of Civil Procedure section 2002(a) provides, in relevant part, that “[e]xcept as otherwise provided . . . all actions shall be prosecuted by and in the name of the real party in interest, without distinction between contracts under seal and parol contracts.”<sup>179</sup> The question, which the court never fully analyzed, was whether an unexecuted assignment becomes a contract which somehow grants the future assignee status as a real party in interest. The court answered this question in the affirmative by adopting the plaintiff’s claim that it was the legal owner of the mortgage despite an unexecuted assignment.<sup>180</sup>

The *Mallory* decision is not entirely inconsistent with the previously discussed decisions as one of the main reasons the court allowed the case to proceed was that, in the complaint, the bank stated it was in “the process of formalizing the assignment.”<sup>181</sup> While not as strict as Ohio, Massachusetts, or New York, if Pennsylvania continues to follow the precedent set by *Mallory*—that an assignment needs to be formalized or in the process of being formalized—Pennsylvania will effectively prevent foreclosures by third parties completely unrelated to the mortgage or by parties who have absolutely no ability to ever formalize an assignment.<sup>182</sup>

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175. *Id.* at 994 n.6 (omission in original) (quoting *Commonwealth v. Ulrich*, 565 A.2d 859, 862 (Pa. Commw. Ct. 1989) (internal quotation marks omitted)).

176. *Id.* (first alteration in original) (quoting *Fusco v. Hill Fin. Sav. Ass’n*, 683 A.2d 677, 681 (Pa. Super. Ct. 1996) (internal quotation marks omitted)).

177. *Id.* at 993–94.

178. *Id.* (citing PA. R. CIV. P. 2002).

179. *Id.* (alteration in original) (omission in original) (quoting PA. R. CIV. P. 2002) (internal quotation marks omitted).

180. *Id.* at 994.

181. *Id.* at 993.

182. While *Mallory* is the leading Pennsylvania case, a lower court decision issued earlier that same year came to a very different conclusion. *Wells Fargo Bank, NA v. D’iorio*, No. 6846-2008 (Pa. Ct. Com. Pl. Sept. 8, 2009). In *D’iorio*, the court vacated an order granting summary judgment in favor of Wells Fargo. Wells Fargo neither assigned the mortgage before filing the complaint, nor attached the required documentation to the complaint or an explanation for the lack thereof. The court stated that

Pennsylvania mortgage foreclosure actions are governed by Pennsylvania Rules of Civil Procedure 1141–1150. These Rules require a plaintiff to set forth in the complaint the parties to and the dates of any assignments of the mortgage, including a statement of place of the

b. *Illinois*

In *U.S. Bank National Ass'n v. Cook*,<sup>183</sup> the U.S. District Court for the Northern District of Illinois was presented with the question of what constitutes adequate evidence of a valid assignment.<sup>184</sup> The counterplaintiff alleged inter alia that U.S. Bank was not the assignee of the mortgage and therefore could not foreclose.<sup>185</sup> The bank presented testimony of a company executive that the mortgage in question was included in a Pooling and Servicing Agreement (“PSA”) which contained the assignment language.<sup>186</sup> Based solely on the bank’s contention that the PSA contained the mortgage in question and on the testimony of the bank executive, the court granted the bank’s motion for summary judgment and allowed the bank to foreclose.<sup>187</sup> There was no mention in the opinion that the bank produced a chain of assignments which would give validity to the assignment in question.<sup>188</sup> There was also no mention of the court examining the PSA to determine if this mortgage was in fact included in the PSA.<sup>189</sup> The court allowed the testimony of bank employees and the fact that the mortgage was allegedly contained in a pooling and servicing agreement to suffice as enough evidence to prove a timely assignment and to prove the requirements of standing.<sup>190</sup>

Judicial reliance on similarly dubious evidence—such as affidavits signed by low level bank employees who never reviewed the underlying documents—is not limited to just this instance in Illinois.<sup>191</sup> As mentioned above, banks have been using this type of evidence to prove the elements of foreclosures in both judicial and non-judicial states.<sup>192</sup> Despite several national banks temporarily halting all

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recording of the assignments, along with other elements of the cause of action. PA. R. CIV. P 1147. Such averments are essential to a complaint in mortgage foreclosure; procedural requirements must be strictly followed.

*Id.* at 2. Following this statement, the court came to the opposite conclusion from that of *Mallory* and vacated the summary judgment on almost identical facts. Compare *Mallory*, 982 A.2d at 986 (holding that only requirement for standing in foreclosure proceeding is proof that holder was in process of properly assigning mortgage at time of filing), with *Wells Fargo Bank, NA*, No. 6846-2008 at 2 (holding that standing in foreclosure proceeding requires proof of *finalized* mortgage assignment at time of filing). Taking these two cases together, one must give more weight to *Mallory* as it is an appellate court decision; however, the completely different results reached from the same facts in *D’iorio* leave some doubt as to *Mallory*’s validity.

183. No. 07 C 1544, 2009 WL 35286 (N.D. Ill. Jan. 6 2009).

184. *Cook*, 2009 WL 35286, at \*4.

185. *Id.* at \*3.

186. *Id.*

187. *Id.*

188. *Id.*

189. *Id.*

190. *Id.* at \*3–4.

191. See Morgenson, *supra* note 9 (explaining how banks relied on questionable documentation in all judicial foreclosure states).

192. See Andrew Martin & David Streitfeld, *Halt in Foreclosures a New Blow to Home Sales*, N.Y. TIMES, Oct. 8, 2010, at A1 (explaining how J.P. Morgan Chase, Bank of America, and GMAC Mortgage had been using flawed affidavits as grounds for foreclosure but have now halted foreclosure proceedings in all judicial foreclosure states due to questionable accuracy of signed court documents).

foreclosure proceedings based on the questionable quality of the evidence, Bank of America resumed judicial foreclosures shortly thereafter and it is expected that other banks will follow.

### 3. California and Increased Levels of Formality Neglect

As a non-judicial foreclosure state,<sup>193</sup> California has used a different type of analysis to reject the neglect-based foreclosure defense in some instances, but to embrace it in others. In *Tina v. Countrywide Home Loans, Inc.*,<sup>194</sup> the U.S. District Court for the Southern District of California gave no weight to the mortgagor's citation to the *Boyko Foreclosure Cases* as authority requiring that a foreclosing entity produce the actual note in question.<sup>195</sup> The court cited to section 2924 of the California Civil Code to show that California's requirements for non-judicial foreclosure sales do "not include providing the original note prior to the sale."<sup>196</sup> Aside from occurring in a non-judicial foreclosure state, the primary distinction between *Tina* and the *Boyko Foreclosures Cases* was that *Tina* involved the presentation of the note, rather than its proper assignment.<sup>197</sup>

While one California court rejected the proposition that a foreclosing entity must produce the actual note in order to foreclose, another California court embraced this defense as a way to ensure that foreclosing entities in California prove they are the owner of the note with the requisite authority to foreclose on the property.<sup>198</sup> In *Saxon Mortgage Services Inc. v. Hillery*,<sup>199</sup> the court cited to *Rose Foreclosure Cases* as authority for the proposition that "[t]o show standing in a foreclosure action, . . . the plaintiff must show that it is the holder of the note and the mortgage at the time the complaint was filed [and] . . . that the holder of the note and mortgage is harmed, usually by not having received payments on the note."<sup>200</sup> In *Saxon*, there was no evidence in the record that "New Century [a lender] ever assigned MERS the promissory note or otherwise gave MERS the authority to assign the note."<sup>201</sup> Therefore, MERS never had the authority to assign

193. See *supra* note 67 for a list of non-judicial foreclosure states.

194. No. 08 CV 1233 JM (NLS), 2008 U.S. Dist. LEXIS 88302 (S.D. Cal. Oct. 30, 2008).

195. *Tina*, 2008 U.S. Dist. LEXIS 88302, at \*20. Arizona and Nevada—two states with similar non-judicial foreclosure laws to those in California—have responded in a similar fashion to the *Boyko Foreclosure Cases*. See, e.g., *Ernestberg v. Mortg. Investors Grp.*, 2:08-cv-01304-RCJ-RJJ, 2009 U.S. Dist. LEXIS 4560, at \*13-14 (D. Nev. Jan. 22, 2009) (distinguishing *Boyko Foreclosure Cases* because it dealt with judicial foreclosure, whereas instant case involved nonjudicial foreclosure proceedings, as authorized under Nevada law); *accord* *Goodyke v. BNC Mortg., Inc.*, No. CV 09-0074-PHX-MHM, 2009 U.S. Dist. LEXIS 89331, at \*6 (D. Ariz. Sept. 10, 2009) (rejecting *Boyko Foreclosure Cases* as authoritative because, in part, *Ernestberg* had already distinguished it in a "factually analogous" scenario).

196. *Tina*, 2008 U.S. Dist. LEXIS 88302, at \*21 (citing CAL. CIV. CODE § 2924 (Deering 2010)).

197. *Id.* at \*20-21.

198. *Saxon Mortg. Servs., Inc. v. Hillery*, No. C-08-4357 EMC, (Docket No. 7), 2008 U.S. Dist. LEXIS 100056, \*15-16 (N.D. Cal. Dec. 9, 2008). See *supra* Part II.B and section 3-309 of the U.C.C. for an explanation of the distinction between requiring a note to be produced and requiring a foreclosing entity to prove that it is the owner of the note. U.C.C. § 3-309 (2002).

199. No. C-08-4357 EMC, (Docket No. 7), 2008 U.S. Dist. LEXIS 100056 (N.D. Cal. Dec. 9, 2008).

200. *Saxon*, 2008 U.S. Dist. LEXIS 100056, at \*14 (alterations and omissions in original) (quoting *Rose Foreclosure Cases*, 521 F. Supp. 2d 650, 653 (S.D. Ohio 2007) (internal quotation marks omitted)).

201. *Id.* at \*3.

the note to Consumer,<sup>202</sup> the financial entity claiming ownership of the note and on whose behalf Saxon was attempting to foreclose.<sup>203</sup> The court held that because there was no record that the assigning entity ever had authority to assign the note and mortgage to the foreclosing entity, there was no evidence that the foreclosing entity had standing.<sup>204</sup>

The neglect-based foreclosure defense has also been somewhat successful in California when the foreclosing entity brought a foreclosure on behalf of an unknown or undisclosed third party. In both *In re Hwang*<sup>205</sup> and *In re Vargas*,<sup>206</sup> the Bankruptcy Court for the Central District of California dismissed proofs of claims brought by foreclosing entities which did not join the owners or assignees of the notes on whose behalf the entities were filing the proofs of claims and the motions for relief from the automatic stay.<sup>207</sup> While *Hwang* was eventually reversed by the district court, the reversal of *Hwang* cannot be extended to *Vargas*.<sup>208</sup>

In *Hwang*, IndyMac brought a motion for relief from the automatic stay. The bankruptcy court noted that “IndyMac sold the note to Freddie Mac, which in turn most likely sold it again as part of a securitization transaction. Insofar as the record before the court discloses, the owner of the note today is unknown.”<sup>209</sup> The court in *Hwang* stated that the right to enforce a note as a servicer on behalf of another entity established constitutional standing.<sup>210</sup> However, the court held that this right to enforce a note alone does not establish the servicer as a real party in interest, which is an element of prudential standing.<sup>211</sup> Without that other entity joined as a party to the motion, the bankruptcy court refused to grant the motion for relief from the automatic stay.<sup>212</sup> The court wanted to “discourage an apparently common practice in the secondary mortgage market of failure to deliver notes when they are sold, often numerous times, so that the possessor of the note may be far removed from the real owner of the note,”<sup>213</sup> while at the same time acknowledging the fact that “the markets rely on the ability of the noteholder to bring foreclosure proceedings to realize the value of the note.”<sup>214</sup> As a balance between these two public policies, the court determined that Indymac

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202. Consumer is the name of the financial entity involved, not an individual mortgagor.

203. *Saxon*, 2008 U.S. Dist. LEXIS 100056, at \*17.

204. *Id.* at \*16.

205. 396 B.R. 757 (Bankr. C.D. Cal. 2008), *rev'd*, 438 B.R. 661 (C.D. Cal. 2010).

206. 396 B.R. 511 (Bankr. C.D. Cal. 2008).

207. *Hwang*, 396 B.R. at 767–68; *Vargas*, 396 B.R. at 515–16.

208. *Compare Hwang*, 438 B.R. 661 (C.D. Cal. 2010) (reversing lower court because foreclosing entity was noteholder), with *Vargas*, 396 B.R. 511 (Bankr. C.D. Cal. 2008) (denying MERS's motion because it was neither noteholder nor assignee).

209. *Hwang*, 396 B.R. at 764.

210. *Id.* at 768–69.

211. *Id.* at 767–69.

212. *Id.* at 772.

213. *Id.* at 765.

214. *Id.*

would still be allowed to collect payments even though it did not have standing to get relief from the automatic stay in order to foreclose.<sup>215</sup>

On appeal, the district court reversed and remanded the bankruptcy court decision after holding that a non-owner noteholder was entitled to bring a foreclosure action as a real party in interest.<sup>216</sup> The district court held that the real party in interest under Federal Rule of Civil Procedure 17 “is the party with the right to enforce a claim under the applicable substantive law.”<sup>217</sup> The court then determined that under California law the noteholder is entitled to enforce the note despite not being the owner of the note.<sup>218</sup> The court next stated that the bankruptcy court’s assumption that the note had been securitized was based on evidence not properly before the court and was therefore an abuse of the court’s discretion.<sup>219</sup> Finally, the district court held that because the owner of the note could make a claim against Indymac for the proceeds of the foreclosure sale, the owners are not considered indispensable parties requiring joinder under Federal Rule of Civil Procedure 19.<sup>220</sup>

Eight days before the bankruptcy court originally decided *Hwang*, the same court decided *Vargas*.<sup>221</sup> In *Vargas*, MERS was claiming to join and to foreclose on behalf of “its assignees and/or successors in interest.”<sup>222</sup> The court denied MERS’s motion for relief from the automatic stay because it was unable to identify those same assignees or successors in interest.<sup>223</sup> Additionally, the court in *Vargas* imposed sanctions on the law firm that brought the motion with no evidentiary support.<sup>224</sup> As nothing in the opinion suggests that MERS held the note in *Vargas*, as IndyMac had in *Hwang*, MERS is not a real party in interest as interpreted by the district court in *Hwang*. Therefore, the *Vargas* holding is unaffected by the reversal of *Hwang*.

### III. DISCUSSION

While courts may disagree as to the significance of an untimely or unproven assignment,<sup>225</sup> when the neglect and disregard for the assignment process reaches the level of bringing a foreclosure with no hope of assignment, with inadequate or

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215. *Id.*

216. *In re Hwang*, 438 B.R. 661, 665–67 (C.D. Cal. 2010).

217. *Id.* at 665.

218. *Id.* (citing CAL. COM. CODE § 3301 (West 2008)).

219. *Id.*

220. *Id.* at 667 (citing FED. R. CIV. P. 19).

221. *In re Vargas*, 396 B.R. 511 (Bankr. C.D. Cal. 2008).

222. *Id.* at 514 (internal quotation marks omitted).

223. *Id.* at 516–17.

224. *In re Vargas*, No. LA08-17036SB, 2008 WL 4864986. The court’s issuance of sanctions is mentioned in Westlaw’s electronic version of the opinion, but not in the hard-copy version published in the *Bankruptcy Reporter*. According to Westlaw’s electronic version, “the court finds that sanctions should be imposed on the law firm under [Federal Rule of Bankruptcy Procedure] 9011 for bringing the motion with no evidentiary support.” *Id.* (footnote omitted).

225. See *infra* Part III.A.2. for a discussion of judicial disagreement about the appropriate consequences of an untimely or unproven assignment.



fraudulent evidence, or on behalf of unknown or undisclosed third parties,<sup>226</sup> standing should not be afforded to the foreclosing financial institution regardless of the court, the governing state law, or the countervailing public policies. Those cases with the highest levels of formality neglect should always be dismissed without prejudice and, similarly, bankruptcy claims should always be denied with leave to amend.

The cases where plaintiffs have raised the improper assignment defense generally fall into two distinct categories. First and foremost, homeowners have used this defense when the financial institution that could have received a proper mortgage assignment did not do so in a timely fashion or had questionable evidence of the assignment.<sup>227</sup> As the assignment and foreclosure processes are governed by state law and often end up in state court, the states are split on whether banks can foreclose on the mortgages in this category.<sup>228</sup> Second, homeowners have used this defense when the foreclosing financial institution could not prove it received a legal or authorized assignment, or when the financial institution brought a foreclosure on behalf of an unknown third party.<sup>229</sup> Decisions dealing with this latter category of cases have unanimously stated that such foreclosures are improper and should be prevented from going forward.<sup>230</sup>

The following discussion proceeds, first, by analyzing how the mortgage assignment requirement should be applied to the federal standing doctrine and comparing two situations where assignment issues come up in foreclosure proceedings. The discussion then places recent foreclosure cases within the context of two conflicting public policies: (1) helping families and communities by preventing unwarranted foreclosures, and (2) protecting the health of the economy by allowing foreclosures to go through.<sup>231</sup> An argument is thereupon made that courts addressing these types of cases should always consider the above policies to ensure that the enforcement of the foreclosure requirements does not increase the severity of the current financial crisis.<sup>232</sup> Finally, the discussion establishes a level—based on an analysis of case law—at which the severity of the neglect or disregard will cause all courts to dismiss cases without prejudice or deny relief from stay with leave to amend proofs of claim.<sup>233</sup>

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226. See *infra* Part III.A.3 for a discussion of how courts have treated severe forms of neglect in the assignment process.

227. See *infra* Part III.A.2 for a discussion of cases in which homeowners have used the improper assignment defense against financial institutions that tardily received, or had questionable evidence of, their mortgage assignments.

228. See *infra* Part III.A.2.

229. See *infra* Part III.A.3.

230. See *infra* Part III.A.3.b for a discussion of cases where judges have prevented financial institutions from foreclosing on behalf of unknown third parties.

231. See *infra* Part III.B for a discussion of these competing public policies.

232. See *infra* Part III.B.3 for a discussion of how courts can accommodate the policy goal of protecting homeowners from unwarranted foreclosures without producing a disastrous effect on the economy.

233. See *infra* Part III.A.3.b for an analysis of the threshold degree of neglect that will cause all courts to prevent foreclosures from proceeding.

## A. *Mortgage Assignments and the Federal Standing Doctrine*

### 1. Improper Assignments Applied to the Federal Standing Doctrine

The standing requirements established in *Lujan v. Defenders of Wildlife*<sup>234</sup> and *Sprint Communications Co. v. APCC Services, Inc.*<sup>235</sup> illustrate the legal reasons why a non-assignee should not be given standing to foreclose on a given property in federal court and the policy downsides to allowing a nonassignee plaintiff to foreclose. To establish federal standing under *Lujan*, a foreclosing plaintiff must demonstrate: (1) an actual injury, (2) caused by the opposing party, that (3) will likely be remedied by a favorable decision.<sup>236</sup>

#### a. *Element 1: Injury*

The injury requirement of federal standing doctrine can only be met by the party who actually received the injury or by the assignee.<sup>237</sup> While an assignee has the right to bring a foreclosure complaint for an injury sustained before it was the owner of the mortgage, that assignee only gets this right upon assignment.<sup>238</sup> As standing must be argued at the time the complaint is filed,<sup>239</sup> if a party brings a foreclosure motion without a proper assignment they have no legal title and therefore no legal standing.<sup>240</sup> Therefore, until the assignment is made, the injury in question is to the last party to have received a valid assignment and not the future assignee.<sup>241</sup>

When a future assignee brings a foreclosure before they are the actual assignee, there is no injury to the plaintiff and therefore no standing to bring a case in federal court.<sup>242</sup> While the U.C.C. requires an endorsement of the note, or at least requires the plaintiff have possession of the note,<sup>243</sup> a state's requirement to become an assignee—via actual assignment, equitable assignment, or delivery of the note and mortgage<sup>244</sup>—must be met before the injury in question is an injury to the assignee.<sup>245</sup> Additionally, one of the prudential standing

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234. 504 U.S. 555 (1991).

235. 128 S. Ct. 2531 (2008).

236. *Lujan*, 504 U.S. at 560–61.

237. See *Sprint Commc'ns*, 128 S. Ct. at 2541 (declaring that an assignee may sue in federal court).

238. See *id.* (explaining that assignment of legal title is sufficient to allow a party to bring federal claim based on claims of her assignors).

239. See *Lujan*, 504 U.S. at 561 (stating that standing is required at pleading stage).

240. See *Sprint Commc'ns*, 128 S. Ct. at 2541 (stating that only party with legal title can bring suit).

241. See *id.* at 2542–43 (stating that assignor suffered original injury, but that assignment gave assignee right to bring claim).

242. See *Rose Foreclosure Cases*, 521 F. Supp. 2d 650, 653 (S.D. Ohio 2007) (holding that to have standing plaintiff must be holder of note).

243. See *supra* Part II.B.

244. See *supra* Part II.F.1 for a discussion of the assignment requirements imposed by courts in Ohio, Massachusetts, and New York.

245. See *Sprint Commc'ns*, 128 S. Ct. at 2542 (stating that assignment allows assignees to bring suits based on injuries to assignors).

requirements is that a plaintiff may only assert its own legal rights.<sup>246</sup> As the injuries here are originally those of the assignors, when a bank attempts to bring a foreclosure before receiving an assignment or with no proof of assignment, the bank is attempting to bring a suit based on the rights of a third party. Such suits are insufficient for prudential standing.<sup>247</sup> As the injury in this situation remains that of the owner, if a non-assignee is allowed to foreclose, the actual owner of the note would also be able to sue the defendant, creating double liability for the defendant.<sup>248</sup> The correct application of the standing doctrine should prevent against this potential for double liability.

*b. Element 2: Injury Caused by Opposing Party*

The causation requirement of federal standing doctrine can be established without a proper assignment. Causation is established when the “injury is fairly traceable to the defendant’s acts or omissions.”<sup>249</sup> In foreclosure cases, causation is met by the fact that the homeowner’s inability to pay the mortgage caused the default which led to the foreclosure. While an argument could be made that the financial system is at fault through either subprime lending<sup>250</sup> or the move towards a dispassionate mortgage industry,<sup>251</sup> there is at least some causal connection between the defendant’s inability to pay and the injury in question. Since only some causal connection is required for purposes of standing, the defendant’s inability to pay should be sufficient.<sup>252</sup>

*c. Element 3: Likelihood that a Favorable Decision Will Redress the Injury*

The third requirement for federal standing—redressability—is also impossible to meet when an entity is assigned a mortgage after the complaint is filed. To demonstrate redressability, there must be a “causal connection between the alleged injury and the relief sought.”<sup>253</sup> According to the first requirement for federal standing, when the plaintiff has not been assigned the mortgage at the time of the complaint, the injury is that of the last party in the assignment chain. Because there is no injury to a future assignee under the first requirement, the benefit of a foreclosure brought by a future assignee on a mortgage will give the future assignee redress for an injury suffered by an entity not party to the suit.<sup>254</sup>

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246. See *supra* note 93 and accompanying text for a list of the prudential standing requirements.

247. See *In re Hwang*, 396 B.R. 757, 768–69 (Bankr. C.D. Cal. 2008) (holding that only real party in interest can bring foreclosure motion, that only legal owner not physical holder can be real party in interest, and that failure to bring suit with real party in interest prohibits finding of sufficient prudential standing), *rev’d*, 438 B.R. 661 (C.D. Cal. 2010).

248. See *Redish & Katt*, *supra* note 93, at 1901–02 (stating that multiple suits against defendants for rights to indivisible property creates potential for double liability).

249. 15 MOORE ET AL., *supra* note 98, § 101.41[2].

250. See *supra* Part II.A.1 for a discussion of the subprime lending crisis and how it precipitated the current financial crisis.

251. See *supra* Part II.A.2 for a discussion of the securitization process and how it places distance between the decision making entities and the actual borrower.

252. 15 MOORE ET AL., *supra* note 98, § 101.41[3].

253. *Id.* § 101.42[3].

254. See *Sprint Communications Co. v. APCC Services, Inc.*, 128 S. Ct. 2531, 2542 (2008) (reasoning

Without an assignment prior to trial, there is no causal connection between the relief sought and the alleged injury. Unless the entity that was actually injured brings the suit, therefore, the requirement that it be likely that a favorable decision will redress the injury cannot be met.

As a non-assignee cannot meet element one or three of *Lujan's* standing requirements, a foreclosure complaint brought by a non-assignee in federal court should be dismissed. While this analysis is only binding on federal courts, it illustrates several reasons non-assignees should be prevented from foreclosing.

## 2. Defeating Standing with Untimely and Unproven Assignments

When a homeowner uses the foreclosing entity's neglected assignment as a defense, the issue is generally about the timing, or adequate documentation, of the assignment rather than the impossibility of proving that an assignment could exist.<sup>255</sup> While it is clear that an entity to which a mortgage has not yet been assigned should not have standing in federal court, the different evidentiary requirements for proving an assignment and the different standing requirements in state courts are such that an untimely assignment—or a poorly documented assignment—does not necessarily defeat a foreclosure motion.<sup>256</sup> When looking at the federal standing analysis above and the ways different courts, both state and federal, have dealt with the issue of assignments as a vehicle to confer standing, two main issues become apparent. First, was the assignment completed before the complaint or claim was filed?<sup>257</sup> Second, is there enough evidence to establish the existence of the assignment?<sup>258</sup>

While federal courts clearly should require—for purposes of standing—that the assignment be complete before filing the complaint, *U.S. Bank N.A. v. Mallory*<sup>259</sup> suggested that establishing a non-assignee's intent to assign is enough for that plaintiff to be a real party in interest under Pennsylvania state law.<sup>260</sup> Although *Mallory* did not claim that the intent to assign amounts to an actual assignment,

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that an assignee for collection-only can be redressed for an injury to the assignor on fact that plaintiff was an assignee).

255. See *supra* Part II.F to compare cases dealing with untimely assignments to cases dealing with a complete inability to either assign the note or join the actual owner of the note.

256. See *U.S. Bank Nat'l Ass'n v. Cook*, No. 07 C 1544, 2009 WL 35286, at \*3–4 (N.D. Ill. Jan. 6, 2009) (holding that bank executive testimony claiming that mortgage was included in pooling and servicing agreement was sufficient evidence to prove assignment); *US Bank N.A. v. Mallory*, 982 A.2d 986, 993 (Pa. Super. Ct. 2009) (holding that because bank was “in the process of formalizing” its assignment when its complaint was filed, failure to complete its assignment before filing was not enough to prevent foreclosure).

257. See, e.g., *Deutsche Bank Nat'l Trust Co. v. Bailey*, 2009 WL 294688, at \*2–3 (N.Y. Sup. Ct. Feb. 9, 2009) (holding that bank lacked standing because written assignment was signed after complaint had been served on defendant).

258. See, e.g., *Cook*, 2009 WL 35286, at \*3–4 (holding that bank executive testimony claiming that mortgage was included in pooling and servicing agreement was sufficient evidence to prove proper assignment); *Rose Foreclosure Cases*, 521 F. Supp. 2d 650, 654–55 (S.D. Ohio 2007) (upholding General Order 07-03 requiring that foreclosure complaints include a legible copy of the note, a copy of the mortgage, any assignments, and affidavits documenting plaintiff's ownership).

259. 982 A.2d 986 (Pa. Super. Ct. 2009).

260. *Mallory*, 982 A.2d at 993.

the court allowed the case to move forward absent a pre-complaint assignment.<sup>261</sup> *Mallory* exemplifies a relaxed state standing doctrine which allows foreclosure cases to be successful even though the same case in federal court would not meet the federal standing doctrine.<sup>262</sup>

Under federal standing doctrine, the question is less about the timing of the assignment, and more about whether the plaintiff can prove the assignment exists. Recent decisions provide guidance on the various ways an assignment may be proved. In Ohio, an equitable assignment has been held to be sufficient.<sup>263</sup> In New York, delivery of the note and mortgage has been held sufficient.<sup>264</sup> In Massachusetts, an actual assignment has been required unless the claimant previously held some rights to the property and a financial interest.<sup>265</sup> However, under the relaxed evidentiary standard applied by an Illinois district court in *U.S. Bank National Association v. Cook*, the alleged inclusion of the mortgage in a pooling and servicing agreement, along with testimony from an executive of the foreclosing entity, was held sufficient to establish the existence of the assignment.<sup>266</sup>

The Illinois district court's dubious reliance on the financial institution's pooling and servicing agreement, and testimony of the institutions' executives, leaves open the question of whether such documents and witnesses can be relied upon.<sup>267</sup> In response to concerns over the validity of foreclosures based on this type of evidence, several banks halted all judicial foreclosures.<sup>268</sup> Bank of America temporarily halted all foreclosures, both judicial and non-judicial, citing problems with precisely this type of evidence.<sup>269</sup> With the banks themselves acknowledging problems with the evidence, courts should require actual proof of the written assignment documents and not just affidavits or testimony of bank officials.

While the above-mentioned evidentiary standards may differ slightly in determining how an assignment may be proved and when it is untimely, three of the five standards preclude financial institutions from foreclosing when there is insufficient evidence that the assignment was completed prior to the commencement of the foreclosure.<sup>270</sup> However, when neglected assignment

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261. *Id.*

262. *Compare id.* (allowing a foreclosure to proceed despite the fact that the assignment had not been completed prior to the complaint), with *supra* Part III.A.1 (discussing application of improper assignments to the elements of the federal standing doctrine).

263. See *supra* notes 127–29 and accompanying text.

264. See *supra* note 159–63 and accompanying text.

265. See *supra* notes 144–57 and accompanying text.

266. See *supra* note 183–91 and accompanying text for a discussion of Illinois' relaxed evidentiary standards.

267. See *supra* note Part II.D.4 for a discussion of the questionable evidence used by banks to establish the requirements to foreclose.

268. Martin & Streitfeld, *supra* note 192.

269. David Streitfeld & Nelson D. Schwartz, *Top Bank Halts its Foreclosures in All 50 States*, N.Y. TIMES, Oct. 9, 2010, at A1.

270. As discussed above, courts in Massachusetts, New York, and Ohio have required that an assignment exist prior to the complaint. By contrast, courts in Illinois and Pennsylvania have not imposed this requirement.

formalities cause the foreclosing entity itself to be uncertain as to the validity of the assignment or unable to find the actual owner of the note and mortgage, there is a consensus in recent case law that the foreclosure should not proceed.<sup>271</sup>

### 3. Defeating Standing with Invalid Assignments and Undisclosed Mortgage Owners

While non-judicial foreclosure states are not forced to consider the federal standing requirements, several cases in non-judicial foreclosure states exemplify the uncertainty and severe problems that result from financial institutions regularly ignoring assignment formalities. In the first subset of this category, banks attempted to foreclose even though the assignments they received may never have been valid.<sup>272</sup> In the second subset, financial institutions attempted to bring a foreclosure on behalf of unknown third parties.<sup>273</sup>

#### a. *The Assignment That Never Was*

In the previous cases discussed, the question concerned whether the relevant assignment was timely and whether there was sufficient evidence to prove its existence.<sup>274</sup> The question in the two following cases is whether the assignments—although timely and proven to exist—were done with proper authority or if somewhere in the chain of assignments an entity assigned the mortgage with no authority to do so.

In *In re Hayes*,<sup>275</sup> the Bankruptcy Court for the District of Massachusetts stated that “reliance upon back-dated, unrecorded assignments, have confounded the identity of the current holder of the mortgage for the purpose of filing the Motion for Relief from Stay, as well as the proof of claim.”<sup>276</sup> The court made this statement without attempting to explain how the entities failed to establish that the mortgage made it from the originator to the entity, attempting to foreclose on the house, Argent Mortgage Companies.<sup>277</sup> The court then granted the moving party leave to clean up the mess and file an amended claim.<sup>278</sup>

271. See *infra* Part III.A.3.b for a discussion of this consensus.

272. See generally *Saxon Mortg. Servs., Inc. v. Hillery*, No. C-08-4357 EMC, (Docket No. 7), 2008 U.S. Dist. LEXIS 100056 (N.D. Cal. Dec. 9, 2008); *In re Hayes*, 393 B.R. 259, 268 (Bankr. D. Mass. 2008).

273. See generally *In re Hwang*, 396 B.R. 757 (Bankr. C.D. Cal. 2008), *rev'd*, 438 B.R. 661 (C.D. Cal. 2010); *In re Vargas*, 396 B.R. 511 (Bankr. C.D. Cal. 2008).

274. See *supra* Part III.A.2 for a discussion of untimely or unproven assignments.

275. 393 B.R. 259 (Bankr. D. Mass. 2008).

276. *Hayes*, 393 B.R. at 269.

277. See *id.* at 270.

Deutsche Bank failed to establish that Argent Mortgage Company, LLC effectively assigned the mortgage executed by the Debtor to it or that Argent Mortgage Company, LLC's grant of authority to Citi Residential Lending, Inc. under the Limited Power of Attorney was sufficient to empower Citi Residential Lending, Inc. to execute the Confirmatory Corporation Assignment, dated April 16, 2008, on its behalf, so as to effectively transfer the mortgage on the Perkins Avenue property from Argent Mortgage Company, LLC to Deutsche Bank. Moreover, Argent Mortgage Company, LLC was not a party to the PSA and Deutsche Bank failed to submit evidence that Argent Mortgage Company, LLC ever conveyed its rights in and to the mortgage on the Perkins Avenue property to Argent Securities Inc.

In *Saxon Mortgage Services, Inc. v. Hillery*,<sup>279</sup> the U.S. District Court for the Northern District of California determined that because the original lender “[n]ever assigned MERS the promissory note or otherwise gave MERS the authority to assign the note,”<sup>280</sup> MERS never had the authority to assign the note to Consumer.<sup>281</sup> Therefore, Saxon could not foreclose as the agent of Consumer (another financial entity), because Consumer did not receive an assignment from an entity which could properly assign the mortgage.<sup>282</sup>

Under the standards used by courts in Massachusetts, Pennsylvania, New York, and Ohio, the foreclosing entities in *Hayes* and *Saxon* would be unable to proceed. The standards used in Massachusetts, New York, and Ohio all require evidence that the assignment happened before the foreclosure commenced.<sup>283</sup> In *Hayes* and *Saxon*, there was no evidence that the banks ever had authority to make an equitable assignment or to deliver the note or mortgage, and no evidence that the banks held any previous legal interest in the mortgages.<sup>284</sup> As such, no assignment took place or could take place. The standard used in Pennsylvania allows parties to foreclose if they are in the process of assigning the mortgage.<sup>285</sup> In Pennsylvania, the complete inability to legally assign the mortgage precludes a finding that a financial entity is in the process of assigning the mortgage.<sup>286</sup> Therefore, in Pennsylvania, the foreclosures in *Hayes* and *Saxon* would not be allowed to go forward.

By contrast, the Illinois standard—as presented in *Cook*—allows entities to foreclose even when the only evidence of a valid assignment is the plaintiff’s testimony through company executives that a pooling and servicing agreement includes the mortgage in question.<sup>287</sup> In both *Hayes* and *Saxon*, therefore, this standard would likely have been met. As in *Cook*, the evidence presented by the banks in *Saxon* and *Hayes* was that of a bank employee and not hard proof of an actual written assignment.<sup>288</sup> While Pennsylvania would likely join Massachusetts, New York, and Ohio in not allowing the foreclosure in this situation, under *Cook*,

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*Id.* (citation omitted).

278. *Id.*

279. No. C-08-4357 EMC, (Docket No. 7), 2008 U.S. Dist. LEXIS 100056 (N.D. Cal. Dec. 9, 2008).

280. *Saxon*, 2008 U.S. Dist. LEXIS 100056, at \*3.

281. *Id.* at \*16.

282. *Id.* at \*17.

283. See *supra* Part II.F.1 for a discussion of the evidentiary requirements in Massachusetts, New York, and Ohio.

284. See *Saxon*, 2008 U.S. Dist. LEXIS 100056, at \*3 (stating that no evidence showed authority for assignor to assign the mortgage to supposed assignee); *In re Hayes*, 393 B.R. 259, 270 (Bankr. D. Mass. 2008) (stating that insufficient evidence existed to prove existence of valid assignments between involved financial entities).

285. See *supra* Part II.F.2.a for a discussion of Pennsylvania’s standard.

286. See *supra* Part II.F.2.a for a discussion of how the Pennsylvania Superior Court allowed an unassigned mortgage to be foreclosed upon because the financial entity was in the process of finalizing a legal assignment of the note and mortgage.

287. See *supra* Part II.F.2.b for a discussion of *Cook*’s relaxed evidentiary standards.

288. The prevalent use of this type of questionable evidence is what caused multiple national banks to halt all foreclosures and investigate whether they were adequately proving the foreclosure elements. See *supra* Part II.D.4 for a discussion of why banks temporarily halted foreclosures.

Illinois would likely still allow the foreclosure to go through. The Pennsylvania standard—which requires a plaintiff to prove either the existence of a valid assignment or the immediate ability to get a valid assignment—prevents an invalid assignment from being the basis for foreclosure. Under the *Cook* standard, however, the reliance on questionable testimony from mortgage industry executives and pooling and servicing agreements, could allow invalidly assigned mortgages, like the mortgage at issue in *Saxon*, to slip through the cracks.<sup>289</sup> Allowing improper foreclosures based on inadequate evidence creates a potential for double liability, questionable validity of title, and uncertainty in the housing market.<sup>290</sup>

*b. Unknown Owner and Holder of the Note*

All of the abovementioned standards, including the one applied in *Cook*, will likely prohibit foreclosure when a foreclosing entity does not hold the note and tries to foreclose on a property without disclosing the third party on whose behalf they were acting. The case highlighting this scenario, *In re Vargas*,<sup>291</sup> comes from the Bankruptcy Court for the Central District of California. *Vargas* dealt with a situation where MERS attempted to get relief from an automatic stay to foreclose on a property on behalf of an undisclosed third party.<sup>292</sup> MERS “purport[ed] to join as moving parties ‘its assignees and/or successors in interest,’ which [were] otherwise unidentified.”<sup>293</sup> The court concluded that the original lender assigned the note for it to be securitized.<sup>294</sup> The court then determined that, because MERS only held the deed of trust as an agent of the noteholder, it was not authorized to act on behalf of the new owner without evidence of an agency contract.<sup>295</sup> Without MERS having authority to bring the motion in question, the motion for relief from the stay was dismissed on this and other grounds.<sup>296</sup>

In situations similar to *Vargas*—where neither the assignee, the owner, nor the holder of the note brought the foreclosure—courts in Pennsylvania, Massachusetts, New York, Ohio, and even Illinois, have determined that the parties attempting to foreclose do not have standing to foreclose on the property.<sup>297</sup> In *Vargas*, the assignment process employed by the lenders became so sloppy that

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289. See *supra* Parts II.F.2.a and II.F.2.b to compare the Pennsylvania standard with the Illinois district court’s standard.

290. See Ron Lieber, *After Foreclosure, a Focus on Title Insurance*, N.Y. TIMES, Oct. 9, 2010 at B1 (explaining problems with titles and title insurance resulting from inadequate foreclosure documentation); Martin & Streitfeld, *supra* note 192 (explaining how flawed foreclosure documentation impacts the housing market); Morgenson, *supra* note 9 (discussing how allowing inaccurate documentation can lead to multiple banks making claims for single house).

291. 396 B.R. 511 (Bankr. C.D. Cal. 2008).

292. *Vargas*, 396 B.R. at 515.

293. *Id.*

294. *Id.* at 516.

295. *Id.* at 517.

296. *Id.* at 521–22.

297. See *supra* Part II.F for a discussion of cases in Pennsylvania, Massachusetts, New York, Ohio, and Illinois requiring that an assignee or legal owner bring the foreclosure claim in order for the foreclosure to proceed.



even MERS—the entity created to track assignments—completely lost track of the mortgage and the note.<sup>298</sup> In this situation, MERS conceded that it was not the owner or the assignee, but rather the agent or servicer for the owner or assignee.<sup>299</sup> Without knowing who the assignee was, there was no way to prove that an assignment happened or, if it did happen, whether it was valid. Even the relaxed evidentiary requirements used by the Illinois district court in *Cook* would not be met in this situation.<sup>300</sup> Additionally, as only the party with legal title has federal standing to foreclose, the plaintiffs have no way to establish standing in federal court (absent bringing the party with legal title into the suit). Bringing a foreclosure on behalf of an undisclosed third party, therefore, breaks a threshold where all courts, both state and federal, should hold that a foreclosing financial institution is not able to foreclose.

*B. The Public Policy Behind the Arguments*

The cases discussed in this Comment emerged during a severe economic crisis which led to millions of foreclosures and should only be followed in the future, if doing so will not increase the severity of the economic crisis or increase the foreclosure rate.<sup>301</sup> While there are no established places in the federal standing doctrine<sup>302</sup> or in the above-mentioned state cases to consider public policy,<sup>303</sup> a few courts have explicitly considered two strong countervailing public policies,<sup>304</sup> namely: (1) protecting families and communities by not allowing the financial institutions responsible for the mortgage crisis to foreclose on homes without the legal standing to do so, and (2) preventing further harm to financial markets that are incredibly dependent on the mortgage industry's ability to recoup debt when homeowners are unable to pay.<sup>305</sup> Ultimately, all courts should consider both public policies in reaching their decisions as opposed to considering just one or the other.

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298. See *Vargas*, 396 B.R. at 516–17.

299. *Id.* at 515.

300. See *supra* Part II.F.2.b for a discussion of Illinois' relaxed evidentiary standards.

301. See *supra* Part II.C for a discussion of the three waves of foreclosures caused by the decreased value received per foreclosure.

302. See *supra* Part II.E for a discussion of the federal standing doctrine.

303. See, e.g., *Deutsche Bank Nat'l Trust Co. v. Bailey*, 2009 WL 294688, at \*2–3 (N.Y. Sup. Ct. Feb. 9, 2009) (laying out New York's standing requirements, which do not include public policy considerations).

304. E.g., *In re Hwang*, 396 B.R. 757, 765 (Bankr. C.D. Cal. 2008) (considering both markets' reliance on foreclosures and need to prevent banks from using neglectful assignment procedures), *rev'd*, 438 B.R. 661 (C.D. Cal. 2010); *Boyko Foreclosure Cases*, Nos. 1:07CV2282, 07CV2532, 07CV2560, 07CV2602, 07CV2631, 07CV2638, 07CV2681, 07CV2695, 07CV2920, 07CV2930, 07CV2949, 07CV2950, 07CV3000, 07CV3029, 2007 WL 3232430, at \*3 n.3 (N.D. Ohio Oct. 31, 2007) (stating that banking entities were taking advantage of homeowners).

305. See *supra* Part II.C for an understanding of the interconnectedness of the families being foreclosed upon and the health of the economy.

### 1. Keeping People in Their Homes

As stated above, the number of foreclosures has increased dramatically since the housing bubble burst, and as a result of this increase, there is a strong public policy interest in keeping families in their homes. The families targeted for the subprime mortgages were the first group of non-investor homeowners affected, followed later by those families in prime mortgages who lost their jobs as a result of the economic downturn caused by the housing bubble.<sup>306</sup> The increased foreclosure rate has done more than just affect the families living in the homes being foreclosed upon. The foreclosure crisis

has been a huge burden on the economy, has kept house prices on a downward spiral and has resulted in misery and anxiety for millions of people. In some areas so many homes have been abandoned that the entire community has fallen apart as schools close, public services are cut and homes are ransacked for fittings or taken over by criminals. That has also sent property values plunging for those people still in their homes and paying mortgages.<sup>307</sup>

As the banks and other financial institutions are a primary cause of these foreclosures,<sup>308</sup> much of the backlash and public support for foreclosure prevention is at the expense of those banks and financial institutions attempting to collect on the mortgages through foreclosure. The strength of this public policy promoting a reduction in the foreclosure rate is seen most notably in the failed governmental attempts to keep people in their homes through loan modification and mediation,<sup>309</sup> but it can also be seen in the way attorneys fighting financial institutions on behalf of homeowners characterize their fight.<sup>310</sup>

### 2. Protecting the Economy

While the public policy in favor of reducing the number of foreclosures has been gaining momentum, there is a much less discussed public interest in allowing foreclosures to go forward. As stated above, the waves of foreclosures and increased number of foreclosures are a result of the mortgage industry's interconnectedness with the global economy.<sup>311</sup> When the housing bubble burst, the value of individual homes dropped considerably making it so banks no longer recovered the full value of the original loan when they foreclosed on a property.<sup>312</sup>

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306. See *supra* Part II.C for a discussion of the three waves of foreclosures.

307. van Duyn, *supra* note 64.

308. See *supra* Section II.A for a discussion of how subprime lending and mortgage-backed securitization contributed to the current economic crisis.

309. See *generally* WALSH, *supra* note 65, at 1–2 (describing different types of modification and mediation programs).

310. See, e.g., Moe Bedard, *Bring Down the Banks With These Foreclosure Defense Tactics*, LOANWORKOUT.ORG (July 7, 2008), <http://loanworkout.org/2008/07/bring-down-the-banks-with-these-foreclosure-defense-tactics/> (characterizing defense of consumers in foreclosure actions as fighting “the most powerful opponents in the world”).

311. See *supra* Part II.C for a discussion of the mortgage industry's interconnectedness with the global economy.

312. See Brescia, *supra* note 24, at 330 (stating that lenders are worried about viability of outstanding loans amid decrease in housing values).

Due to the dependence of the financial sector on mortgage-backed securities, this inability to recover the full amount on millions of foreclosures caused a shock to the financial world that resulted, not only in over five million jobs being lost, but another wave of mortgage foreclosures.<sup>313</sup> If the economy was affected so significantly by a reduction in the value recovered on foreclosed properties, a complete inability to recover any value from foreclosed properties could have an even more serious effect on the economy.<sup>314</sup> While this Comment is in no way suggesting that the financial entities should not be held accountable for the damage they caused to homeowners, communities, and the economy as a whole, the public interest in restoring the health of the economy must also be considered when determining if a financial entity should be allowed to foreclose.

### 3. How Courts Should Address These Two Policies

The presence of these two public policies and the suddenness with which they crept into judicial decision making processes is exemplified by an attorney's statement in the *Holschuh Foreclosure Cases* that "he ha[d] brought 'hundreds' of these foreclosures cases, and that '[u]ntil recently, no judge . . . had questioned' his practice of bringing such cases without filing the required documents, such as an affidavit, with the complaint."<sup>315</sup> Most courts side with either the banks or the homeowners, and very few courts expressly acknowledge the need to protect the interests of both the homeowners and the banks. As both interests are equally important, all courts faced with potentially impermissible foreclosures should seek an outcome which promotes both interests.

#### a. Drawing the Line Between Permissible and Impermissible Foreclosures

When deciding what happens to a note with an unknown owner, the district court and bankruptcy court for the central district of California established an appropriate line between permissible and impermissible foreclosures which serves to promote both public interests and should be an example to other courts. The original bankruptcy court decision in *In re Hwang*<sup>316</sup> considered two potential holdings and stated the policy behind each.<sup>317</sup> First, the court considered not allowing anyone to enforce the note until it was delivered to the owner.<sup>318</sup> The court stated that this option would "discourage an apparently common practice in the secondary mortgage market of failure to deliver notes when they are sold,

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313. Goodman & Healey, *supra* note 58; Goodman & Healy, *supra* note 50.

314. See van Duyn, *supra* note 64 (stating that a further increase in mortgage losses could have detrimental "knock-on" effects for global economy).

315. *Holschuh Foreclosure Cases II*, Nos. 07-cv-166, 07-cv-190, 07-cv-226, 07-cv-279, 07-cv-423, 07-cv-534, 07-cv-536, 07-cv-642, 07-cv-706, 07-cv-727, 07-cv-731, 07-cv-963, 07-cv-1047, 07-cv-1119, 07-cv-1150, 2007 U.S. Dist. LEXIS 95673, at \*16 (S.D. Ohio, Dec. 27, 2007) (second alteration in original) (omission in original).

316. 396 B.R. 757 (Bankr. C.D. Cal. 2008), *rev'd*, 438 B.R. 661 (C.D. Cal. 2010).

317. *Hwang*, 396 B.R. at 765.

318. *Id.*

often numerous times, so that the possessor of the note may be far removed from the real owner of the note.<sup>319</sup> Next, the court considered requiring the homeowner to make payments on the note even though it would not be paying the owner of the note.<sup>320</sup> In doing so, the court stated “the markets rely on the ability of the noteholder to bring foreclosure proceedings to realize the value of the note.”<sup>321</sup> The court ultimately decided that the bank holding the note had the right to enforce the note by collecting payment, but that it could not foreclose on the property without the actual owner.<sup>322</sup> This attempt to walk the line between the two policies should be replicated by other courts in any situation where a court finds the law governing the permissibility of the foreclosure to be uncertain.

While the bankruptcy court’s decision successfully considered both public policies, the district court reversed the bankruptcy court’s eventual holding citing established California law.<sup>323</sup> The district court held that California law gave a non-owner noteholder the right to enforce the note, including the right to foreclose.<sup>324</sup> Despite this reversal, the bankruptcy court’s original policy concerns are still being met when one compares the district court’s decision in *Hwang* to the bankruptcy court’s decision in *Vargas*.<sup>325</sup> Therefore, the line drawn by these two cases can still serve as a guidepost to other jurisdictions.

The district court decision in *Hwang* promotes the economy’s need for certainty in the foreclosure process and for a continued ability to recoup debt from foreclosures.<sup>326</sup> Allowing a noteholder to enforce the note without the owner satisfies the market reliance on the foreclosure process. However, when neither the noteholder nor the owner is party to the foreclosure action—as was the case in *Vargas*—the foreclosure is still prevented from proceeding.<sup>327</sup> Preventing foreclosures in this situation serves the purpose of discouraging sloppy assignment processes as was the goal of the original *Hwang* decision. The real effect of the district court’s *Hwang* decision was simply redrawing the line originally drawn by the bankruptcy court, slightly more in favor of the foreclosing financial institutions. In any event, whenever a court is asked to draw the line between permissible foreclosures and impermissible foreclosures, the line should take both public policies into consideration.

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319. *Id.*

320. *Id.*

321. *Id.*

322. *Id.* at 772.

323. *In re Hwang*, 438 B.R. 661, 665–67 (C.D. Cal. 2010) (citing Cal. Com. Code § 3301(West 2008)).

324. *Id.*

325. *Compare Hwang*, 438 B.R. at 665 (reversing lower court because foreclosing entity was noteholder), with *In re Vargas*, 396 B.R. 511, 516–17 (Bankr. C.D. Cal. 2008) (denying MERS’s motion because it was neither noteholder nor assignee).

326. *See Hwang*, 438 B.R. at 665 (allowing noteholder to foreclose injects proceeds from eventual foreclosure sale into economy).

327. *Vargas*, 396 B.R. 511, 516–17 (Bankr. C.D. Cal. 2008).

*b. Parties Should Be Allowed to Re-file When Initial Filings Are Inadequate*

After establishing the proper line between permissible and impermissible foreclosures, courts must consider what to do with foreclosure filings which are initially inadequate. In the *Boyko Foreclosure Cases*, Judge Boyko acknowledged the rights of the financial institutions to foreclose, but adamantly stated that the courts will not be forgiving with the requirements to establish standing.<sup>328</sup> Judge Boyko's opinion, while acknowledging the rights of the financial institution, leaned much more in favor of homeowners.<sup>329</sup> This leaning is evinced by Judge Boyko's statement that a family's "focus is either, 'how do I save my home,' or 'if I have to give it up, I'll simply leave and find somewhere else to live.'"<sup>330</sup>

The decision in the *Boyko Foreclosure Cases* dismissed the foreclosure cases without prejudice.<sup>331</sup> This dismissal without prejudice does not decide the case on the merits, thus enabling financial institutions to file another complaint if they are able to meet the requirements set out by Judge Boyko.<sup>332</sup> When contrasting Judge Boyko's adamant declaration that the courts will not be flexible in these situations and his rebuke of the financial institutions with Judge Holschuh's finding of an equitable assignment in Ohio law, it is clear that Judge Boyko was influenced by his policy leanings towards protecting consumers.<sup>333</sup>

While only a few cases have expressly acknowledged the need to consider both public policies when determining how to address inadequate filings, one case from the bankruptcy court for the Southern District of New York demonstrated complete disregard for the market reliance on foreclosures and thereby created precedent that could have severe negative repercussions throughout the economy.<sup>334</sup> The court held that because a creditor could not present any proof that they owned the note and mortgage, the court "wiped out a \$461,263 mortgage debt on the property" and allowed the debtor to keep their home free of

328. *Boyko Foreclosure Cases*, Nos. 1:07CV2282, 07CV2532, 07CV2560, 07CV2602, 07CV2631, 07CV2638, 07CV2681, 07CV2695, 07CV2920, 07CV2930, 07CV2949, 07CV2950, 07CV3000, 07CV3029, 2007 WL 3232430, at \*3 n.3 (N.D. Ohio Oct. 31, 2007).

329. See generally *Boyko Foreclosure Cases*, 2007 WL 3232430.

330. *Id.* at \*3 n.3. Judge Boyko further noted that:

the financial institutions or successors/assignees rush to foreclose, obtain a default judgment and then sit on the deed, avoiding responsibility for maintaining the property while reaping the financial benefits of interest running on a judgment. The financial institutions know the law charges the one with title (still the homeowner) with maintaining the property.

*Id.* at \*3.

331. *Id.*

332. See *supra* Part II.E.1 for a discussion of the effects of a dismissal without prejudice.

333. Compare *Boyko Foreclosure Cases*, 2007 WL 3232430 at \*3 n.3 (admonishing financial institutions and stating that court will not be forgiving with standing requirements), with *Holschuh Foreclosure Cases I*, Nos. 07-cv-166, 07-cv-190, 07-cv-226, 07-cv-279, 07-cv-423, 07-cv-534, 07-cv-536, 07-cv-642, 07-cv-670, 07-cv-706, 07-cv-714, 07-cv-727, 07-cv-731, 07-cv-963, 07-cv-999, 07-cv-1047, 07-cv-1091, 07-cv-1119, 07-cv-1150, 2007 U.S. Dist. LEXIS 90812, at \*8 (S.D. Ohio, Nov. 27, 2007) (allowing for some flexibility in assignments through a finding that Ohio recognizes equitable assignments), and *Rose Foreclosure Cases*, 521 F. Supp. 2d 650 (S.D. Ohio 2007) (presenting neutral legal analysis with no consideration of policy).

334. Morgenson, *supra* note 164.

any debt.<sup>335</sup> Unlike other bankruptcy cases, no leave was apparently given to amend the claim nor any type of chance to correct the problems with the original claim.<sup>336</sup> This case, therefore, goes against the second public policy at issue—preventing further harm to the global economy by allowing some foreclosures to proceed.

Due to the large number of cases and claims that could be affected by similar assignment improprieties,<sup>337</sup> judges should hesitate before giving too much credence to the neglected-assignment foreclosure defense as a tool to completely erase debt. As the economic crisis was substantially caused by the reduced value of mortgage backed securities, a trend to completely erase the debt backing those securities would have an equally or even greater effect on the economy than did the original decrease in the amount received per foreclosure.<sup>338</sup> While completely erasing the debt would create immediate and substantial gain to the individual homeowner, the effect of such precedents on the larger economy could be catastrophic.<sup>339</sup> Had the bankruptcy court in this case considered both public policies, it could have given the bank leave to amend its proof of claim and not created such a disastrous precedent.

While most of the cases discussed in this Comment did not expressly consider the two relevant public policies, the cases siding with the homeowners generally held the financial institutions to the relevant foreclosure requirements through either dismissal without prejudice or relief to amend the proof of claim.<sup>340</sup> These decisions walk the line between the two public policies and give banks some necessary flexibility to fix their filings. Holding the financial institutions to the relevant foreclosure requirements but allowing them a second chance to adequately prove an assignment and the standing requirements will discourage the future practice of improper assignments and the use of inadequate evidence, while still allowing the rightful assignees to obtain foreclosure on houses in delinquency. As courts deciding these cases should always be considering the two competing public policies and since dismissals without prejudice adequately promote both policies, courts should always be dismissing inadequate foreclosure filings, and proofs of claims, without prejudice and with leave to amend.

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335. *Id.*

336. *Cf. In re Hayes*, 393 B.R. 259, 270 (Bankr. D. Mass. 2008) (giving creditor leave to amend its proof of claim when unable to prove assignment upon first filing).

337. A study found that 41.1% of mortgage claims in Chapter 13 bankruptcies were filed without the note attached. Porter, *supra* note 32, at 147. If that percentage has any correlation to the percentage of mortgages with assignment problems—which is plausible since the cases discussed in this Comment have shown that neglected formalities can result in lost or missing notes—a high percentage of mortgages could have some level of assignment impropriety. See *supra* Part II.D.4 for a discussion of the widespread use of questionable evidence as the support for a bank's ability to foreclose.

338. See *supra* Part II.C for a discussion of how the inability to regain value through foreclosures can impact the general health of the economy.

339. See *supra* Part II.C for a discussion of how the second wave of foreclosures—where creditors' inability to collect from debtors caused mortgage-backed securities to plummet—caused substantial damage to the national economy.

340. See *supra* Part II.F and accompanying text for a discussion of these judicial decisions.

## IV. CONCLUSION

The dramatic increase in mortgage-backed securitization created an environment in which financial entities felt free to neglect the standard assignment formalities that generally serve as the basis for proving that a foreclosing entity has authority to foreclose.<sup>341</sup> These improper, neglectful, or nonexistent assignments are only coming to light as financial institutions attempt to foreclose using these assignments as their basis for doing so. As shown by this Comment, the severity of neglected formalities falls on a spectrum from untimely, but otherwise satisfactory, assignments; to unauthorized assignments; to—in some cases—a complete inability to determine who actually owns the note or has the ability to enforce the note.<sup>342</sup> As the problems with the assignment process increase in severity, more and more courts should—and are—finding that such problems will prohibit a foreclosure from going forward.<sup>343</sup>

As a high percentage of mortgages likely have deficiencies associated with the assignment processes, courts need to be careful how they deal with the neglect-based defenses.<sup>344</sup> While some judges may be quick to punish the mortgage industry and the financial institutions that were largely responsible for the current financial crisis,<sup>345</sup> judges need to realize that foreclosures are a significant and important part of today's economy. Nevertheless, judges do have an obligation to ensure that there is sufficient evidence that all standing requirements are met and that the proper parties are before the court.<sup>346</sup> Courts should always consider these two important public policies before making any decision and should strive for a legal standard which serves to promote both policies.<sup>347</sup>

If a foreclosing entity is unable to meet the appropriate pleading standard, courts should walk the fine line between the two competing policies and dismiss the case without prejudice. A dismissal without prejudice prevents improper foreclosures, but gives financial institutions a chance to refile if they are able to correct the standing or ownership issues present in the first filing. Neglected formalities—such as timing issues and inadequate evidence—which are less severe will likely be correctable and will eventually go through. Conversely, where the neglect or disregard for the process resulted in severe deficiencies—such as bringing foreclosures on behalf of undisclosed third parties—the problems will likely be uncorrectable. While a consideration of both public policies suggests that

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341. See *supra* Part II.A.2 for a discussion of the link between securitization and neglected assignment formalities.

342. See *supra* Parts III.A.2 and III.A.3.

343. See *supra* Part III.A.3 for a discussion of how courts deal with severe assignment neglect.

344. See *supra* notes 337 and accompanying text for a discussion of the large number of mortgages that may suffer from some form of assignment deficiency.

345. See *supra* notes 328–33 and accompanying text for a discussion of Judge Boyko's critical take on the culpability of financial institutions.

346. See *supra* Part II.E.1 for a discussion of the requirement that judges must dismiss (without prejudice) if there is no standing to foreclose.

347. See *supra* notes 316–22 and accompanying text for an example of when a court considered two countervailing public policies.

a foreclosing entity should have the opportunity to refile; if the problems with the first filing cannot be corrected, then the foreclosing entity should always be prevented from foreclosing. Therefore, it is through a consideration of both relevant public policies and through dismissals without prejudice that the courts will be able to distinguish between the varying levels of assignment neglect to ensure that only the most severe and irreparable forms of neglect will prevent a foreclosure.



