THE PAPER CHASE: SECURITIZATION, FORECLOSURE, AND THE UNCERTAINTY OF MORTGAGE TITLE

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ABSTRACT

The mortgage foreclosure crisis raises legal questions as important as its economic impact. Questions that were straightforward and uncontroversial a generation ago today threaten the stability of a $13 trillion mortgage market: Who has standing to foreclose? If a foreclosure was done improperly, what is the effect? And what is the proper legal method for transferring mortgages? These questions implicate the clarity of title for property nationwide and pose a too-big-to-fail problem for the courts.

The legal confusion stems from the existence of competing systems for establishing title to mortgages and transferring those rights. Historically, mortgage title was established and transferred through the "public demonstration" regimes of UCC Article 3 and land recordation systems. This arrangement worked satisfactorily when mortgages were rarely transferred. Mortgage finance, however, shifted to securitization, which involves repeated bulk transfers of mortgages.

To facilitate securitization, deal architects developed alternative "contracting" regimes for mortgage title: UCC Article 9 and MERS, a private mortgage registry. These new regimes reduced the cost of securitization by dispensing with demonstrative formalities, but at the expense of reduced clarity of title, which raised the costs of mortgage enforcement. This trade-off benefitted the securitization industry at the expense of securitization investors because it became apparent only subsequently with the rise in mortgage foreclosures. The harm, however, has not been limited to securitization investors. Clouded

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mortgage title has significant negative externalities on the economy as a whole.

This Article proposes reconciling the competing title systems through an integrated system of note registration and mortgage recordation, with compliance as a prerequisite to foreclosure. Such a system would resolve questions about standing, remove the potential cloud to real-estate title, and facilitate mortgage financing by clarifying property rights.

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INTRODUCTION

Since 2007, an estimated seven-million or more homes have been sold in foreclosure or distressed sales,[1] a loss in homeownership unparalleled in American history. The impact of these foreclosures on households, communities, and the macroeconomy is widely recognized.[2] The foreclosure crisis, however, raises equally weighty legal issues. The foreclosure crisis is forcing a reexamination of the nineteenth-century commercial- and real-property-law systems that continue to undergird critical sectors of the U.S. economy in the twenty-first century. This reexamination is occurring in the shadow of a too-big-to-fail problem, because a court's decision to uphold well-established law could trigger a financial crisis.

Problems in the foreclosure process have been apparent since the start of the foreclosure crisis,[3] but the issue burst onto the national scene in the fall of 2010 with the emergence of the "robosigning" scandal involving banks' use of fraudulent affidavits to establish standing to foreclose.[4] Then, in January 2011, the Massachusetts Supreme Judicial Court sent shockwaves through the real-estate- and commercial-law world by issuing a unanimous ruling in *U.S. Bank*

1. I arrived at the seven-million figure by adding industry extrapolations and metrics from July 2007–June 2013 (6.5 million foreclosure sales completed), *see Industry Extrapolations and Metrics (June 2013)*, HOPE NOW 5 (Aug. 12, 2013), http://www.hopenow.com/industry-data/2013-06-04-HopeNow.Ful_%20Report_(June).DRAFT.pdf, and my own estimate of foreclosure sales from January–June 2007 and July–December 2013 (more than 0.5 million foreclosure sales completed).

2. *See, e.g.*, CONG. OVERSIGHT PANEL, OCTOBER OVERSIGHT REPORT: AN ASSESSMENT OF FORECLOSURE MITIGATION EFFORTS AFTER SIX MONTHS 5–6 (2009), *available at* http://www.gpo.gov/fdsys/pkg/CPRT-111JPRT52671/pdf/CPRT-111JPRT52671.pdf (detailing the effect of foreclosures on neighboring property values, educational and religious institutions, foreclosing banks, and the economy as a whole); KATHLEEN C. ENGEL & PATRICIA A. MCCOY, THE SUBPRIME VIRUS: RECKLESS CREDIT, REGULATORY FAILURE, AND NEXT STEPS 124 (2011) (partially attributing the national economic woes of early 2009 to skyrocketing foreclosures); FIN. CRISIS INQUIRY COMM'N, FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES 402–10 (2011), *available at* http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf (documenting the impact of the foreclosure crisis on individual homeowners, housing markets, and financial institutions); DAN IMMERGLUCK, FORECLOSED: HIGH-RISK LENDING, DEREGULATION, AND THE UNDERMINING OF AMERICA'S MORTGAGE MARKET 133–66 (2009) (examining the costs of high-risk mortgage lending for borrowers, lenders, investors, neighborhoods, cities, renters, and the national and international economies).

3. *See* Gretchen Morgenson, *Foreclosures Hit a Snag for Lenders*, N.Y. TIMES, Nov. 15, 2007, at C1 (reporting on a 2007 federal judicial decision that "rais[ed] questions about the legal standing of investors in mortgage securities pools").

4. *See* Gretchen Morgenson, *Banks' Flawed Paperwork Throws Some Foreclosures into Chaos*, N.Y. TIMES, Oct. 4, 2010, at A1 (noting banks' use of "dubiously prepared" affidavits).

National Ass'n v. Ibanez.[5] *Ibanez* held that a pair of foreclosure sales was invalid because the foreclosing banks were not the mortgagees of record at the time of the foreclosure sale.[6]

Ibanez was soon followed by two related decisions from the Massachusetts Supreme Judicial Court, *Bevilacqua v. Rodriguez*[7] and *Eaton v. Federal National Mortgage Ass'n.*[8] *Bevilacqua* held that the purchaser at an invalid nonjudicial foreclosure sale did not have title to the property,[9] while *Eaton* held that a foreclosure sale was invalid because the foreclosing bank did not hold the promissory note at the time of the sale.[10]

A generation ago, none of these opinions would have been controversial. They would have been viewed as straightforward applications of well-established commercial and real-property law: a party cannot foreclose on a mortgage unless it is the mortgagee (or its agent);[11] a mortgage can be enforced only by a person who can enforce the underlying debt;[12] a mortgage is but incidental to the

5. U.S. Bank Nat'l Ass'n v. Ibanez, 941 N.E.2d 40 (Mass. 2011). For some discussion of the upheaval that *Ibanez* caused or was thought likely to cause, see, for example, Gretchen Morgenson, *Massachusetts Ruling on Foreclosures Is a Warning to Banks*, N.Y. TIMES, Jan. 7, 2011, at B1 (noting that *Ibanez* "open[ed] the door to other foreclosure do-overs" in Massachusetts); Chad Bray, *Massachusetts High Court Ruling Focuses on Foreclosure Paperwork*, WALL ST. J. L. BLOG (Jan. 7, 2011, 5:48 P.M.), http://blogs.wsj.com/law/2011/01/07/massachusetts-high-court-ruling-focuses-on-foreclosure-paperwork (describing *Ibanez* as a decision that "spooked bank investors"); Felix Salmon, *The Ibanez Case and Housing-Market Catastrophe Risk*, REUTERS (Jan. 7, 2011), http://blogs.reuters.com/felix-salmon/2011/01/07/the-ibanez-case-and-housing-market-catastrophe-risk (predicting a flood of "legal craziness"); Rich Vetstein, *Apocalypse Now? Will the Massachusetts Ibanez Case Unravel Widespread Irregularities in the Residential Securitized Mortgage Market?*, MASS. REAL ESTATE L. BLOG (Jan. 8, 2011), http://www.massrealestatelawblog.com/2011/01/08/apocalypse-now-will-the-massachusetts-ibanez-case-unravel-widespread-irregularities-in-the-residential-securitized-mortgage-market (anticipating that "[o]ther courts across the country will likely be influenced by the ruling").

6. *Ibanez*, 941 N.E.2d at 55. For commentary on *Ibanez*, see generally Recent Case, U.S. Bank Nat'l Ass'n v. Ibanez*, 941 N.E.2d 40 (Mass. 2011)*, 125 HARV. L. REV. 827 (2012).

7. Bevilacqua v. Rodriguez, 955 N.E.2d 884 (Mass. 2011).

8. Eaton v. Fed. Nat'l Mortg. Ass'n, 969 N.E.2d 1118 (Mass. 2012).

9. *Bevilacqua*, 955 N.E.2d at 898.

10. *Eaton*, 969 N.E.2d at 1134.

11. *See, e.g.*, New England Sav. Bank v. Bedford Realty Corp., 680 A.2d 301, 309–10 (Conn. 1996) (holding that the mere holder of a promissory note, if not the owner of the underlying debt, cannot exercise the equitable power of foreclosure).

12. RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 5.4(c) (1997) ("A mortgage may be enforced only by, or in [sic] behalf of, a person who is entitled to enforce the obligation the mortgage secures."); *id.* § 5.4 cmt. e ("Mortgage[s] may not be enforced except by a person having the right to enforce the obligation or one acting on behalf of such a person. As

promissory note;[13] and one cannot generally convey better title than one has.[14]

These cases did not arise because of prior uncertainty about the law, but because a too-big-to-fail industry—the housing-finance industry—found the prior law inconvenient and both changed and disregarded it, banking on its too-big-to-fail status to guarantee favorable legal outcomes. The confusion wrought by the conflict between housing-finance industry practice and well-established law made resolution of such issues so pressing that the Massachusetts Supreme Judicial Court took these three cases on expedited, direct appeal from the trial court, and the Permanent Editorial Board for the Uniform Commercial Code (UCC) felt compelled to issue a special report on the application of the UCC to mortgage notes.[15] Although the Massachusetts Supreme Judicial Court's rulings upheld well-established legal principles, the Court was also deeply cognizant that its rulings risked clouding title across Massachusetts and departed from its usual practice by making its ruling in *Eaton* apply only prospectively to future foreclosures.[16]

mentioned, in general a mortgage is unenforceable if it is held by one who has no right to enforce the secured obligation." (emphasis omitted)).

13. *See, e.g.*, Carpenter v. Longan, 83 U.S. (16 Wall.) 271, 275 (1873) ("All the authorities agree that the debt is the principal thing and the mortgage an accessory.").

14. BRUCE A. MARKELL, JOHN DOLAN & LAWRENCE PONOROFF, CORE CONCEPTS IN COMMERCIAL LAW: PAST, PRESENT AND FUTURE 1 (2004) (discussing *nemo dat quod non habet* as the foundational principle of commercial law). The UCC is replete with provisions that allow a good-faith purchaser to take better title than the seller had, but these are distinct situational exceptions to the *nemo dat* rule. *See, e.g.*, U.C.C. § 2-403(1) (2011) (protecting good-faith purchasers of goods); *id.* § 3-203(b) (vesting in transferees "any right of the transferor to enforce the instrument, including any right as a holder in due course"); *id.* § 7-504(a) (allowing transferees to retain title and rights that a transferor purported to convey in cases in which a document has been delivered but not duly negotiated); *id.* § 8-302(a) (entitling purchasers of even uncertificated securities to "all rights in the security that the transferor had or had power to transfer"); *id.* §§ 9-320(a)–(b) (enabling buyers of goods to take the goods free of security interests in most circumstances). Similarly, there are exceptions to *nemo dat* in property law. For example, in the four states that still recognize the fee tail—Delaware, Maine, Massachusetts, and Rhode Island—it is possible for someone with an entailed estate to convey the estate in fee simple.

15. *See generally* PERMANENT EDITORIAL BD. FOR THE UNIF. COMMERCIAL CODE, REPORT OF THE PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE: APPLICATION OF THE UNIFORM COMMERCIAL CODE TO SELECTED ISSUES RELATING TO MORTGAGE NOTES (2011), *available at* http://www.ali.org/00021333/PEB%20Report%20-%20November%202011.pdf. The Permanent Editorial Board for the UCC is a joint committee of the American Law Institute and the Uniform Law Commission that curates the UCC, issuing reports regarding what it believes are the proper legal interpretations of the UCC when particular controversies arise, as well as drafting occasional amendments to the UCC.

16. Eaton v. Fed. Nat'l Mortg. Ass'n, 969 N.E.2d 1118, 1132–33 (Mass. 2012).

The Massachusetts trilogy is but the most prominent and comprehensive group of a growing number of state and federal rulings dealing with standing to foreclose.[17] There have been nearly three thousand reported opinions dealing with this issue in some way over the past five years.[18] Standing doctrine differs between federal

17. *See, e.g.*, *In re* Kemp, 440 B.R. 624, 626 (Bankr. D.N.J. 2010) (sustaining an objection to proof of a claim when the plaintiff could not prove an enforceable right to the note under state law); *In re* Tarantola, No. 4:09-bk-09703-EWH, 2010 WL 3022038, at *6 (Bankr. D. Ariz. July 29, 2010) (denying a motion for relief from a stay for a lack of real interest in the property when the plaintiff could not prove the valid assignment of the note); *In re* Canellas, No. 6:09-bk-12240-ABB, 2010 WL 571808, at *5 (Bankr. M.D. Fla. Feb. 9, 2010) (finding no evidence of a proper assignment of the mortgage nor the note to the foreclosing party prior to foreclosure); *In re* Wilhelm, 407 B.R. 392, 405 (Bankr. D. Idaho 2009) (denying a motion for relief from a stay for a lack of real interest in the property when the plaintiff could not prove valid assignment of the note); *In re* Jacobson, 402 B.R. 359, 370 (Bankr. W.D. Wash. 2009) (holding that the servicer for the holder of the note, who had no beneficial interest in the note, was not the real party of interest and was not entitled to relief from a stay); *In re* Hwang, 396 B.R. 757, 765 (Bankr. C.D. Cal. 2008) (holding that a noteholder plaintiff must join the owner of the note, the real party in interest, before it could seek relief from a stay), *rev'd*, 438 B.R. 661 (Bankr. C.D. Cal. 2010); *In re* Hayes, 393 B.R. 259, 268 (Bankr. D. Mass. 2008) (holding that a putative mortgagee lacked standing for failing to provide proof of a valid assignment of the mortgage); Glaski v. Bank of Am., 160 Cal. Rptr. 3d 449, 452 (Ct. App. 2013) (holding that "borrowers have standing to challenge void assignments of their loans even though they are not a party to, or a third party beneficiary of, the assignment agreement"); U.S. Bank v. Coley, No. CV076001426, 2011 WL 2734603, at *3 (Conn. Super. Ct. June 10, 2011) (dismissing a foreclosure complaint for lack of standing because the mortgage assignment was four months subsequent to the foreclosure suit's initiation); Davenport v. HSBC Bank USA, 739 N.W.2d 383, 385 (Mich. Ct. App. 2007) (holding that the foreclosure must be vacated when the bank "did not yet own the indebtedness that it sought to foreclose"); Edelstein v. Bank of N.Y. Mellon, 286 P.3d 249, 252 (Nev. 2012) (requiring the party seeking to foreclose to demonstrate that it was both the holder of the promissory note and the beneficiary of the deed of trust); Wells Fargo Bank Nat'l Ass'n v. Erobobo, No. 31648/2009, 2013 WL 1831799, at *10 (N.Y. Sup. Ct. 2013) (denying a motion for summary judgment in a foreclosure because the assignment of the note and mortgage were void for not complying with the pooling and servicing agreement (PSA)); Wells Fargo Bank, Nat'l Ass'n v. Jordan, No. 91675, 2009 WL 625560, at *9–10 (Ohio Ct. App. Mar. 12, 2009) (dismissing a foreclosure action for a lack of standing because the putative mortgagee could not prove it owned the mortgage at the time the complaint was filed); Deutsche Bank Nat'l Trust Co. v. Byrams, 275 P.3d 129, 133 (Okla. 2012) (reversing and remanding summary judgment for the foreclosure plaintiff because standing did not exist at the time an action was instituted); Niday v. GMAC Mortg., LLC, 284 P.3d 1157, 1169 (Or. Ct. App. 2012) (holding that a deed-of-trust beneficiary who uses the Mortgage Electronic Registration System, Inc. (MERS) cannot undertake a nonjudicial foreclosure); U.S. Bank Nat'l Ass'n v. Kimball, 27 A.3d 1087, 1096 (Vt. 2011) (upholding the denial of standing to foreclose because the bank could not demonstrate that it was the holder of the note at the time the foreclosure action was initiated). For citations to other cases addressing the issue of standing in foreclosure actions, see *supra* notes 5–8 and accompanying text and *infra* notes 22, 34, 265 and accompanying text. A sampling of leading cases are also collected in the Appendix.

18. A search on November 1, 2013, of the Lexis State & Federal Cases database lists for "(foreclosure w/s standing) AND (mortgage or "deed of trust" or "trust deed")" yields 2,999 cases since 2007. An identical search in the Westlaw ALLCASES database yields 2,781

and state courts, but there is broad agreement among courts that some sort of standing or similar status is necessary for both judicial and nonjudicial foreclosure,[19] just as it is for any sort of debt-collection action.[20] There is also broad agreement that the party

decisions since 2007. A search for the same terms in the previous seven-year period yields only 297 cases on Lexis and 234 cases on Westlaw. This search is both over- and underinclusive, but it is nonetheless illustrative.

19. *See* Dale Whitman & Drew Milner, *Foreclosing on Nothing: The Curious Problem of the Deed of Trust Foreclosure Without Entitlement To Enforce the Note*, 66 ARK. L. REV. 21, 23 (2013) ("While plenty of uncertainty existed, one concept clearly emerged from litigation during the 2008–2012 period: in order to foreclose a mortgage by judicial action, one had to have the right to enforce the debt that the mortgage secured. It is hard to imagine how this notion could be controversial."). Some states permit only judicial foreclosures. Others allow for either judicial or nonjudicial foreclosure, whereas yet others have solely nonjudicial foreclosure procedures. *See generally* MORTG. BANKERS ASS'N, JUDICIAL VERSUS NON-JUDICIAL FORECLOSURE, *available at* http://www.mbaa.org/files/ResourceCenter/ForeclosureProcess/JudicialVersusNon-JudicialForeclosure.pdf.

20. The standing issue has also arisen in the context of credit cards. *See, e.g.*, B-Line, LLC v. Wingerter, 594 F.3d 931 (6th Cir. 2010) (reversing sanctions against the purchaser of an undocumented credit-card-debt claim in bankruptcy); Sykes v. Mel Harris & Assocs., 285 F.R.D. 279 (S.D.N.Y. 2012) (certifying a class in a suit against a debt collector for alleged Fair Debt Collection Practices Act (FDCPA) and Racketeer Influenced and Corrupt Organizations Act (RICO) violations regarding credit-card-debt collection); Sykes v. Mel Harris & Assocs., 757 F. Supp. 2d 413 (S.D.N.Y. 2010) (denying a motion to dismiss in a suit against a debt collector for alleged FDCPA and RICO violations regarding credit-card-debt collection); LVNV Funding LLC v. Guest, 953 N.Y.S.2d 550 (City Ct. 2012) (sanctioning a plaintiff's counsel in a debt collection lawsuit for failing to provide sufficient documentation to establish standing); Midland Funding LLC v. Wallace, 946 N.Y.S.2d 67 (City Ct. 2012) (same); MBNA Am. Bank, N.A. v. Nelson, 841 N.Y.S.2d 826 (Civ. Ct. 2007) (dismissing the bank's motion to affirm an arbitration award for, among other things, failure to provide a copy of the actual retail credit contract); Jessica Silver-Greenberg, *JPMorgan Sued over Credit Card Debt Cases*, N.Y. TIMES, May 10, 2013, at B1 (discussing California's suit against JPMorgan for credit-card-debt-collection issues); Jessica Silver-Greenberg, *Problems Riddle Moves To Collect Credit Card Debt*, N.Y. TIMES, Aug. 13, 2012, at A1 ("Lenders . . . are churning out lawsuits without regard for accuracy, and improperly collecting debts from consumers."); Jeff Horwitz, *'Robo' Credit Card Suits Menace Banks*, AM. BANKER (Jan. 30, 2012, 10:16 A.M.), http://www.americanbanker.com/issues/177_20/robosigning-credit-card-suits-1046175-1.html ("If banks prove unsuccessful in defending themselves from claims that their records are shoddy, they run the risk of inviting a new regulatory crackdown and legal battles over the validity of claims involving tens of billions of dollars in unsecured debt."). Some state and local governments have adopted their own chain-of-title requirements for debt collection. *See* Daniel J. Langin, Introducing Certainty to Debt Buying: Account Chain of Title Verification for Debt 3 (Jan. 5, 2011) (unpublished manuscript), *available at* http://ftc.gov/os/comments/debtcollecttechworkshop/00027-60064.pdf.

Credit-card and other consumer loans present somewhat different issues than mortgages regarding chain of title, not least because unsecured loans only have a promissory note or other credit agreement, not a security instrument. As a result, there will not be confusion regarding which title system applies, only questions of what is sufficient proof to show standing and prove a debt. Even in these regards, credit-card debt differs from mortgages, as it is much less formal. Whereas a mortgage will usually involve an in-person closing and a single bringing the foreclosure action or sale must have standing at the time the litigation or sale process is commenced. There is far less agreement, however, about what determines who has standing to bring the foreclosure.[21]

Standing or similar doctrines require the party pursuing a foreclosure to have a legally cognizable interest in the mortgage. The modern mortgage market is financed largely through securitization, a financing method that involves multiple bulk transfers of mortgages. If loans have not been successfully transferred to the party seeking to foreclose, then that party has no privity with the loan—and therefore lacks standing to foreclose. Courts, however, cannot agree even on what law governs transfers or determines ownership of mortgages, which creates confusion over standing.[22] This confusion over standing thus stems from confusion about what is required to transfer a mortgage loan. Are mortgage loans transferred by negotiation—meaning indorsement and physical delivery of the promissory note—or by sale contract, or by recordation in land records? Can mortgages

extension of credit, there is unlikely to be anyone with true personal knowledge of credit-card debt, which is applied for remotely, underwritten and repeatedly authorized, cleared, and settled through automated systems. Likewise, the small size of credit-card debt may make it uneconomical to take greater care documenting chains of title. For divergent views on what is sufficient proof of indebtedness in the credit-card context, compare Manuel Newburger, *Should Sellers of Debt Warrant the Accuracy of Data They Provide?*, DBA MAG., Spring 2013, at 16, 42 (arguing that debt buyers are entitled to rely on warranties), with Dalié Jiménez, Illegality in the Sale and Collection of Consumer Debts 25 (June 3, 2013) (unpublished manuscript), *available at* http://ssrn.com/abstract=2250784 (advancing the opposite argument).

21. There is also subsidiary disagreement about what documentation suffices as evidence to show standing. This is where the standing issue in general intersects with robosigning. For discussion of evidentiary showings in credit-card-debt-collection actions, see *supra* note 20.

22. This is the case, for example, in Arizona. *Compare* Varbel v. Bank of Am. Nat'l Ass'n, No. 1 CA-CV 12-0263, 2013 WL 817290, at *2 (Ariz. Ct. App. Mar. 5, 2013) (holding that a nonjudicial foreclosure sale does not require the production of the note or its chain of custody), *with In re* Tarantola, No. 4:09-bk-09703-EWH, 2010 WL 3022038, at *5 (Bankr. D. Ariz. July 29, 2010) (denying a motion for relief from a stay for a lack of real interest in the property when the plaintiff could not prove the valid assignment of the note). It is also the case in Michigan. *Compare* Davenport v. HSBC Bank USA, 739 N.W.2d 383, 385 (Mich. Ct. App. 2007) (holding that a foreclosure must be vacated when the bank "did not yet own the indebtedness that it sought to foreclose"), *with* Residential Funding Co. v. Saurman, 805 N.W.2d 183, 183 (Mich. 2011) (holding that MERS had standing to foreclose nonjudicially). Oregon, as compared to Michigan and Arizona, does not allow MERS standing to foreclose nonjudicially. *See* Niday v. GMAC Mortg., LLC, 284 P.3d 1157, 1169 (Or. Ct. App. 2012) (determining that a deed-of-trust beneficiary who used MERS could not undertake a nonjudicial foreclosure). Washington also does not give MERS standing to foreclose nonjudicially. *See* Bain v. Metro. Mortg. Grp., Inc., 285 P.3d 34, 36–37 (Wash. 2012) (holding that MERS could not utilize the Washington nonjudicial foreclosure procedure because it was not the lawful beneficiary of a deed of trust because it does not hold the note).

be transferred separately from promissory notes? What is the effect of unrecorded mortgage transfers? It is necessary to determine how mortgage loans are transferred in order to verify who has title to the mortgage, meaning here the right to enforce it.[23]

Understanding the emergence of the mortgage-title-system problem and how it might be fixed requires spelunking into some of the hoariest and most technical minutiae of commercial and real-property law. These byzantine rules serve as the legal infrastructure for critical parts of the economy. A $13 trillion residential mortgage market depends directly on clarity of mortgage title,[24] but the implications of mortgage-title-system problems are further reaching. At stake is not only the integrity of the legal system and its insistence on the rule of law when dealing with economically vulnerable and often unrepresented defendants,[25] but also potentially ruinous liability for the nation's largest financial institutions. Also at stake is clarity of title to a large part of the real property in the United States, because mortgage-title-system problems implicate the alienability of real property itself. Clouded mortgage title poses a systemic risk to the economy because clarity of property title is a fundamental sine qua non of modern economies.[26] As the bursting of the housing bubble has shown, housing markets are uniquely linked to the macroeconomy.[27]

23. *See* Henry Hansmann & Reinier Kraakman, *Property, Contract, and Verification: The* Numerus Clausus *Problem and the Divisibility of Rights*, 31 J. LEGAL STUD. S373, S384–85 (2002) (describing different types of property-rights verification regimes).

24. BD. OF GOVERNORS OF THE FED. RESERVE SYS., FEDERAL RESERVE STATISTICAL RELEASE Z.1, FINANCIAL ACCOUNTS OF THE UNITED STATES: FLOW OF FUNDS, BALANCE SHEETS, AND INTEGRATED MACROECONOMIC ACCOUNTS FIRST QUARTER 2013, tbl.L.216, l. 1 (2013).

25. *See, e.g.*, *In re* Foreclosure Cases, Nos. 1:07CV2282, 07CV2532, 07CV2560, 07CV2602, 07CV2631, 07CV2638, 07CV2681, 07CV2695, 07CV2920, 07CV2930, 07CV2949, 07CV2950, 07CV3000, 07CV3029, 2007 WL 3232430, *3 n.3 (N.D. Ohio Oct. 31, 2007).

26. *See, e.g.*, HERNANDO DE SOTO, THE MYSTERY OF CAPITAL: WHY CAPITALISM TRIUMPHS IN THE WEST AND FAILS EVERYWHERE ELSE 6–8, 46–58 (2000) (arguing that the success of Western capitalism depends on the ability of individuals to leverage clear legal title as capital); Daron Acemoglu, Simon Johnson & James A. Robinson, *The Colonial Origins of Comparative Development: An Empirical Investigation*, 91 AM. ECON. REV. 1369, 1395 (2001) (arguing that institutional differences affecting the protection of property rights account for some of the differences in per capita income among former European colonies); Daron Acemoglu & Simon Johnson, *Unbundling Institutions*, 113 J. POL. ECON. 949, 984 (2005) (finding that property-rights institutions are key determinants of economic growth); J. Bradford DeLong & Andrei Shleifer, *Princes and Merchants: European City Growth Before the Industrial Revolution*, 36 J.L. & ECON. 671, 692–93 (1993) (finding a negative correlation between absolutist regimes with insecure property rights and city growth); Simon Johnson, John McMillan & Christopher Woodruff, *Property Rights and Finance*, 92 AM. ECON. REV. 1335, 1352–53 (2002) (finding that private-sector investment is constrained by a perception of weak

The mortgage title issue is narrowly a question about the transfer of mortgages loans, not the transfer of real estate. There is no real question today about how to transfer Blackacre. The conveyance of present possessory estates in real property is a matter of state real-property law. Conveyance procedures vary by state, but these procedures are not in doubt. Similarly, there is no question about how to mortgage real property. Instead, the issue is one of subsequent transfers of mortgages.

Nonetheless, the mortgage chain of title does affect the ability to transfer *clear* title to real property. The Massachusetts Supreme Judicial Court's *Bevilacqua* decision illustrates a concept familiar to a generation of property-law students: an invalid foreclosure sale is ineffective to pass title.[28] If the seller is not the person entitled to foreclose, the foreclosure sale is no different from a sale of the Brooklyn Bridge. Accordingly, the foreclosure-sale purchaser has no ability to transfer title to the property, no matter her equities, because she lacks title, just like the hapless buyer of the Brooklyn Bridge.[29]

property rights, even when financing is available). *See generally* Armen A. Alchian & Harold Demsetz, *The Property Right Paradigm*, 33 J. ECON. HIST. 16 (1973) (noting that vulnerable property rights result in underinvestment); Harold Demsetz, *Toward a Theory of Property Rights*, 57 AM. ECON. REV. 347 (1967) (same).

27. *See* Adam J. Levitin & Susan M. Wachter, *Why Housing?*, 23 HOUSING POL'Y DEBATE 5, 19–20 (2013) (identifying three transmission channels between housing and the macroeconomy). The risk is through both clouded title itself and resulting litigation liability for financial institutions. *See* CONG. OVERSIGHT PANEL, NOVEMBER OVERSIGHT REPORT: EXAMINING THE CONSEQUENCES OF MORTGAGE IRREGULARITIES FOR FINANCIAL STABILITY AND FORECLOSURE MITIGATION 65 (2010), *available at* http://cybercemetery.unt.edu/archive/cop/20110402010313/http://cop.senate.gov/documents/cop-111610-report.pdf.

28. *See* Bevilacqua v. Rodriguez, 955 N.E.2d 884, 898 (Mass. 2011). The case of *Rockafellor v. Gray*, 191 N.W. 107 (Iowa 1922) (taking back a property sold at an invalid foreclosure sale after several subsequent transfers), is included in the leading property-law textbook. *See* JESSE DUKEMINIER & JAMES E. KRIER, PROPERTY (1st ed. 1981).

29. Judicial foreclosures are generally difficult to challenge postsale even if there was no authority to foreclose because of finality doctrines, *see* GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW 632 (5th ed. 2007), and sometimes specific statutory provisions, *see, e.g.*, 735 ILL. COMP. STAT. ANN. 5/15-1509 (West 2011) (limiting the remedy to a postsale challenge to the proceeds of the sale, rather than the return of the property); OHIO REV. CODE ANN. § 2329.45 (West 2004) (providing that the reversal of a foreclosure-sale judgment does not affect the title of the purchaser, but instead requires restitution by the foreclosing creditor of the former homeowner). *But see* N.Y. C.P.L.R. § 2003 (McKinney 2012) (allowing a sale to be set aside for up to a year if a substantial right of the debtor was prejudiced by a defect in sale procedure). In nonjudicial-foreclosure states, however, finality doctrines do not apply, and a postsale challenge is generally possible. *See* Elizabeth Renuart, *Toward a More Equitable Balance: Homeowner and Purchaser Tensions in Non-Judicial Foreclosure States*, 24 LOY. CONSUMER L. REV. 562, 579–80 (2012). Some states impose statutes of limitations for postsale challenges. *See id.* at 583 n.95. Moreover, it is not clear whether these limits would

This means that there are potentially questions about title to many of the millions of properties that have gone through foreclosure sales during the past five years.

The mortgage-title-system problem may reach even farther, extending beyond properties that have gone through foreclosure. A mortgage lien is a contingent form of ownership. If a property is mortgaged, it is difficult to sell unless the mortgage lien is released. Absent release of the lien, the buyer takes the property subject to the mortgage lien, even though the associated debt remains owed by the seller: liens follow property, while debts remain with obligors. Therefore if the *seller* defaults on the debt, the mortgagee may foreclose on the mortgage and force the sale of the property now owned by the *buyer*. The question about who has the lien on Blackacre can morph into the question of who owns Blackacre. Absent clarity about who is the mortgagee, title to Blackacre is not marketable. Moreover, unless title to land is clear, it can affect other property interests, such as leaseholds, easements, and boundaries.[30] Therefore, problems in determining who is a mortgagee can affect title on far more than foreclosure properties. Confusion over mortgage transfer methods and thus over rights in mortgages has potentially far-reaching consequences.

This Article examines the legal and market developments that have befouled the law of mortgage title. It argues that the current confusion in the law is, at its core, the result of competing mortgage title systems. This is a novel conceptualization of the problem driving foreclosure-standing litigation, but, once the problem is understood in this manner, a solution—reconciliation of title systems—is readily apparent.

Both land title systems and promissory note title systems purport to cover mortgage title. Article 3 of the UCC provides a little-remarked title system for promissory notes.[31] Local land records provide a title system for land and encumbrances upon it, such as mortgages. Yet because of the common-law doctrine that "the mortgage follows the note," the UCC Article 3 system has also had

apply if the seller had no right to conduct a sale, as opposed to challenges relating to sale procedures.

30. *See* David E. Woolley & Lisa D. Herzog, *MERS: The Unreported Effects of Lost Chain of Title on Real Property Owners*, 8 HASTINGS BUS. L.J. 365, 366–68 (2012) (discussing the impact of unclear title on boundary disputes).

31. For a discussion of the Article 3 provisions that establish this title system for promissory notes, see *infra* Part I.A.3.

the potential to serve as a mortgage title system when a note is secured by a mortgage.

There was always a latent tension between these public-law mortgage title systems, but it was of little consequence until the late twentieth century because mortgages were rarely transferred, and mortgages were seldom separated from notes. The formalities of both systems were clear and followed, and as a result, there was seldom a discrepancy between them. And even if discrepancies existed between the title systems, they were rarely of consequence. Title was seldom challenged because foreclosures were rare, and default judgments and isolated problems usually could be settled quietly.

The long-dormant tension between these systems became a problem as the mortgage finance market developed from balance-sheet lending to securitization. Securitization transactions require multiple bulk transfers of mortgages in order to achieve various credit ratings, bankruptcy, tax, accounting, and bank-regulatory-capital benefits. Absent clear documentation of these transfers, the various transactional benefits are in doubt, which would undermine the economic viability of securitization. Title-and-transfer system clarity is essential for securitization.

Both UCC Article 3 and land records provide a high degree of title clarity. Despite the potential tension between them, these systems have fundamental similarities. Both are property rights verification systems that operate through "public demonstration." Both systems require compliance with demonstrative legal formalities to achieve property rights. Compliance provides the evidentiary certainty of the property rights. Both systems are examples of the "paperization principle," a legal evolution aimed at reducing fraud, uncertainty, and adjudication costs.[32] Thus, obtaining property rights under these public demonstration regimes has up-front costs due to formalities, but compliance with the formalities ensures a high degree of security in the property rights, both vis-à-vis other competing claimants to the property rights and as to the ability to enforce the mortgage property rights. These benefits accrue, however, only to securitization investors; they have no intrinsic value to the sell-side of the securitization industry, which see them as transaction costs to be eliminated.

32. *See* Robert Charles Clark, *Abstract Rights Versus Paper Rights Under Article 9 of the Uniform Commercial Code*, 84 YALE L.J. 445, 476–77 (1975).

Accordingly, the sell-side developed alternative mortgage title-and-transfer systems that dispensed with demonstrative public formalities in favor of private, bilateral contracting. Thus, a private electronic mortgage registry—the Mortgage Electronic Registration Systems, Inc. (MERS)—was created, and UCC Article 9 was revised to operate as a system for the sale of notes and mortgages. Bilateral "contracting" regimes reduced the transaction costs in mortgage transfers and hence in mortgage securitizations by dispensing with demonstrative legal formalities. These up-front costs savings, however, came at the expense of certainty in property rights vis-à-vis other competing claimants and a reduced ability to enforce the property rights. In other words, the mortgage transfer regime change shifted costs from deal formation to deal enforcement. Costs were thus shifted from the financial institutions that created securitizations to securitization investors, because the investors could not observe and price this risk shift because deal documents remained unchanged. The cost shift only became apparent with the rise of foreclosures and foreclosure litigation in 2007.

Even now, securitization investors cannot gauge the impact of the risk shift in terms of their loss-given-default on a mortgage, which is a factor preventing the resurrection of the securitization market.[33] Continued legal confusion about mortgage transfers frustrates deal formation in the housing-finance market, which weighs down the economy overall. Thus, resolving the legal questions about mortgage transfer is critical for restarting the housing-finance market.

It is important to emphasize that the question of which system governs mortgage transfers and title is distinct from compliance. Confusion over which system governs can frustrate compliance, but compliance problems can exist even with legal clarity, and it is the specter of widespread compliance problems that directly pose the too-big-to-fail concern. Although this Article focuses on the systems question, in many reported cases it appears as if there has been

33. There have been only a handful of private-label residential-mortgage securitization deals since 2008. *See* Al Yoon, *Deal May Signal Thaw in Mortgage Securities*, WALL ST. J. (Mar. 20, 2013, 6:47 P.M.), http://online.wsj.com/article/SB10001424127887324373204578372833475791270.html. In contrast, the private-label commercial-mortgage securitization market has made a much more vigorous rebound. Adam J. Levitin & Susan M. Wachter, *The Commercial Real Estate Bubble*, 3 HARV. BUS. L. REV. 83, 112–13 (2013).

compliance with, at best, one, and often none, of the competing title-and-transfer systems.[34]

It is also important to emphasize what is and what is not at issue in challenges to foreclosure standing. Foreclosure standing litigation does not directly relate to the issue of whether the homeowner is in default on the mortgage or even indebted and to what amount.[35] The mortgage-title-system issue does not generally go to the question of the validity of the mortgage loan or its generic enforceability. Problems with mortgage title do not mean that a loan is not outstanding or that it is not in default. Instead, the mortgage title issue is about the specific question of *who* has the right to enforce the mortgage and the consequences of improper foreclosures.

Insisting that foreclosures be carried out only by parties with standing may appear to be a procedural nicety that has little to do with moral rights or economic reality.[36] Such a view fundamentally misunderstands the mortgage contract. The mortgage contract is not simply an agreement that the home may be sold upon a default on the loan. Instead, it is an agreement that if the homeowner defaults on the loan, the mortgagee may sell the property *pursuant to the requisite legal procedure*. A mortgage loan involves a bundle of rights, including procedural rights. These procedural rights are not merely notional; they are explicitly priced by the market. Mortgage finance availability and pricing is statistically correlated with variations in procedural protections for borrowers.[37] Retroactively liberalizing the

34. *See, e.g.*, *In re* Maisel, 378 B.R. 19, 22 (Bankr. D. Mass. 2007) (finding no evidence of a proper assignment of the mortgage nor the note to the foreclosing party prior to foreclosure); Wells Fargo Bank, N.A. v. Marchione, 887 N.Y.S.2d 615, 620 (App. Div. 2009) (finding no evidence of a proper assignment of the mortgage to the foreclosing party prior to foreclosure); HSBC Bank U.S.A. Nat'l Ass'n v. Miller, 889 N.Y.S.2d 430, 433 (Sup. Ct. 2009) (holding that a mortgagee's assignee lacked standing to foreclose because the mortgagee did not hold the promissory note at the time the complaint was filed).

35. *See, e.g.*, U.S. Bank, Nat'l Ass'n v. Moore, 278 P.3d 596, 602 (Okla. 2012) ("[F]or the homeowners, absent adjudication on the underlying indebtedness, today's decision to reverse the dismissal of the petition and motion to vacate cannot cancel their obligation arising from an authenticated Note, or insulate them from foreclosure proceedings based on proven delinquency. This Court's decision [that the plaintiff lacks standing to foreclose] in no way releases or exonerates the debt owed by the defendants on this home.").

36. Tamara Keith & Renee Montaigne, *Sorting out the Banks' Foreclosure Mess*, NPR (Oct. 15, 2010, 4:00 AM), http://www.npr.org/templates/story/story.php?storyId=130582451 (quoting JPMorgan Chase CEO Jamie Dimon as saying that "for the most part by the time you get to the end of the process, you know, we're not evicting people who deserve to stay in the house").

37. *See* Lee J. Alston, *Farm Foreclosure Moratorium Legislation: A Lesson from the Past*, 74 AM. ECON. REV. 445, 456 (1984) (pointing out the consequences of laws preventing the

rules for mortgage enforcement creates an unearned windfall for mortgagees. Moreover, enforcement of bargained-for procedural requirements such as standing gives homeowners leverage to achieve negotiated solutions to loan defaults, such as a loan modification. Alternatively, enforcement of the bargained-for procedural leverage can buy the homeowner time to relocate, enabling a softer landing with fewer social dislocations and externalities.

At the same time, however, we should recognize the economic costs from lack of clarity in mortgage title. When it is not clear who can foreclose, the result is a defaulted loan sitting in limbo. *Someone* is still owed money on the loan and is not being paid. If the homeowner has abandoned the property, the result is deadweight loss. If the homeowner remains in residence, the result is a substantial transfer of wealth from the real lender to the homeowner. The homeowner has functionally secured a rent-free dwelling, but it is with uncertain tenure and little alienability, as the house is still encumbered. This situation is bad for both the ultimate economic lender on the loan and for the economy as a whole, as part of the housing market is unable to clear. Thus, although the rule of law is part of the microeconomic bargain, insistence upon it may be less than optimal from a macroeconomic standpoint.

This Article proceeds as follows. Part I reviews the traditional mortgage title-and-transfer systems: UCC Article 3 and land records. It emphasizes how these systems required demonstrative formalities of transfer but created high degrees of certainty in the property rights transferred. Part II explains how the change in mortgage financing from balance-sheet lending to securitization affected the demands made on mortgage title-and-transfer systems. Part III examines the

foreclosure of farms); Quinn Curtis, *State Foreclosure Laws and Mortgage Origination in the Subprime*, J. REAL EST. FIN. & ECON. 19 (2013), http://link.springer.com/article/10.1007/s11146-013-9437-9 ("The provisions that make foreclosure easier—nonjudicial process and readily available deficiency judgments—lead to increased applications and accepted applications in the subprime market . . . ."); Lawrence D. Jones, *Deficiency Judgments and the Exercise of the Default Option in Home Mortgage Loans*, 36 J.L. & ECON. 115, 126–27 (1993) (noting the lender response to default rates); Mark Meador, *The Effects of Mortgage Laws on Home Mortgage Rates*, 34 J. ECON. & BUS. 143, 146 (1982) (estimating a 13.87 basis-point increase in interest rates on new homes as a result of antideficiency laws); Karen M. Pence, *Foreclosing on Opportunity: State Laws and Mortgage Credit*, 88 REV. ECON. & STAT. 177, 180 (2006) (noting that the availability—and hence, the cost—of mortgages in states with judicial foreclosure proceedings is greater than in states with nonjudicial foreclosures); Michael H. Schill, *An Economic Analysis of Mortgagor Protection Laws*, 77 VA. L. REV. 489, 491 (1991) (arguing that "the relatively modest costs associated with state mortgagor protection laws do suggest that mortgagor protections may indeed promote economic efficiency").

additional mortgage transfer methods created to facilitate securitization: MERS and revised UCC Article 9. It suggests that the securitization sell-side and the securitization buy-side may have had different understandings of how transfers were to occur in securitizations, which the sell-side exploited to capture the cost savings from regime change and increase the volume of its fee-based business and hence its profits.

Part IV reviews existing reform proposals and considers how mortgage title systems could be reconciled. It proposes the creation of a registration system for mortgage notes that would be linked via unique identifiers to mortgages recorded in the land records. Registration would create a rebuttable presumption of ownership, and matching mortgage recordation and note registration would be a precondition of foreclosure. Linked note-and-mortgage title systems would preserve borrowers' interest in keeping the terms of notes private, resolve questions about foreclosure standing, remove the potential cloud to real-estate title, and facilitate mortgage financing transactions generally by clarifying property rights.

The Article concludes with some observations about the lessons that the mortgage-title-system confusion holds out for commercial law more generally and the problem of too-big-to-fail in the courts. The title-system problem stands as a reminder of the problems that can arise when certainty of property rights is eroded to reduce transaction costs and of the toll that too-big-to-fail problems take on the judicial system.

I. TRADITIONAL MORTGAGE TITLE SYSTEMS

The obligation colloquially referred to as a "mortgage" is usually embodied in two separate instruments: a promissory note and a security instrument.[38] The promissory note is what creates the debt obligation, whereas the security instrument is what makes real property the collateral securing performance on the note. The security instrument is what enables the remedy of foreclosure—the forced sale of the collateral property—upon default on the note. The note is enforceable without the security instrument, as an unsecured

38. The name and operation of the security instrument vary by state, but the differences are not essential for our purposes. Sometimes the security instrument is called a "mortgage"; other times, a "deed of trust" or "trust deed." In some states the mortgage transaction is a two-party transaction, whereas in other states a three-party escrow arrangement is used.

debt. The security instrument, however, has little meaning without the note.

Traditionally, mortgage title and transfer was governed by Article 3 of the UCC and land recordation systems. UCC Article 3 is generally thought of as *payment*-system law, but it is also *property* law for certain payment and debt instruments. UCC Article 3 is a title-and-transfer system for notes. Although a few scholars have recognized this feature of Article 3,[39] a further corollary has gone unremarked: not only is UCC Article 3 a property-law system for notes, but it is also a property-law system for *mortgages*. This is because of the common-law doctrine providing that "the mortgage follows the note," meaning that a transfer of the note effectuates a transfer of the associated security interest. Thus, UCC Article 3 is a *mortgage* title-and-transfer system too, despite the word "mortgage" never appearing in Article 3. This point bears particular emphasis because UCC Article 3 has never been understood as a mortgage title system, even though it functions as one.

Mortgages are also understood as conveyances of interests in real property. Accordingly, both their creation and their transfer are potentially subject to state law on real-estate conveyance. Moreover, mortgages and their transfers are typically recorded in land recordation systems, and it is land records that are typically thought of as the system of mortgage title.

Yet, once UCC Article 3 is understood to cover not just notes, but also mortgages, it becomes clear that there have long been two separate—and possibly conflicting—title systems for mortgages: title per the UCC Article 3 system might not correspond with title as evidenced in the land records. In such a case, which system controls? Can title to the mortgage and note be split? And if so, what are the enforcement rights that go with each instrument by itself?

This Article argues that both UCC Article 3 and land recordation systems are what it terms "public demonstration" regimes for establishing property title, as opposed to what it terms "contracting" regimes. Public demonstration regimes establish property title through the use of demonstrative formalities that are publicly observable. This is akin to establishing title through physical markers like cattle brands and tags or signs noticing ownership, be

39. *See* Neil B. Cohen, *The Calamitous Law of Notes*, 68 OHIO ST. L.J. 161, 177–81 (2007) (discussing the obtainment of good "title" to notes). *See generally* James Steven Rogers, *Negotiability as a System of Title Recognition*, 48 OHIO ST. L.J. 197 (1984).

they copyright indications or private-property signs on real property. These demonstrative formalities are potentially cumbersome and costly, but they engender a high degree of certainty in property rights because they are more easily verified by third parties.

A contracting regime, in contrast, is a completely private set of bilateral arrangements for the transfer of property rights. Because it is a bilateral contracting arrangement, the requirements are whatever the parties agree to so long as the transfer agreement is sufficient to support a simple contract.[40] Contracting regimes sacrifice the easy verifiability by third parties in favor of potentially lower transaction costs for property transfer. To the extent that the property transfer is unlikely to affect third parties, a contracting regime would seem to sacrifice relatively little to obtain greater efficiency. Thus, if Somerset sells Gloucester a cake, there seems relatively little purpose to requiring public formalities beyond what the parties themselves want to feel comfortable with the enforceability of their transaction. If Gloucester is worried Somerset will try to reclaim the cake, he may insist on greater formalities to the extent they are cost effective, but the decision is entirely between the contracting parties.

If the transfer implicates third parties' rights, however, then a contracting regime may in fact impose negative externalities on the third party by muddling their rights. A mortgage would seem the classic case of a transfer that is likely to affect third parties. Not only are there the third-party obligor on the note and potentially tenants on the property, but there are also potentially other lienholders, beneficiaries of servitudes, and taxing authorities that are affected. Accordingly, it makes sense that traditional mortgage title systems were public demonstration regimes because public demonstration regimes helped clarify the legal rights of third parties.

UCC Article 3 and land recordation systems are both types of public demonstration regimes. Both have their origins in the eighteenth and nineteenth centuries. In the case of UCC Article 3, this means that the use of integrated, formalized writings transferred through indorsement and physical delivery and enforced via presentment. In the case of real-estate conveyance, this means the

40. Historically, contracting regimes involved some level of demonstrative formality, such as the requirement of either seal or consideration. Modern contract law has dispensed with the seal and reduced consideration to a legal fiction. The Statute of Frauds—another historical requirement of demonstrative formality—may still apply, potentially imposing some minimal requirements of demonstrative formalities for a transfer of property by contract to be legally enforceable.

recording of conveyances in public records and possibly other requirements, such as witnesses and notarization.

Establishing clear property title means, at its core, freedom from competing claims to the property and the ability to fully exercise dominion over the property. Freedom from claims means that there is superior title to that of other transferees, such as prior or subsequent purchasers and lienholders, as well as bankruptcy trustees vested with the powers of hypothetical purchasers and creditors.[41] Freedom from claims also means superior title to that of transferors and those subrogated to transferors' rights, most importantly, again, bankruptcy trustees.[42] Full exercise of dominion means, in the case of a right to payment such as a mortgage, the ability to successfully enforce the right to payment. This would include freedom from defenses to enforcement. The critical common feature of the UCC Article 3 and land recordation systems as mortgage title systems is that they require compliance with demonstrative public formalities in order to achieve a high level of certainty in property rights in mortgages.

A. UCC Article 3

1. *Scope*. UCC Article 3 applies only to negotiable instruments.[43] For a promissory note to be negotiable under Article 3, it must comply with specific statutory requirements. The note must be "an unconditional promise . . . to pay a fixed amount of money."[44] The note must be payable on demand or at a definite time[45] and not contain additional undertakings by the obligor other than a few that do not concern us here.[46] And finally, the note must be payable to bearer or order when first issued.[47] This final requirement means that the instrument must contain language along the lines of "payable to

41. *See* 11 U.S.C. § 544(a) (2012) (addressing the rights and powers of bankruptcy trustees).

42. *Id.* § 541 (defining the property of a bankruptcy estate); *id.* § 704 (listing the duties of a trustee in bankruptcy).

43. U.C.C. § 3-102(a) (2011).

44. *Id.* § 3-104(a); *see also id.* § 3-106 (defining an unconditional promise). The note may provide for interest and other charges as well. *Id.* § 3-104(a).

45. *Id.* § 3-104(a)(2).

46. *Id.* § 3-104(a)(3).

47. *Id.* § 3-104(a)(1).

the order of [a name]" or "payable to bearer." If the note simply said, "Payable to John Doe," it would not be negotiable.[48]

Most mortgage notes purport to be negotiable and are generally assumed to be so by courts and litigants. Although scholars have questioned whether mortgage notes are in fact negotiable,[49] there is no question that they are *supposed* to be negotiable. Housing and Urban Development (HUD) guidelines restrict Federal Housing Administration (FHA) insurance to mortgage loans made with negotiable notes.[50] The Fannie Mae/Freddie Mac uniform note, which is used for most mortgage loans, purports to be negotiable.[51] Fannie and Freddie—the largest purchasers of mortgage loans—will not purchase mortgages that do not use their uniform note unless the note is negotiable.[52] Until recently, there were no reported decisions regarding the negotiability of the Fannie/Freddie uniform note or the HUD model note,[53] but the modern mortgage finance market is built upon an assumption of negotiability.[54]

48. Historically, the obligor would only have to pay John Doe, but in most jurisdictions, choses in action are now freely assignable, even in the face of language to the contrary. *See* RESTATEMENT (SECOND) OF CONTRACTS § 322 (1981) (limiting the effect of contractual prohibition of assignment).

49. *See, e.g.*, Ronald J. Mann, *Searching for Negotiability in Payment and Credit Systems*, 44 UCLA L. REV. 951, 968–73 (1997); Dale A. Whitman, *How Negotiability Has Fouled Up the Secondary Mortgage Market, and What To Do About It*, 37 PEPP. L. REV. 737, 749–57 (2010).

50. U.S. DEP'T OF HOUS. AND URBAN DEV., HUD 4155-2, LENDER'S GUIDE TO THE SINGLE FAMILY MORTGAGE INSURANCE PROCESS 6-B-7 (2011), *available at* http://portal.hud.gov/hudportal/HUD?src=/program_offices/administration/hudclips/handbooks/hsgh/4155.2.

51. Bruce D. Bolander & Mark C. Suchman, *Sale and Lien Perfection Under the U.C.C.*, *in* PRACTICING LAW INST., STRUCTURED MORTGAGE AND RECEIVABLES FINANCING 623, 665 (R.S. Dayan ed., 1989).

52. *See* FANNIE MAE, SELLING GUIDE: FANNIE MAE SINGLE FAMILY 22–23 (2013), *available at* https://www.fanniemae.com/content/guide/sel040913.pdf (noting that a lender selling a mortgage loan not closed on a uniform instrument warrants that the note constitutes a negotiable instrument).

53. *See e.g.*, *In re* Walker, 466 B.R. 271, 283–84 (Bankr. E.D. Pa. 2012) (holding a note to be negotiable and collecting other cases). Although not noted in the opinion, the note in question was the Fannie/Freddie Multistate Fixed Rate Note for Single Family, Form No. 3200 1/01. Motion for Summary Judgment Exhibit A, *In re Walker*, 466 B.R. 271 (No. 10-bk-12592). The mortgage was a Fannie/Freddie uniform instrument for Pennsylvania for Single Family, Form No. 3039 1/01. Motion for Summary Judgment Exhibit B, *In re Walker*, 466 B.R. 271 (No. 10-bk-12592).

54. *See* Jeffrey P. Naimon, Jacob Thiessen & Jennifer Beall, *Assignee Liability in Residential Mortgage Transactions*, 19 REV. BANKING & FIN. SERV. 89A, 89D (2003) ("Institutions and practices that we take for granted would be far different without the holder in due course rule, if they could exist at all.").

Even if the notes are not formally negotiable, the UCC contemplates that in appropriate circumstances, such as when indicated by custom and usage, the notes should still be governed by Article 3.[55] For the purposes of this Article, there is no need to resolve the question of whether the notes are in fact negotiable. Instead, it is merely enough to observe that this is yet another point on which there is a real question about what law applies and how an enormous market rests on legally uncertain underpinnings. The following analysis treats the notes as negotiable.

2. *UCC Article 3 as a Note Transfer System*. UCC Article 3 provides a method for transferring negotiable instruments.[56] Transfer of a negotiable instrument under Article 3 occurs through delivery of the instrument to the transferee "for the purpose of giving to the person receiving delivery the right to enforce the instrument."[57] Thus, for negotiable instruments, transfer is about enforcement rights. Indeed, absent enforcement rights, there is very little value in possessing a promissory note (negotiable or otherwise); a note that is "payable to Donald Trump" is of little use to me.

A transfer under Article 3 requires delivery.[58] Delivery requires a voluntary transfer of physical possession.[59] Article 3 requires physical movement of paper as part of a note transfer.[60] The logic for this requirement is discussed in the following Section. Some transfers of notes are "negotiations," meaning a transfer of an instrument by someone other than its maker to someone who then becomes a

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55. Official Comment 2 to UCC section 3-104 notes:

> [I]t may be appropriate, consistent with the principles stated in Section 1-102(2), for a court to apply one or more provisions of Article 3 to the writing by analogy, taking into account the expectations of the parties and the differences between the writing and an instrument governed by Article 3.

U.C.C. § 3-104 cmt. 2 (2011). UCC Section 1-103(a)(2) explains that among the purposes and policies of the UCC is "to permit the continued expansion of commercial practices through custom, usage, and agreement of the parties." Accordingly, even if a mortgage note does not fit the statutory definition of a negotiable instrument, it may still be appropriate to apply Article 3 to the note because such notes are considered negotiable by custom and usage. If the note is not negotiable and Article 3 is not applied by analogy, then the note would be governed by the common law of contracts.

56. *Id.* §§ 3-201, 3-203.

57. *Id.* § 3-203(a).

58. *Id.*

59. *Id.* § 1-201(15).

60. *Id.* § 3-203(a).

"holder."[61] To be a holder, a person must possess an instrument payable to either bearer or to himself.[62] This means that holder status depends in part on to whom the instrument is payable.

If an instrument is payable to bearer, delivery alone will suffice for a negotiation.[63] If an instrument is payable to (or to the order of) an identified person, however, then the negotiation requires not just delivery, but also indorsement by the prior holder.[64] An indorsement is a signature on the instrument or on a piece of paper affixed to the instrument (known as an allonge).[65] If the indorsement identifies a particular party to whom the instrument is payable, it is called a "special indorsement."[66] Any other type of indorsement by the holder is called a "blank indorsement."[67] The indorsement need not have a blank in it, such as "pay to _____" or "pay to the order of ______." Indeed, the indorser's signature alone constitutes a blank indorsement. A blank indorsement transforms the instrument into bearer paper—an instrument that is payable to the bearer—similar to cash.[68] Either way, indorsement gives the transferee all of the transferor's rights to enforce the instrument.[69]

The standard rule in contract and property law is that transferees take only those rights that the transferor had—meaning that the transferee is subject to any claims or defenses that could have been raised against the transferor.[70] Negotiability is a deviation from this rule, enabling certain transferees to take title superior to that of the transferors. This special type of transferee is the "holder in due course," a holder of an instrument who has taken the instrument in good faith, for value, and without notice of default or defect in the instrument.[71] A holder in due course is immune from competing claims to the instrument,[72] from claims in recoupment,[73] and from

61. *Id.* § 3-201(a).
62. *Id.* § 1-201(21)(A).
63. *Id.* § 3-201(b).
64. *Id.* § 3-201(b); *see id.* § 1-201(21)(B) (defining "holder").
65. *Id.* § 3-204(a).
66. *Id.* § 3-205(a).
67. *Id.* § 3-205(b).
68. *Id.*
69. *Id.* § 3-203(b).
70. *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 336 (1981); 6A C.J.S. *Assignments* § 124 (2004).
71. U.C.C. § 3-302(a).
72. *Id.* § 3-306.
73. *Id.* §§ 3-305(a)(3), 3-305(b).

defenses to enforcement other than infancy, duress, lack of capacity, illegality, fraud in the inducement, and insolvency discharge.[74] Thus, the holder in due course has particularly secure property rights: freedom from claims to the instrument and freedom from some defenses, thereby enabling easier enforcement of the property rights.

The ability of a purchaser of a negotiable note to become a holder in due course significantly enhances the liquidity and hence the value of the instrument. Because a holder in due course is immune from some defenses, counterclaims, and competing claims, much less diligence is required of a purchaser of a negotiable note. Holder-in-due-course status is used to shield mortgage investors from assignee liability in the secondary mortgage market,[75] which has encouraged the funding of more aggressive mortgage lending.[76]

3. *UCC Article 3 as a Note Title System.* UCC Article 3 functions not only as a transfer system, but also as a title system for negotiable notes, even though it is seldom conceived of as such. Article 3 is not expressly a title system. Indeed, the operative concept in Article 3 is not ownership, but enforcement rights.[77] The main rights given by UCC Article 3 are to a "person entitled to enforce" an instrument,[78] not to an "owner."[79] A person entitled to enforce is: (1) a holder of an instrument, (2) a nonholder in possession with rights of a holder, or (3) a person not in possession who is entitled to enforce the instrument pursuant to Article 3's lost-instrument provisions.[80]

The first category of person entitled to enforce, a holder, requires physical possession of the instrument, which must be payable

74. *Id.* §§ 3-305(a)(1)–(2), 3-305(b).

75. *See generally* Naimon et al., *supra* note 54.

76. ENGEL & MCCOY, *supra* note 2, at 234–35; Kurt Eggert, *Held Up in Due Course: Predatory Lending, Securitization, and the Holder in Due Course Doctrine*, 35 CREIGHTON L. REV. 503, 507 (2002); Christopher Lewis Peterson, *Predatory Structured Finance*, 28 CARDOZO L. REV. 2185, 2233–34 (2007).

77. The terminology of "title" was used in the original 1951 version of Article 3, which is still in force in New York. *See* N.Y. U.C.C. LAW § 3-417 (McKinney 2013) (warranty of "good title" to transferees and payors).

78. U.C.C. § 3-301.

79. Property law has long recognized that property is a "bundle of rights" that can be disaggregated, with enforcement rights as but one of the sticks in the bundle. *See* Wesley Newcomb Hohfeld, *Fundamental Legal Conceptions as Applied in Judicial Reasoning*, 26 YALE L.J. 710, 746 (1917) ("'[P]roperty' . . . consists of a complex aggregate of rights (or claims), privileges, powers, and immunities.").

80. *See* U.C.C. § 3-301 (referencing sections 3-309 and 3-418(d)).

either to the bearer or to the possessor.[81] The second category is a narrow class of parties subrogated to the rights of a holder, such as an insurer.[82] It too requires possession of the instrument and carries with it the absolute right to require the transferor to indorse the instrument to the possessor or in blank.[83] The final category, a person seeking to enforce a lost instrument, obviously does not require current possession of the instrument. But it does require proving that the party was otherwise a person entitled to enforce before the instrument was lost[84]—by proving possession upstream in the chain of title—as well as proving the terms of the instrument.[85] Thus, irrespective of how a party qualifies as a person entitled to enforce, it is necessary to prove both possession and that the instrument is either bearer paper or payable to the order of the party seeking enforcement.[86] In other words, enforcement rights are contingent upon title rights.

To appreciate how Article 3 functions as a title system, it is necessary to consider a key feature of negotiable instruments: under the doctrine of merger, the instrument is the reification of the payment obligation. This means the physical piece of paper is the claim itself, as the duty to pay is merged in the instrument,[87] whereas

81. *Id.* § 1-201(21). The concept of "person entitled to enforce" is a form of statutory standing that predates federal standing doctrine. *See generally* Ann Woolhandler & Caleb Nelson, *Does History Defeat Standing Doctrine?*, 102 MICH. L. REV. 689 (2004) (discussing the origins of federal standing doctrine). Constitutional and prudential standing may involve separate analyses. *See* Gladstone Realtors v. Vill. of Bellwood, 441 U.S. 91, 99 (1979) ("Even when a case falls within . . . constitutional boundaries, a plaintiff still may lack standing under . . . prudential principles . . . .").

82. *See* U.C.C. § 3-301 cmt. ("A nonholder in possession of an instrument includes a person that acquired rights of a holder by subrogation or under Section 3-203(a).").

83. *See id.* § 3-203(c) ("[I]f an instrument is transferred for value and the transferee does not become a holder because of lack of indorsement by the transferor, the transferee has a specifically enforceable right to the unqualified indorsement of the transferor . . . .").

84. *See* U.C.C. § 3-309(a)(i) (1990). In the 2002 Official Text of Article 3, which has been adopted in ten states as of 2012, *see* PERMANENT EDITORIAL BD. FOR THE UNIF. COMMERCIAL CODE, *supra* note 15, at 2 n.6, the lost-note provision has been expanded to cover parties that purchased a note from a person entitled to enforce who had lost the instrument, *see* U.C.C. § 3-309(a)(1)(B) (2002).

85. U.C.C. § 3-309(b) (2011). Query how one can determine whether a lost note was in fact negotiable and whether UCC Article 3 therefore even applies.

86. Or, technically, that the person entitled to enforce that is not a holder has the right to have the instrument indorsed to be payable to it. *See id.* § 3-203(c) ("[T]he transferee has a specifically enforceable right to the unqualified indorsement of the transferor, but the negotiation of the instrument does not occur until the indorsement is made.").

87. Grant Gilmore, *Formalism and the Law of Negotiable Instruments*, 13 CREIGHTON L. REV. 441, 449 (1979); *see* U.C.C. § 3-203 cmt. 1 ("An instrument is a reified right to payment.

with a nonnegotiable instrument, the writing is merely a memorialization of the contract with no more than an evidentiary effect.

The merger doctrine's origins lie in the original function of negotiable-instrument law—monetizing debt instruments in economies that lacked paper currency.[88] By creating an instrument that could be taken free of claims and personal defenses, negotiable-instrument law created a private form of paper currency. In so doing, the merger doctrine transformed intangible contract rights into a peculiar form of personality.

As atavistic as reification may seem, it can actually enhance economic activity. Reification turns negotiable instruments into liquid assets by enabling some level of freedom from claims and defenses for all holders (not just those in due course), and it encourages borrowing by eliminating the risk of multiple satisfactions.

Reification enables the terms of the instrument to be determined by looking at the four corners of the instrument. "My face is my fortune, Sir," quipped Professor Karl Llewellyn.[89] Indeed, the statutory definition of negotiable instrument requires an unconditional promise to pay a sum certain and prohibits additional undertakings.[90] Reification functions like an integration clause, keeping out parol evidence, thereby eliminating some possible defenses to enforcement. The result is to reduce diligence demands

The right is represented by the instrument itself."); *id.* § 3-310(b) (providing that when a note is given for an obligation, "the obligation is suspended to the same extent the obligation would be discharged if an amount of money equal to the amount of the instrument were taken," and that if a person entitled to enforce an instrument ceases to have possession of the instrument, "the obligation may not be enforced to the extent of the amount payable on the instrument"). The merger doctrine is, of course, a fiction because an action can still be brought on a lost or destroyed instrument. *Id.* §§ 3-309, 3-312(b) (permitting enforcement of a lost or destroyed instrument if the terms of the instrument can be proven). If the debt were truly merged into the instrument, it would be definitively discharged with the destruction of the instrument.

88. *See* Cohen, *supra* note 39, at 182 (explaining that the merger doctrine "is designed for a day in which pieces of paper that were not money passed in commerce as sort of a quasi-currency"); *see also* Gilmore, *supra* note 87, at 448–50 (discussing the origins of the merger doctrine). National paper currencies are a relatively new invention. The United States lacked a national paper currency until the 1862 issuance of "Greenbacks" as a Civil War financing mechanism. *See* Ali Khan, *The Evolution of Money: A Story of Constitutional Nullification*, 67 U. CIN. L. REV. 393, 424–26 (1999). Prior to the adoption of Greenbacks and then national bank notes during the Civil War, paper currency consisted of private, negotiable bank notes. *See id.* at 410–13.

89. Karl N. Llewellyn, *Meet Negotiable Instruments*, 44 COLUM. L. REV. 299, 299 (1944).

90. U.C.C. § 3-104.

on purchasers of negotiable instruments[91] and to ease enforcement of the instrument. Instead of having to prove the underlying contract, the party enforcing the instrument need only show that the instrument has been dishonored.[92] If the party enforcing the instrument is a holder in due course, enforcement is even easier because personal defenses are cut off.[93] Irrespective of holder-in-due-course status, however, reification enhances enforcement rights.

Reification also enhances security of property rights from competing claims. Reification enables title via possession (if the note is payable to the bearer[94]), and possession clarifies title because there can be only one possessor at a time.[95] Reification also enables transfer by indorsement. Indorsement creates a chain of title that travels with the instrument and provides an easy, objective manner for establishing who has rights to the instrument. The two faces of the instrument itself will indicate who has rights in it based on the presence (or absence) of indorsements. Thus, to Llewellyn's "[m]y face is my fortune, Sir," we might add, "and my past is behind me." Clarity of title is furthered by the fact that a holder in due course—requiring, inter alia, indorsement and possession—takes the instrument free of competing claims.[96]

By enhancing freedom from defenses and freedom from claims, reification increases the liquidity, and hence the value, of negotiable instruments. The negotiable instrument is thus "a courier without luggage."[97] Increased liquidity may benefit both creditors and obligors. Creditors gain an easy-to-enforce, liquid asset. Depending on market power, obligors might capture some of this benefit, as

91. *See* Adam J. Levitin, *Finding* Nemo*: Rediscovering the Virtues of Negotiability in the Wake of* Enron, 2007 COLUM. BUS. L. REV. 83, 100 (2007) (observing that negotiable-debt purchasers "do not have to worry about whether there are defenses to the debt beyond those involving the legitimacy of the instrument"); *see also* Edward J. Janger, *The Cost of Liquidity Enhancement: Transparency Cost, Risk Alteration, and Coordination Problems*, 4 BROOK. J. CORP. FIN. & COM. L. 39, 46 (2009) ("The core doctrines of liquidity enhancement, freedom from claims and freedom from defenses . . . facilitate negotiability . . . .").

92. *See* U.C.C. § 3-308(b) ("If the validity of signatures is admitted [which is assumed unless specifically denied] or proved . . . a plaintiff producing the instrument is entitled to payment if the plaintiff proves entitlement to enforce the instrument . . . unless the defendant proves a defense or claim in recoupment."); *id.* § 3-308 cmt. 2.

93. *Id.* § 3-305(b).

94. *Id.* § 3-109(a).

95. Rogers, *supra* note 39, at 205.

96. U.C.C. § 3-306; *see* Cohen, *supra* note 39, at 179–80.

97. Overton v. Tyler, 3 Pa. 346, 347 (1846).

there could be a discount in lending terms for the use of a negotiable instrument because of the liquidity benefit to the creditor.

A final, unappreciated benefit of reification is that it protects debtors from multiple satisfactions. Payment made to any person entitled to enforce discharges the instrument.[98] Historically, the UCC and the Negotiable Instruments Law before it sometimes required presentment—an actual demand for payment when the note became due—as part of the enforcement process.[99] The requirement of presentment, like most UCC terms, was only a default rule, however; it could be altered by agreement.[100] Although presentment is no longer the default rule for most notes in the jurisdictions that adopted the 1991 revision of UCC Article 3,[101] it is still the default rule in New York.[102] When presentment is required as part of enforcement, the party to whom presentment is made may require exhibition of the instrument, identification of the person making presentment, and evidence of that person's authority if acting as an agent, as well as a signed receipt for payment and surrender of the instrument upon full payment.[103]

By embodying the obligation in the instrument, the exchange of the instrument for final payment is made, and the instrument's subsequent destruction or cancellation helps shield against multiple satisfactions of the debt. Avoidance of multiple satisfactions is so fundamental to developed economies that it is taken for granted. Elimination of multiple-satisfaction risk, however, is a major factor separating developed and developing credit economies.[104] In the

98. U.C.C. §§ 3-603(b)–(c).

99. U.C.C. § 3-501 (1951); Negotiable Instruments Law § 145 (1905). The former UCC section 3-501 is still in force in New York, N.Y. U.C.C. LAW § 3-501 (McKinney 2013), and South Carolina, S.C. Code Ann. § 36-3-501 (Supp. 2012).

100. U.C.C. § 1-302 (2001); U.C.C. § 1-102(3) (1991); *see also* U.C.C. § 3-502 cmt. 2 (2011) ("In the great majority of cases presentment and notice of dishonor are waived with respect to notes.").

101. *See* U.C.C. § 3-502(a) (2011) (noting that presentment is not required for notes that are not payable on demand or at or through a bank, or if the terms of the note do not require presentment).

102. N.Y. U.C.C. LAW § 3-505. Presentment and notice of dishonor may still be waived contractually under New York law. *Id.* § 1-102(3). The Freddie Mac Single Family Uniform Note (including the New York version) contains such a waiver. FREDDIE MAC, FORM 3233: NEW YORK FIXED RATE NOTE para. 9 (2013), *available at* http://www.freddiemac.com/uniform/doc/3233-NewYorkFRNote.doc.

103. N.Y. U.C.C. LAW § 3-505; U.C.C. § 3-501(b)(2).

104. *See* Catherine S.M. Duggan, Credit and Coercion: Indirect Regulation and the Institutional Foundations of Lending Markets 46–50 (unpublished manuscript) (on file with the

absence of legal records that can be relied upon to show that a debt has been satisfied, creditors will often seek multiple satisfactions of debt. If a debtor fears multiple satisfaction of the same debt, the debtor will not borrow, thereby chilling economic activity.[105] Making the physical instrument the avatar of the payment obligation not only provides a system of tracking functional title in terms of freedom from claims. It also enables verification of the terms of the obligation and hence greater ability to enforce as well as provide a mechanism for verifying the discharge of the obligation.

4. *UCC Article 3 as a Mortgage Title-and-Transfer System*. UCC Article 3 says nothing about mortgages associated with notes. Instead, whether the transfer of the note has any effect on the mortgage is a question of state common law. In most states there is at least some statement in case law to the effect that "the mortgage follows the note,"[106] but few states have this as a definitive point of law either in case law or statute.[107] In most states, it exists merely as dicta,[108] and in some states there is also law that the "note follows the mortgage."[109]

Nonetheless, the "mortgage follows the note" principle was incorporated into the Restatement (Third) of Property, which provides that "[a] transfer of an obligation secured by a mortgage also transfers the mortgage unless the parties to the transfer agree otherwise."[110] If the mortgage does indeed follow the note, then

Duke Law Journal) (presenting a game-theoretic model of lending in which the lender pursues the borrower after payment and empirical evidence of this model).

105. *Id*. at 175–92.

106. *See* AM. SECURITIZATION FORUM, TRANSFER AND ASSIGNMENT OF RESIDENTIAL MORTGAGE LOANS IN THE SECONDARY MORTGAGE MARKET 16–21 (2010), *available at* http://www.americansecuritization.com/uploadedfiles/asf_white_paper_11_16_10.pdf (detailing cases and statutory provisions relating to the mortgage-follows-the-note doctrine); *see also* 55 AM. JUR. 2D *Mortgages* § 927 (2009) ("The mortgage follows the debt, in the sense that the assignment of the note evidencing the debt automatically carries with it the assignment of the mortgage.").

107. An important exception is California. *See* CAL. CIV. CODE § 2936 (West 2012) ("The assignment of a debt secured by mortgage carries with it the security.").

108. Likewise, the ongoing validity of the Supreme Court decision in *Carpenter v. Longan*, 83 U.S. (16 Wall.) 271 (1872), is questionable, as it was decided as a matter of general federal common law, which was disavowed by *Erie R.R. Co. v. Tompkins*, 304 U.S. 64, 78–80 (1938). *See Carpenter*, 83 U.S. at 277 ("We think the doctrine we have laid down is sustained by reason, principle, and the greater weight of authority.").

109. *See, e.g.*, U.S. Bank Nat'l Ass'n v. McConnell, 305 P.3d 1, 6 (Kan. Ct. App. 2013) ("In Kansas, it has been the law since 1899 that the note follows the mortgage.").

110. RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 5.4(a) (1997). Confusingly, section 5.4(b) states that "[e]xcept as otherwise required by the Uniform Commercial Code, a transfer

Article 3 also functions as a mortgage title-and-transfer system. The title to the mortgage would track the title to the note, and transfers of the note would effectuate transfers of the mortgage.

Significantly, Article 3 says nothing about the enforceability of *mortgages*. The "mortgage follows the note" concept would seem to be about ownership rather than physical possession. Thus, although possession of a note may confer the right to enforce the note, it is not clear whether it also confers the right to foreclose on the associated mortgage. As Article 3 does not address the enforceability of mortgages, mortgage enforceability would presumably be a matter of nonuniform state law and likely keyed to "ownership" of either the mortgage or the note, rather than physical possession of the note.

B. Land Recordation Systems

UCC Article 3 is not just a title-and-transfer system for notes, but also for mortgages. The problem is that it is not clearly an *exclusive* title-and-transfer system for mortgages because mortgages are also governed by real-property law. Real-property law is far from uniform, so the following discussion is necessarily generalized, but the basic legal contours of real-property law are clear.

A mortgage is an estate in real property—if the payment obligation secured by the mortgage is not made, the mortgagee may sell the property to satisfy the obligation. States are split on whether the granting of a mortgage is to be understood as creating a present or contingent estate in real property.[111] States that take the former view are called title-theory states, while states that adopt the latter view are lien-theory states.[112] In a title-theory state, a mortgage (or deed of trust) is seen as a sale and repurchase arrangement: title to the land is presently conveyed to the mortgagee or deed-of-trust trustee and is then reconveyed to the mortgagor upon satisfaction of

of a mortgage also transfers the obligation the mortgage secures unless the parties to the transfer agree otherwise." *Id.* § 5.4(b). Thus, as the Restatement would have it, the mortgage follows the note, but the note also follows the mortgage. It is not clear how this principle fits with three-party, deed-of-trust arrangements in which the note goes to the lender, but the trust deed goes to the deed trustee, effectuating a split of the mortgage and note.

111. *See id.* § 1.1 ("A mortgage is a conveyance or retention of an interest in real property as security for performance of an obligation."); REAL ESTATE FINANCING § 3.10 (2013), *available at* LexisNexis, 4A-3 Real Estate Financing § 3.10 (listing states by theory adopted).

112. *See* RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 4.1 cmt. a (describing the three types of theories of mortgage law recognized by U.S. courts).

the debt or sold upon default.[113] In a lien-theory state, a mortgage is a contingent conveyance, triggered only by default on the loan.[114]

Because a mortgage is understood as a conveyance of a present estate in real property in a title-theory state, it follows that the granting and transfer of mortgages must comply with the formalities of land conveyance.[115] This may include the requirement of a writing to comply with the state Statute of Frauds, and other formalities, such as the signature of the conveyor, the signature of witnesses, and particular methods of describing the transferred property. Even in lien-theory states, however, various formalities may still be required for the granting and transfer of mortgages. Thus, land records are another type of public demonstration regime for establishing property rights.

Among the formalities associated with land conveyance is recordation. Every state has a real-property recordation statute.[116] Recordation of title to real property is not mandatory, as recordation itself does not establish title to land. Moreover, it is not recordation that creates the right to foreclose, but the security instrument itself. Presumably the recordation of a defective security instrument that did not include a right to foreclose would not create a right to foreclose upon default. Recordation by itself only establishes evidence of title and potentially priority of rights vis-à-vis competing claimants to the property.[117]

113. *See id.* § 4.1 cmt. a(1).

114. *See id.* § 4.1 cmt. a(2) ("Under [lien] theory, the mortgagee acquires only a 'lien' on the mortgaged real estate and the mortgagor retains both legal and equitable title and the right to possession until foreclosure or a deed in lieu of foreclosure.").

115. See 4 RICHARD R. POWELL ET AL., POWELL ON REAL PROPERTY § 37.27, at 37-177 to -178 (2010) ("Because mortgages involve an interest in land, the usual formalities for transferring property interests must be met. . . . As with other transactions involving real estate, it is always important to record the document creating the real estate interest—in this case the assignment."); *see also* U.S. Bank Nat'l Ass'n v. Ibanez, 941 N.E.2d 40, 51 (Mass. 2011) ("Like a sale of land itself, the assignment of a mortgage is a conveyance of an interest in land that requires a writing signed by the grantor.").

116. *See* 14 RICHARD R. POWELL ET AL., POWELL ON REAL PROPERTY § 82.02[1][b] (2012), at 82-15 to -17.

117. *Cf.* LYNN M. LOPUCKI & ELIZABETH WARREN, SECURED CREDIT: A SYSTEMS APPROACH 426 (7th ed. 2012) (noting that a certificate of title "is prima facie evidence of ownership, but if ownership is with a person other than the person shown on the certificate, the certificate is no impediment to proof of that fact").

Property is recorded in county land records. Every county or parish in the United States has a real-estate recordation system.[118] The precise details and operations of these local land records vary, but, in most cases, title to land can be determined by a search of local land records.

Local land records also track various encumbrances on land, such as easements or liens, but only to the extent that these encumbrances have been recorded.[119] Most states do not require mortgage liens to be recorded in local land records,[120] but there are exceptions.[121] Similarly, statutory liens, such as state tax liens and construction liens, are not always recorded.

Accordingly, mortgage recording is not meant to be a title system for mortgages per se. Instead, it is meant to be a notice and a priority system, providing potential lenders with information about whether a property is encumbered and then ranking competing encumbrances. Yet, by serving as a priority system, mortgage recording is a de facto title system for mortgages. Compliance with the formalities of recording vests the mortgagee with superior rights and locks in the mortgage's priority vis-à-vis competing liens. Lack of recording makes a mortgagee vulnerable to becoming subordinated to a subsequent recorded mortgage, thereby reducing the value of the

118. Several states also have additional, nonmandatory Torrens registration systems, usually at the state level, which register actual title rather than recording documentary evidence of title. *See* R.G. Patton, *The Torrens System of Land Title Registration*, 19 MINN. L. REV. 519, 524 (1934). In a Torrens system, the state investigates title. If satisfied after the investigation, the state registers title. Registered owners have indefeasible title. The state provides indemnification for any legitimate claimant to superior title, but only monetary relief is possible; the property remains with the registered owner. Thomas J. Miceli & C.F. Sirmans, *The Economics of Land Transfer and Title Insurance*, 10 J. REAL EST. FIN. & ECON. 81, 81–82 (1995) (noting that Torrens systems establish public funds to compensate legitimate claimants to registered land who emerge after registration). In a Torrens system, transfer of title is effective only upon registration of the transfer.

119. *See* RESTATEMENT (THIRD) OF PROP.: SERVITUDES §§ 2.1, 5.1 (2000).

120. *See, e.g.*, Nevada *ex rel.* Bates v. Mortg. Elec. Registration Sys., Inc., 493 F. App'x 872, 874 (9th Cir. 2012) (holding that there is no duty to record a mortgage in Nevada).

121. *See, e.g.*, GA. CODE. ANN. § 44-2-1 (2010) ("Every deed conveying lands *shall* be recorded in the office of the clerk of the superior court of the county where the land is located." (emphasis added)); ILL. COMP. STAT. ANN. 765 5/28 (West 2001) ("Deeds, mortgages, powers of attorney, and other instruments relating to or affecting the title to real estate in this state, *shall* be recorded in the county in which such real estate is situated . . . ." (emphasis added)); Montgomery Cnty. v. MERSCORP, Inc., 904 F. Supp. 2d 436, 445 (E.D. Pa. 2012) (holding that the "shall be recorded" language in the Pennsylvania recording statute, 21 PA. STAT. ANN. § 351 (West 2001), requires all real-estate conveyances, including assignments of mortgages, to be recorded).

unrecorded mortgage. Moreover, lack of recording makes a mortgagee vulnerable to having the lien voided because a subsequent bona fide purchaser will take the property without being subject to the unrecorded lien.[122] Lack of recording also makes a mortgage vulnerable to being avoided by a trustee in the mortgagor's bankruptcy.[123] Priority ultimately means freedom from competing claims and security in the property rights.

Recording may also vest the mortgagee with enhanced enforcement rights. Although an unrecorded mortgage is generally enforceable against the mortgagor,[124] in some states, nonjudicial foreclosure—usually a faster and cheaper procedure than judicial foreclosure—is only available for recorded mortgages.[125] Being able to proceed through nonjudicial foreclosure might be analogized to freedom from some defenses because defenses are not raised in the nonjudicial setting, but only in litigation brought by the homeowner to stop or invalidate the nonjudicial foreclosure, in which the burdens of persuasion might be different.

Therefore, there is a strong incentive for a mortgagee to record the mortgage in the local land records. This situation is analogous to the choice between using a negotiable or nonnegotiable promissory note. Neither negotiability nor recording is required, but both confer greater legal rights and require greater—and costlier—formalities. Nonetheless, because recording is generally not mandatory, land records are an incomplete mortgage title system.

Still, if a mortgage is recorded, then the land records start to serve as a title system for that mortgage. Evidence of a transfer of a recorded mortgage is created by filing the appropriate notice of assignment in the local land records. Typically such an assignment

122. *See* Grant Gilmore, *The Commercial Doctrine of Good Faith Purchase*, 63 YALE L.J. 1057, 1083 n.88 (1954) (discussing cases in which a "bona fide purchaser of note and mortgage would lose to a bona fide purchaser of the property whenever the mortgage was not recorded").

123. 11 U.S.C. § 544(a) (2012).

124. *See* 55 AM. JUR. 2D *Mortgages* § 924 (2009) ("The assignment of a note and mortgage does not need to be recorded to be valid.").

125. *See, e.g.*, CAL. CIV. CODE § 2932.5 (West 2012) ("The power of sale may be exercised by the assignee if the assignment is duly acknowledged and recorded."); GA. CODE ANN. § 44-14-162(b) (Supp. 2013) (providing that the security instrument vests the secured creditor with title to the security instrument); NEV. REV. STAT. § 106.210(1) (LexisNexis 2013) ("A mortgage of real property . . . which has been assigned may not be enforced unless and until the assignment is recorded."); OR. REV. STAT. § 86.735 (2011) ("[T]he trustee may foreclose a trust deed by advertisement and sale if . . . there is a default by the grantor . . . and the trustee or beneficiary has filed for record in the country clerk's office . . . .").

requires paying a fee to the county; absent payment of the fee, the transfer will not be recorded. Although it is still possible to have an unrecorded assignment, the rights of such an assignee are possibly inferior to those of a subsequent recorded lienholder or purchaser.[126] The mortgage will remain in the county land records until such time as a release of the lien is filed. The release can be filed only by the record holder of the mortgage; an unrecorded transferee of a mortgage cannot release a recorded lien. Thus, a typical title search as part of a real-estate closing will involve a search only for recorded mortgages and recorded assignments, as well as recorded releases.

C. The Uneasy Coexistence of UCC Article 3 and Land Records

The UCC Article 3 and land record systems emerged and remained separate for path-dependent reasons: negotiable-instrument law as a means of monetizing debts[127] and land records as a means of clarifying title to land.[128] Neither was primarily designed as a mortgage title system. But, because both serve as de facto title systems for mortgages, they can potentially produce conflicting title: the mortgagee of record may not match with the holder of the note. Few states have clear law on how this conflict is to be resolved, particularly in regards to who can foreclose.

Despite the potential tension between the note and land records systems for mortgage title, the systems worked together with little incident for over a century. Historically, the potential title-system conflict rarely mattered because the systems typically matched and transfers of either notes or mortgages were relatively rare. When a conflict did exist, it was unlikely to be an issue except in the unusual event of a foreclosure. Foreclosures were fairly rare, however, prior to the bursting of the housing bubble,[129] and most foreclosures were default judgments.[130] Usually there was no question that a payment

126. *See, e.g.*, MASS. GEN. LAWS, ch. 183, § 5 (2011) (providing that purchasers without notice may rely conclusively on real-estate records).

127. *See supra* note 88 and accompanying text.

128. *See supra* notes 118–20 and accompanying text.

129. *See* MORTG. BANKERS ASS'N, NATIONAL DELINQUENCY SURVEY (2010) (indicating foreclosure rates of 2 percent or less in terms of the number of outstanding mortgages from 1979 until 2007).

130. Statistics on default judgment rates are hard to come by, but a 2008 New York State Unified Court System study states that default judgments occur in approximately 90 percent of foreclosure cases. JUDITH S. KAYE & ANN PFAU, RESIDENTIAL MORTGAGE FORECLOSURES: PROMOTING EARLY COURT INTERVENTION 1 (2008), *available at* http://www.nycourts.gov/whatsnew/pdf/ResidentialForeclosure6-08.pdf.

default had occurred, and cultural norms dissuaded shamed borrowers from litigating based on "technicalities." In the unlikely event a borrower did litigate, settlement was feasible for institutional lenders because it would be a one-off occurrence. All of this changed, however, as mortgage finance shifted from balance-sheet lending to securitization.

II. THE SHIFT IN MORTGAGE FINANCING TO SECURITIZATION

Securitization is a relatively recent development in residential mortgage lending.[131] Residential mortgages began to be securitized in 1970,[132] but securitization remained a relatively small part of American housing finance prior to the 1980s.[133] In 1979 only 10 percent of outstanding mortgages by dollar amount were securitized.[134] Instead, mortgage lending was primarily a local affair conducted through depositaries' balance sheets,[135] so mortgage loans were rarely transferred.

The S&L crisis, however, made clear that depositaries were ill-suited to manage the asset-liability-duration mismatch risk posed by financing long-term, fixed-rate loans through deposits. As a result, securitization boomed.[136] By 1983, 20 percent of outstanding mortgages by dollar amount were securitized, and a decade later fully

131. There have been several earlier episodes of quasi-securitization financing for farm and commercial mortgage loans in U.S. history going back to the 1870s. *See* Kenneth Snowden, *Mortgage Securitization in the United States: Twentieth Century Developments in Historical Perspective*, *in* ANGLO-AMERICAN FINANCIAL SYSTEMS 261, 274–75 (Michael D. Bordo & Richard Sylla eds., 1996) ("[T]he first group of banks financed western city building in the 1870s, the second provided mortgage credit for agricultural settlement in the Great Plains during the 1880s, and the last helped fuel agricultural expansion during and immediately after World War I.").

132. *See* Jonathan Tower, *Ginnie Mae Pool No. 1: A Revolution Is Paid Off*, SEATTLE TIMES, Sept. 19, 1999, at F1 (noting that the sale of the first mortgage-backed security (MBS) was in February 1970). Although Fannie Mae has existed since 1938, it did not engage in securitization until 1981. Instead, it held mortgages it purchased on a balance sheet and financed them through the issuance of corporate debt.

133. Adam J. Levitin & Susan M. Wachter, *Explaining the Housing Bubble*, 100 GEO. L.J. 1177, 1188–89 (2012).

134. *See* BD. OF GOVERNORS OF THE FED. RESERVE SYS., FEDERAL RESERVE STATISTICAL RELEASE Z.1, FINANCIAL ACCOUNTS OF THE UNITED STATES: FLOW OF FUNDS, BALANCE SHEETS, AND INTEGRATED MACROECONOMIC ACCOUNTS HISTORICAL ANNUAL TABLES 1975–1984, tbl.L.218 (2013), *available at* http://www.federalreserve.gov/releases/z1/Current/annuals/a1975-1984.pdf (the sum of lines 19 and 20 divided by line 1).

135. Adam J. Levitin & Susan M. Wachter, *The Public Option in Housing Finance*, 46 U.C. DAVIS L. REV. 1111, 1120–21 (2013).

136. *Id.* at 1165.

half of outstanding mortgages by dollar amount were securitized.[137] Today nearly two-thirds of mortgage dollars outstanding are securitized.[138]

The transformation of the mortgage market from a balance-sheet lending market to a securitization market had important implications for the documentation of mortgage transfers. Securitizations are financing transactions structured as sales. Therefore, securitizations require loans to be transferred, often multiple times. Residential mortgage securitization also involves a scalar change in mortgage transfers. Instead of loans being transferred one at a time, thousands are transferred en masse.

The critical feature of securitization is that it involves the issuance of debt obligations against a pool of assets that have been segregated from the other assets and liabilities of the securitizer. The assets are segregated through a sale to a specially created, legally separate entity that issues the debt. The reason for the asset segregation is to enable debt obligations to be priced solely on the quality of the segregated assets rather than on the total picture of a firm's assets and liabilities. When a firm issues debt, the debt is priced based on the debt's claim to the firm's assets, which means that it would be priced based on the total picture of the firm's assets and liabilities: What assets does the firm have, and what are the competing claims (liabilities) to the assets?

A firm can raise funds on potentially more advantageous terms if it can borrow solely against its assets, not its assets *and* liabilities. Securitization enabled such borrowing. To do so, a firm sells assets to a legally separate, specially created entity. The legally separate entity pays for the assets by issuing debt. Because the entity is designed to have almost no other liabilities, the debt it issues will be priced simply on the quality of the transferred assets, without any concern about competing claims to those assets.[139] Therefore, ensuring that the assets are transferred and are free of competing claims is central to securitization.

Although residential-mortgage securitization transactions are complex and vary somewhat depending on the type of entity undertaking the securitization, there is still a core standard

137. *Id.* at 1155.

138. *Id.*

139. *Cf.* Lynn M. LoPucki, *The Death of Liability*, 106 YALE L.J. 1, 23–30 (1996) (noting the use of asset securitization to shield the transferor, rather than the transferee, from claims).

transaction.[140] First, a financial institution (the "sponsor" or "seller") assembles a pool of mortgage loans either made ("originated") by an affiliate of the financial institution or purchased from unaffiliated third-party originators.[141] Second, the pool of loans is sold by the sponsor to a special-purpose subsidiary (the "depositor") that has no other assets or liabilities and is little more than a legal entity with a mailbox. This is done to segregate the loans from the sponsor's assets and liabilities.[142] Third, the depositor sells the loans to a passive, specially created, single-purpose vehicle (SPV), typically a trust in the case of residential-mortgage securitization. The trustee will then typically convey the mortgage notes and security instruments to a document custodian for safekeeping. The SPV issues certificated debt securities to raise the funds to pay for the loans.[143] As these debt securities are backed by the cash flow from the mortgages, they are called mortgage-backed securities (MBS).

A typical mortgage securitization thus has a set of transfers of both the notes and the mortgages from the originator to the seller to the depositor to the trust, with a bailment to the document custodian. We might think of this series of transfers as a sequence going from $A \rightarrow B \rightarrow C \rightarrow D$, as indicated in Figure 1, below. Bankruptcy, tax, accounting, and bank-regulatory-capital purposes mandate that each of these transfers be real and verifiable. If the transfer only goes directly from $A \rightarrow D$ or from $A \rightarrow B \rightarrow D$, without the intermediary

140. The structure illustrated is for private-label MBS. Ginnie Mae and government-sponsored enterprise (GSE) securitizations are structured somewhat differently.

141. The seller might itself be a special-purpose subsidiary of a holding company; for private label securitization, sellers were sometimes themselves special-purpose asset-backed commercial paper issuers, such as Countrywide's Park Granada, Park Monaco, and Park Sienna entities.

142. This intermediate entity is not essential to securitization, but, since 2002, Statement of Financial Accountings Standards 140 has required this additional step for off-balance-sheet treatment because of the possibility that if the originator went bankrupt or into receivership, the securitization would be treated as a secured loan, rather than a sale, and the originator would exercise its equitable right of redemption to reclaim the securitized assets. ACCOUNTING FOR TRANSFER AND SERVICING OF FINANCIAL ASSETS AND EXTINGUISHMENTS OF LIABILITIES, Statement of Fin. Accounting Standards No. 140 (Fin. Accounting Standards Bd. 2000); *Learning the Norwalk Two-Step*, HEADS UP (Deloitte & Touche, New York, N.Y.), Apr. 25, 2011, at 1, 1, *available at* http://www.securitization.net/pdf/dt_headsup.pdf. Statement of Financial Accounting Standards No. 166, effective January 1, 2010, has largely mooted the issue of off-balance-sheet treatment in GSE securitizations. *See generally* ACCOUNTING FOR TRANSFERS OF FINANCIAL ASSETS, Statement of Fin. Accounting Standards No. 166 (Fin. Accounting Standards Bd. 2009).

143. The procedure works slightly differently in Ginnie Mae, Fannie Mae, or Freddie Mac securitizations, which are also known as "Agency" securitizations.

transfers to *B* or *C*, the transaction might not achieve the various bankruptcy,[144] credit rating,[145] tax,[146] and accounting and bank-regulatory-capital[147] benefits that are vital to making securitization economically viable. Therefore, being able to provide clear evidence of the sequences of transfers from $A \rightarrow B \rightarrow C \rightarrow D$—that is, from the originator to the seller to the depositor to the trust—is critical for securitizations.

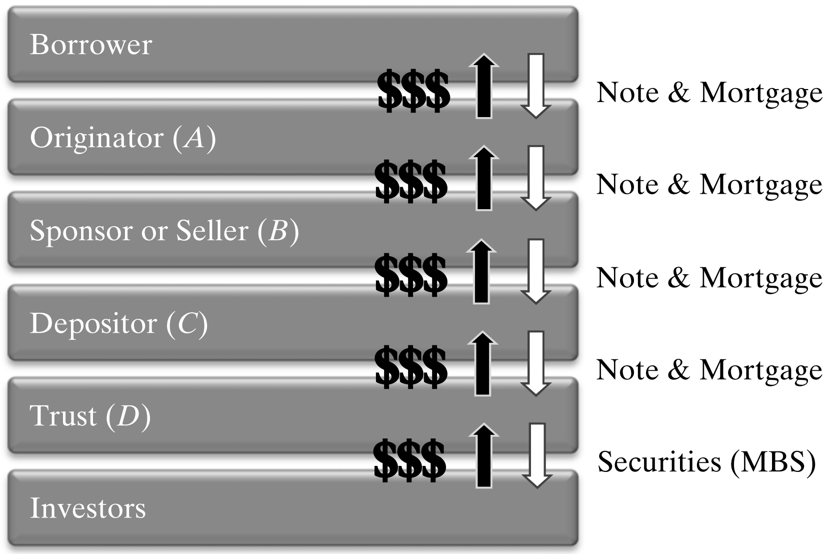
144. For securitizations, it is critical that the trust be bankruptcy remote, meaning that the trust's assets are not affected by the bankruptcy of the depositor, seller, or originator. (Bankruptcy remote has a distinct second meaning, namely, that the trust itself cannot file for bankruptcy.) In other words, the segregated assets must be free of any claims competing with those of the trust. This is accomplished by making sure that the transfers are all "true sales," so that the transferred assets cannot be claimed as property of the bankruptcy estate of the depositor, seller, or originator. *See infra* notes 226–37 and accompanying text.

145. Credit rating agencies are particularly concerned about true-sale treatment because of the bankruptcy remoteness issues discussed above, *see supra* note 144, and will not rate, absent a true-sale opinion letter.

146. Mortgage securitizations are structured for the securitization vehicle to achieve pass-through tax status. Absent pass-through tax status, the securitization vehicle would be taxed on its income from the mortgage loans, and the MBS investors would be taxed on their income from the MBS. Two levels of taxation would make the economics of mortgage securitization unattractive. Therefore, MBS are typically structured to have pass-through status as either grantor trusts or Real Estate Mortgage Investment Conduits (REMIC). Absent the transfer of the mortgages to the pass-through entity, however, there would be two levels of taxation. Moreover, REMIC rules require that transfers occur within a limited time period, *see* 26 U.S.C. §§ 860D(a)(3)–(4) (2006) (requiring substantially all assets of a REMIC to be qualified mortgages acquired within ninety days of the REMIC's creation or other permitted investments); *id.* § 860G(a)(3) (defining "qualified mortgage"), or suffer tax penalties, *see id.* § 860F(a) (imposing a 100 percent tax penalty on net income from prohibited transactions). As a result, MBS transactions are carefully designed to prohibit any activities that would jeopardize pass-through tax status, and tax opinion letters are used to instill confidence in the pass-through status.

147. Financial institutions are required to hold regulatory capital and reserve for losses against their assets. Regulatory-capital requirements follow from Generally Accepted Accounting Principles. Sale treatment enables off-balance-sheet accounting treatment, which reduces regulatory capital, thereby enabling increased leverage and greater returns on equity, all else equal.

Figure 1. Transfer of Note and Mortgage in Typical Securitization



Although securitization enables investors to invest based only on the risks involved in the segregated assets, most MBS investors do not want to assume credit risk. This is because they recognize that they are at an inherent informational disadvantage regarding credit risk to the financial institutions that package and sell MBS. In other words, a lemons problem lurks in MBS.[148] As a result, most MBS are structured to eliminate all but nominal credit risk.[149] So-called "Agency" MBS (Ginnie Mae, Fannie Mae, and Freddie Mac MBS) are guaranteed explicitly or implicitly by the U.S. government.[150] Non-Agency or

148. *See generally* George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q. J. ECON. 488 (1970) (hypothesizing lemons markets); *see also, e.g.*, Paul Calem, Christopher Henderson & Jonathan Liles, *"Cherry Picking" in Subprime Mortgage Securitizations: Which Subprime Mortgage Loans Were Sold by Depository Institutions Prior to the Crisis of 2007?*, 20 J. HOUSING ECON. 120, 134 (2011) (finding empirical evidence that depositaries cherry-picked which loans to securitize based on dimensions of risk that investors tend to disregard or view overly optimistically); Chris Downing, Dwight Jaffe & Nancy Wallace, *Is the Market for Mortgage-Backed Securities a Market for Lemons?*, 22 REV. FIN. STUDIES 2457, 2459 (2009) (finding evidence of a "lemons spread" in Freddie Mac securitizations).

149. *See* Kathleen C. Engel & Patricia A. McCoy, *Turning a Blind Eye: Wall Street Finance of Predatory Lending*, 75 FORDHAM L. REV. 2039, 2054–76 (2007) (noting how MBS are structured to allay lemons concerns).

150. Ginnie Mae MBS are backed by the full faith and credit of the U.S. government. Fannie Mae and Freddie Mac MBS are guaranteed by these GSEs and are perceived to be

"private-label" MBS utilize a variety of credit enhancements to reduce credit risk, most importantly, senior-subordinate tranching, meaning that the MBS are issued in a senior-subordinate structure, with the senior MBS being repaid before the subordinate MBS.[151] As a result, over 90 percent of private-label MBS are rated AAA at issuance,[152] meaning that both default risk and loss-given-default are expected to be negligible. Accordingly, AAA-rated MBS are effective investment substitutes for Agency MBS, with comparable risks and returns.

Investors in these AAA-rated, private-label MBS generally believed that they were assuming only interest-rate risk, not credit risk. Were it otherwise, they would have demanded higher yields than treasuries or Agency MBS, which could only be supported by higher interest-rate mortgages. Thus, to make securitization a competitive method of financing mortgages, it was necessary to convince most MBS investors that credit risk—meaning both the risk of competing claims and the risk of enforcement of the mortgages—had been neutralized.

Securitization thus reproduces key features of both negotiability and mortgage recordation: freedom from claims and enhanced enforceability.[153] Securitization replicates freedom from claims through the creation of a segregated asset pool that is free from the claims of creditors of the entity that created the pool. For investors in AAA-rated tranches, securitization also reproduces the effect of enforcement rights through credit enhancement. The AAA-investors can count on getting paid, irrespective of the defenses that can be raised to the mortgages or limitations on enforcements. Beyond this, securitization creates liquidity in the form of readily transferable securities (which may themselves be negotiable under UCC Article 8). In short, securitization is "synthetic negotiability."

The quality of this synthetic negotiability varies depending on the level of credit enhancement, but significantly, it is achieved without requiring the demonstrative formalities of UCC Article 3 or

implicitly backed by the U.S. government. For the technical workings of these different types of MBS, see Levitin & Wachter, *supra* note 135, at 1144–48, 1159–63.

151. *See* Levitin & Wachter, *supra* note 133, at 1191–92 (detailing credit-enhancement structures in private-label MBS).

152. *See* Jie He, Jun Qian & Phillip E. Strahan, *Credit Ratings and the Evolution of the Mortgage-Backed Securities Market*, 101 AM. ECON. REV. PAPERS & PROCS. 131, 133–34 (2011).

153. *See* Janger, *supra* note 91, at 41–43 (noting how securitization replicates key features of negotiability to enhance liquidity).

land recordation.[154] For all MBS investors, however, freedom from claims is contingent upon being able to prove that the transfer of the mortgage loans to the trust was in fact a sale rather than a financing. The entire edifice of securitization depends upon being able to show that the transfers did in fact occur, which is a matter of mortgage title systems.

III. SECURITIZATION-ERA MORTGAGE TITLE SYSTEMS

Public demonstration regimes like UCC Article 3 and land recordation fit well with a paper-based economy in which mortgage loans did not undergo repeated transfers. They are an uncomfortable fit, however, with the twenty-first-century shift in the medium of business from paper to electronic.[155] Nor do they work well with securitization because securitization involves multiple mass transfers of assets—at a minimum from the originator to the seller to the depositor to the trust. Each separate transfer would require compliance with costly formalities in a public demonstration regime, including physical movements of paper.

The securitization industry—meaning the financial institutions that package and sell MBS (the “sell-side”)—attempted to evolve out of the transaction costs created by public demonstration regimes through both private ordering and law reform. The securitization industry created a private mortgage registry known as the MERS as a means of moving most of its transactions out of the public land-records system, thereby avoiding recordation fees. And through a little-noticed provision included as part of a major revision of Article 9 of the UCC, a new mechanism was created for transferring mortgage notes. Through the MERS and the UCC revision, the securitization industry created a pair of “contracting” regimes for mortgage title that substitute for the traditional public demonstration regimes. These contracting regimes did not reconcile the tension between title systems, and the financial crisis has begun to pull back the curtain on a dysfunctional market infrastructure.

154. *See id.*

155. *See* Cohen, *supra* note 39, at 162 (“The worlds of finance and commerce have changed dramatically [since the late eighteenth century], but the law of notes has been largely constant. This phenomenon—changing commercial practices governed by unchanging law—is the recipe for a commercial calamity.”).

A. MERS

1. *MERS Background*. MERS operates a private mortgage registry known as the MERS System.[156] MERS was created in 1993 by the major sell-side players in the residential-mortgage market to provide an efficient electronic mortgage recording system that tracks ownership and servicing interests in mortgages without requiring recordation of transfers in local land records.[157] The creation of MERS was driven by the demands of mortgage securitization.[158] MERS gained such widespread adoption that by 2007, it was estimated that 60 percent of mortgages outstanding were held in MERS's name,[159] roughly corresponding to the percentage of outstanding mortgage dollars that were securitized.

MERS is a private, contractual superstructure that is grafted onto the public land-recordation system. Financial institutions that are members of MERS register the loans they service (but do not necessarily own) with the MERS System electronic database. Each loan receives a unique identifier known as a MERS Identification Number (MIN). The MIN is sometimes stamped on the note or sometimes simply recorded in the lender's own records. MERS is then inserted in the local land records as the mortgagee, instead of the actual lender. Sometimes this involves an assignment of the mortgage from the lender to MERS, but the more prevalent arrangement has MERS recorded as the original mortgagee, thereby obviating any recordation of assignments. MERS serves as the mortgagee of record, but only as a nominee for the actual lender and supposedly for its successors and assigns.[160] The language included in MERS mortgages is that MERS is acting "solely as nominee for Lender and Lender's successors and assigns."[161] MERS claims no beneficial interest whatsoever in the loan.

156. MERS is a subsidiary of MERSCORP Holdings, Inc., which is in turn owned by a consortium of financial institutions. *About Us*, MERS, http://www.mersinc.org/about-us/about-us (last visited Oct. 19, 2013).

157. Culhane v. Aurora Loan Servs., 826 F. Supp. 2d 352, 368 (D. Mass. 2011); David P. Weber, *The Magic of the Mortgage Electronic Registration System: It Is and It Isn't*, 85 AM. BANKR. L.J. 239, 239 (2011).

158. Christopher L. Peterson, *Two Faces: Demystifying the Mortgage Electronic Registration System's Land Title Theory*, 53 WM. & MARY L. REV. 111, 116 (2011).

159. Kate Berry, *Foreclosures Turn up Heat on MERS*, AM. BANKER (July 10, 2007, 1:00 AM), http://www.americanbanker.com/issues/172_135/-316827-1.html.

160. Peterson, *supra* note 158, at 118.

161. *See* Motion for Summary Judgment Exhibit B, *supra* note 53, at 3.

MERS's goal is to immobilize mortgage title through a common-agency structure by acting as nominee for the lender and those subsequent transferees of the lender that are members of MERS. Although legal title remains in MERS's name, subsequent transfers are supposed to be tracked in MERS's database. Thus, MERS aims to achieve the priority and enforcement benefits of public recordation while tracking beneficial ownership title in its own database.

MERS's operation has two important implications. First, instead of paying county recordation and transfer fees, financial institutions pay only for MERS membership and MERS transaction fees.[162] MERS thus offers potential cost savings in the securitization process through the avoidance of local recording fees. Second, MERS's electronic database, not the county land records, represents the main evidentiary source for determining who is currently the real party in interest on a mortgage.

In theory, MERS's database tracks two distinct characteristics: the identity of the party with the rights to service the mortgage (often an agent for the trustee for the trust created for the ultimate beneficial owners of the mortgage loan) and the legal title to mortgages (for example, the trustee for the trust created for the ultimate beneficial owners of the mortgage).[163] MERS's publicly available records do not track *chain* of title. It is impossible for outsiders to determine if transfers were made in the MERS system and when.[164] Instead, MERS publicly tracks only the current servicer and sometimes the current beneficial owner of a loan.[165]

A major problem with MERS as a title system is that it is not accurate and reliable in terms of what it reports. MERS's members are nominally required to report transfers of mortgage servicing rights to MERS, but MERS does not actually compel reporting of servicing-rights transfers, and there is little incentive to be punctual

162. Peterson, *supra* note 158, at 117. MERSCORP, Inc.'s parent, MERSCORP Holdings, Inc., is owned by the some of the largest banks, servicers, private mortgage insurers, and Fannie Mae and Freddie Mac. *Shareholders*, MERS, http://www.mersinc.org/about-us/shareholders (last visited Oct. 19, 2013).

163. MERS states that it tracks "beneficial ownership interests," but by this MERS really means legal title, rather than ultimate beneficial interests. *See FAQ*, MERS, http://www.mersinc.org/information-for-homeowners/faq-information-for-homeowners (last visited Oct. 19, 2013) ("The MERS® System is a national electronic database that tracks changes in mortgage servicing rights and beneficial ownership interests in loans secured by residential real estate.").

164. Peterson, *supra* note 158, at 125–30. Internally, MERS is able to track servicing transfers and transfers of beneficial ownership, but only to the extent reported by servicers.

165. *Id.* at 129.

with reporting.[166] Indeed, the lack of record validation combined with voluntary reporting has led a federal judge to describe MERS as "the Wikipedia of land registration systems."[167] Not surprisingly, the information in the MERS database is often inaccurate or incomplete.[168]

MERS does not even formally require any reporting of legal title to the mortgages, much less of transfers of legal title; any information about legal title is supplied through strictly voluntary reporting.[169] When MERS does list the legal title, its database typically lists the name of the securitization trustee if the mortgage is securitized, but not the particular designation of the securitization trust.[170] Given that these trustees are financial institutions acting not in their own capacity, nor even as generic trustees (such a capacity not existing), but trustees for particular trusts (for example, Bank of New York Mellon as trustee for Countrywide Alternative Loan Trust 2005-35CB, rather than simply Bank of New York Mellon or Bank of New York Mellon as trustee), this disclosure is of limited use for determining property rights because the leading trustee banks serve thousands of distinct trusts. MERS, then, is really the agent of an agent (the servicer) of a trustee for the ultimate beneficiaries of the mortgage. In the MERS system, the link between the real economic interest in a mortgage and recorded title is long and attenuated.

MERS's database functions as a do-it-yourself private mortgage recordation system. Historically, MERS itself has had only around fifty employees who perform corporate and technology support functions.[171] Employees of MERS's members carry out most of the tasks done in MERS's name, including the making of entries in the

166. *See* Verified Complaint at 4–5, Delaware v. MERSCORP, Inc., No. 6987-CS, 2012 WL 1949867 (Del. Ch. May 23, 2012), 2011 WL 5128209. The Federal Truth in Lending Act, 15 U.S.C. § 1641(g) (2012), and the Real Estate Settlement Procedures Act, 12 U.S.C. §§ 2605(b)–(c), require that borrowers be notified of changes in ownership or servicing.

167. Culhane v. Aurora Loan Servs., 826 F. Supp. 2d 352, 368 (D. Mass. 2011).

168. *See, e.g.*, Verified Complaint, *supra* note 166, at 5 (alleging a 21 percent inaccuracy rate for MERS recording in a sample of one hundred loans); AEQUITAS COMPLIANCE SOLUTIONS, FORECLOSURE IN CALIFORNIA: A CRISIS OF COMPLIANCE 13 (2012), *available at* http://aequitasaudit.com/images/aequitas_sf_report.pdf (noting that MERS records matched with the deed-of-trust beneficiary only 42 percent of the time); Alan M. White, *Losing the Paper—Mortgage Assignments, Note Transfers and Consumer Protection*, 24 LOY. CONSUMER L. REV. 468, 486–87 (2012).

169. Peterson, *supra* note 158, at 117, 127.

170. *Id.* at 129.

171. Verified Complaint, *supra* note 166, at 8.

MERS database. These employees of MERS's members are listed as assistant secretaries or vice presidents of MERS, but they have no actual employment relationship with MERS. There are over twenty thousand of these "corporate signing officers."[172] Accordingly, a transfer of either servicing or legal title in the MERS system involves nothing more than an employee of a MERS member entering the transfer in the MERS database.

A transfer within the MERS system involves voluntary self-reporting and nothing more and therefore fails to incentivize timely, accurate reporting. There are no formalities to a transfer in the MERS system. As a result, MERS may not in fact know who its principal is within the common-agency arrangement at any given point in time because MERS is relying on reporting from its members.

2. *Structural Problems with MERS.* Beyond lack of reliable accuracy, MERS's registry is problematic as a title system because it stands on uncertain legal grounds. MERS lacks statutory authority. To the extent the MERS suffices to perfect and track interests in mortgages, it is on the basis of agency-law principles. But this only raises a host of questions: Can a mortgage be perfected by recording it in the name of a common agent, or does state law require mortgages be recorded in the name of the legal owner? The UCC expressly permits financing statements for security interests in personalty to be recorded in the name of "a representative of the secured party"[173] and that failure to indicate this representative capacity does not affect the validity of a UCC financing statement.[174] But parallel provisions are not found in state mortgage recordation statutes. If recordation in the name of a common agent is allowed, what happens when the mortgage is transferred to a party that is not a principal of the common agent? And is there a limit to how attenuated this agency may be? What is the effect of a sham subagency arrangement? These issues are considered below.

a. Lack of Statutory Authorization. MERS is designed to operate like the Depository Trust Company (DTC), but for mortgage loans instead of securities. Historically, securities transactions cleared

172. *Id.* at 9–10.
173. UCC § 9-502(a)(2) (2011).
174. *Id.* § 9-503(d).

physically: the seller of a security had to deliver the physical stock certificate—itself a type of negotiable instrument—or bond to the buyer.[175] This was an obviously cumbersome system, and by the mid-1960s rising trading volume had overwhelmed Wall Street.[176] By 1968, over fifteen-million trades were occurring daily, all necessitating physical delivery.[177] Back offices became overwhelmed and deliveries lagged, creating major problems in the market as parties failed to meet their delivery obligations.[178] In December 1968 alone, no less than $4.12 billion in trades failed to meet on-time delivery. The liability from these operational deficiencies set off "the greatest rash of broker-dealer firm failures in Wall Street's history."[179]

A critical part of the solution to the "Wall Street Paperwork Crisis" was the creation of the DTC. The DTC used a common-agency structure with a book-entry record system to immobilize physical securities.[180] In the DTC system, instead of individual investors being listed as registered securities' owners with various firms, the DTC is listed in corporate-securities registrations, using the name Cede & Co., as common nominee for the investors.[181] The physical securities are then held in the DTC's vaults, and the DTC tracks the ownership of the securities on its books.[182] The DTC now immobilizes between 85 and 90 percent of all equities, corporate, and municipal bonds issued in paper form in the United States.[183]

The DTC acts as a common agent for all parties using its services, substituting its own book-entry system for those of the individual securities' issuers.[184] Thus, instead of thousands of separate book-entry systems, each requiring paper to move back and forth for

175. Indeed, many bonds were issued in bearer form prior to the 1982 federal prohibition on domestic issuance of bearer bonds.

176. *See* Wyatt Wells, *Certificates and Computers: The Remaking of Wall Street, 1967 to 1971*, 74 BUS. HIST. REV. 193, 193–200 (2000).

177. ALEC BENN, THE UNSEEN WALL STREET OF 1969–1975, at 14 (2000).

178. Wells, *supra* note 176, at 203–06.

179. JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET 452 (3d ed. 2003).

180. VIRGINIA B. MORRIS & STUART Z. GOLDSTEIN, GUIDE TO CLEARANCE & SETTLEMENT: AN INTRODUCTION TO DTCC 6–7 (2009).

181. VIRGINIA B. MORRIS & STUART Z. GOLDSTEIN, LIFE CYCLE OF A SECURITY 9–10 (2010). "Cede" is an acronym for "Central Depository." *Id.* at 9.

182. MORRIS & GOLDSTEIN, *supra* note 180, at 6–7.

183. MORRIS & GOLDSTEIN, *supra* note 181, at 10.

184. *Id.* Although MERS is designed to operate as a common agency, one potential complication is that the depositor entities in securitizations are almost never MERS members and thus have not consented to the common agency.

every transaction, the DTC uses a single book-entry system without any movement of paper.[185] Although the use of the DTC is not required for individual investors, its use is virtually mandated for institutional transactions.[186]

MERS copies the DTC structure by inserting itself, rather than the lender, as the mortgagee in the local land records to immobilize legal title to mortgages and then by tracking the beneficial ownership (or at least the servicing agent of the beneficial owner) of the mortgages in its book-entry system.[187] MERS was designed to obviate the need for paperwork to move for transfers to occur in its book-entry system. The idea animating MERS is to "[p]rocess loans, not paperwork."[188]

Critically, the DTC operates within a statutory framework. It is a "securities intermediary" under UCC Article 8.[189] This means that even though the physical securities are held by the DTC, they are not the DTC's property but the property of the investors.[190] The DTC also has legal duties to comply with the investors' instructions,[191] and the investors' rights vis-à-vis third parties are set out by statute.[192] The Securities and Exchange Commission (SEC) also regulates the DTC as a registered clearing agency, so DTC rules must be approved by the SEC.[193]

185. MORRIS & GOLDSTEIN, *supra* note 180, at 7.

186. *See* 15 U.S.C. § 78q-1(e) (2012) (requiring the SEC to "use its authority . . . to end the physical movement of securities certificates in connection with the settlement among brokers and dealers of transactions in securities").

187. Note that because the beneficial owners of a MERS registered mortgage are typically trusts, the real economic beneficiaries in interest, the MBS investors, are yet a further step removed.

188. Michelle Conlin, *State Court Ruling Deals Blow to U.S. Bank Mortgage System*, REUTERS, Sept. 14, 2012, *available at* http://www.reuters.com/article/2012/09/14/us-foreclosures-courtcase-washington-idUSBRE88D1OF20120914.

189. *See* U.C.C. § 8-102(a)(14) (2011).

190. *See id.* § 8-102(a)(9) (defining "financial asset"); *id.* § 8-102(a)(15) (defining "security"); § 8-102(a)(17) (defining "security entitlement"); *id.* § 8-501 (creating security entitlement); *id.* § 8-503 (providing that "all interests" in a financial asset held by a "securities intermediary" are the property interest of the security-entitlement holder, not the securities intermediary).

191. *See id.* §§ 8-506, 8-507.

192. *Id.* §§ 8-502, 8-510, 8-511.

193. *See* 15 U.S.C. §§ 78s, 78q-1 (2012).

No equivalent statutory or regulatory framework exists for MERS.[194] Instead, MERS is a set of private contractual arrangements grafted onto a preexisting public legal structure—local land-recording offices. The closest MERS comes to a legal authorization is a questionable opinion letter from Covington & Burling LLP that lacks a fifty-state analysis of MERS's operations, despite variations in real-property law that could very well affect MERS's validity for various functions.[195] Lacking a statutory framework, MERS stands on principles of agency law, but the interaction of agency law with mortgage recordation statutes is not well-established.

To the extent that land records are merely meant to serve as a notice system regarding potential claims, rather than as a title system defining rights, recordation in the name of an agent should not present a problem. But if land records are meant to also perform a title function—and they do on a de facto basis, as well as providing a de jure presumption of title—then recording a mortgage in the name of an agent like MERS seems more problematic. As a positive matter, there is a question of the interaction of what state recordation statutes provide. But as a normative matter that potentially affects judicial interpretation of recordation statutes, there is a public interest in having transparency of ownership in society.[196] In the case of mortgage loans, there is a particular public interest in transparency so as to facilitate the restructuring of distressed mortgages. If a homeowner cannot figure out whom to contact about the mortgage, restructuring is likely to be frustrated, even if it is efficient from a net-social-welfare perspective.[197]

This is not to say that MERS is illegal or invalid, but merely to observe that it does not stand on the same sort of legal authority as the DTC model. As a result, there are questions about the legal effect

194. In contrast, the UCC contemplates states using private parties to maintain state UCC filing systems. *See* UCC § 9-501 legislative note.

195. Memorandum from Covington & Burling to R.K. Arnold, President and CEO, MERSCORP, Inc. (Sept. 1, 1997) (on file with the *Duke Law Journal*) (providing a legal opinion on MERS as an original mortgagee, now the dominant form of MERS operations).

196. Although ownership interests could also be masked via the use of subsidiaries, limited-liability parent-subsidiary relationships are recorded in public records, whereas agency relationships (and general partnerships and joint ventures) are matters of private contract.

197. *See, e.g.*, Tamburri v. Suntrust Mortg., Inc., No. C-11-2899 EMC, 2011 WL 6294472, at *2 (N.D. Cal. Dec. 15, 2011) (describing plaintiff homeowner's attempts to determine whom to contact regarding alternatives to foreclosure on her securitized mortgage). Full disclosure: I was retained as an expert witness for the plaintiff in this case, subsequent to the issuance of this opinion.

of MERS's records that simply do not exist for the DTC's records. The underpinnings of roughly 60 percent of mortgage titles in the United States are based on a questionable opinion letter. A 2012 federal district court ruling in an unjust enrichment suit by a Pennsylvania county recorder of deeds has indicated that mortgages assigned in the MERS system are not perfected under Pennsylvania law.[198]

b. Failure of Common Agency. Because MERS stands on common-law agency principles, its authority is limited to the extent that it is an agent. Although recordation in the name of a common agent might work in theory, this is not what happened in most private-label securitization transactions. (A different story exists for government-sponsored enterprise (GSE) securitizations, where bankruptcy remoteness is not a concern.) In most securitization transactions, the sponsor and the servicer are MERS members, but not the depositor or the trustee in its role as trustee (the trustee may belong to MERS in its corporate identity, but not in its trustee identity). To the extent that MERS is not an agent for either depositor or trustee, its common-agency structure might not work.

The depositor in most private-label securitization transactions is a special-purpose subsidiary of the sponsor.[199] Depositors are typically not members of MERS. The depositor is, after all, only a legal-fiction entity used to segregate the mortgages from the other assets of the sponsor. Often the depositor will have no employees or assets other than the mortgages (and associated notes). Therefore, no one ever bothered having the depositors be MERS members, because depositors are understood to be nothing more than a legal fiction required by the rating agencies' concerns over bankruptcy remoteness. Thus, only sponsors and servicers were MERS members.

MERS's common-agency structure would seem to break down without depositor membership. As stated on its trust deeds, MERS "is acting solely as a nominee for Lender and Lender's successors and

198. *See* Montgomery Cnty. v. MERSCORP, Inc., 904 F. Supp. 2d 436, 445 (E.D. Pa. 2012) (holding that the "shall be recorded" language in the Pennsylvania recording statute requires all real-estate conveyances, including assignments of mortgages, to be recorded); *see also* Mortg. Elec. Registration Sys. v. Sw. Homes of Ark., Inc., 301 S.W.3d 1, 5 (Ark. 2009) (holding that MERS was not required to receive notice of the foreclosure of a junior lien because it had no interest in the deed of trust).

199. Adam J. Levitin & Tara Twomey, *Mortgage Servicing*, 28 YALE J. ON REG. 1, 13 (2011). The depositor will also be the SEC shelf registrant.

assigns."[200] But that would be true only to the extent that the successors and assigns accept the agency relationship. The most obvious indication of acceptance of the agency relationship—MERS membership—does not apply to the depositor. Perhaps there is apparent authority, but that is certainly not how the common agency of MERS is supposed to work. If MERS is not an agent of the depositor, it is unclear what, if any, effect there would be from the mortgage continuing to be recorded in MERS's name.

In most states, there would still presumably be a valid mortgage enforceable against the borrower,[201] but the mortgage might not be perfected as against competing liens and purchasers. If the mortgage becomes unperfected upon transfer to the depositor because it is not recorded in the name of the depositor (or the depositor's agent), any preexisting junior mortgage on the property would then become the senior mortgage, absent a resubordination agreement.[202] Similarly, any subsequent recorded lien or sale would take priority to the now unperfected mortgage.

In most securitizations, the mortgage is only held by the depositor for a nanosecond. The transfer from the sponsor to the depositor is deemed to be instantaneously followed by the transfer from the depositor to the trust.[203] Therefore, if the mortgage were subsequently perfected in the hands of the trust, its brief moment of lack of perfection would not matter unless there was already a junior mortgage on the property; subsequent liens and sale are unlikely to be an issue. In many cases, however, there was in fact a junior mortgage on the property at the time of the securitization of the MERS mortgage. Thus, it is possible that many junior liens on

200. *See, e.g.*, James v. ReconTrust Co., 845 F. Supp. 2d 1145, 1152 (D. Ore. 2012) (emphasis omitted).

201. *See supra* notes 118–22 and accompanying text.

202. *See* RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 7.3 (1997).

203. *See, e.g.*, Pooling and Servicing Agreement, Alternative Loan Trust 2005-35CB § 2.01(a)–(b) (July 1, 2005), *available at* http://www.sec.gov/Archives/edgar/data/1334744/000090514805004294/efc5-1780_5738503ex991.txt ("Each Seller, concurrently with the execution and delivery hereof, hereby sells, transfers, assigns, sets over and otherwise conveys to the Depositor, without recourse, all its respective right, title and interest in and to the related Initial Mortgage Loans . . . . Immediately upon the conveyance of the Initial Mortgage Loans referred to in clause (a), the Depositor sells, transfers, assigns, sets over and otherwise conveys to the Trustee for the benefit of the Certificateholders, without recourse, all the right, title and interest of the Depositor in and to the Trust Fund . . . ."). This particular PSA contains duplicative transfer language. *See id.* § 2.04 ("The Depositor hereby assigns, transfers and conveys to the Trustee all of its rights with respect to the Mortgage Loans including, without limitation, the representations and warranties of each Seller made pursuant to Section 2.03(a) . . . .").

mortgages in private-label securitizations may be entitled to senior priority status because of the depositor lapse in the MERS system.[204]

Even in cases in which there is not a preexisting junior mortgage on the same property, the depositor lapse in MERS's common-agency system raises questions about perfection in the hands of the trustee, meaning whether the trustee's mortgage will have priority over competing interests in the mortgaged property. Does the common agency spring again when the mortgage is transferred to the trust? Or is a new recording required? There is no clear answer to this, but securitization industry practice has not taken MERS common-agency structure seriously, in part because doing so would increase operating burdens and costs.

c. Sham Agency. MERS's use of corporate signing officers that are actually employees of MERS's members arguably indicates that MERS's entire common-agency structure is a sham and that there is not in fact any real agency relationship, but rather simply principals dealing directly with each other.[205] MERS exercises no control over the corporate signing officers.[206] MERS's corporate signing officers are not meaningfully acting on MERS's behalf, as they receive and take no direction from MERS, but instead are acting on behalf of their actual employers.[207] Indeed, as MERS itself notes, "a certifying

204. A further complication is that securitization trustees are not members of MERS in their trustee capacities. Trustees and servicers would seem to have authority for the use of MERS, however, as it is clearly contemplated in PSAs. *See id.* § 2.01(c)(ii) (requiring delivery to the trustee "for each Mortgage Loan that is not a MERS Mortgage Loan, the original recorded Mortgage or a copy of such Mortgage certified by Countrywide as being a true and complete copy of the Mortgage . . . and in the case of each MERS Mortgage Loan, the original Mortgage, noting the presence of the MIN of the Mortgage Loans").

205. *See* Culhane v. Aurora Loan Servs., 826 F. Supp. 2d 352 (D. Mass. 2011) ("This Court is deeply troubled that, with little to no oversight, individuals without any tie to or knowledge of the company on whose behalf they are acting may assign mortgages—that is, they may transfer legal title to *someone else's home*. Equally troubling is the conflict of interest posed by these certifying officers wearing 'two hats' simultaneously: that of assignor (as agent for MERS) and assignee (as employee of the note holder or its servicing agent). Indeed, a MERS certifying officer is more akin to an Admiral in the Georgia navy or a Kentucky Colonel with benefits than he is to any genuine financial officer. In its rush to cash in on the sale of mortgage-backed securities, the MERS system supplies the thinnest possible veneer of formality and legality to the wholesale marketing of home mortgages to large institutional investors." (citations omitted)).

206. *See* Verified Complaint at 4, Delaware v. MERSCORP, Inc., No. 6987-CS, 2012 WL 1949867 (Del. Ch. May 23, 2012), 2011 WL 5128209.

207. *Cf.* RESTATEMENT (THIRD) OF AGENCY § 1.01 (2006) (defining "agency" as requiring the agent to be acting on the principal's behalf); *id.* § 3.15 (noting that subagency relationships are defined by section 1.01).

or signing officer is authorized to act on MERS's behalf only with respect to loans and mortgages registered in the MERS® System by the Member for which the certifying or signing officer is an officer."[208] This indicates that the entire use of common agency by MERS is in fact a sham that courts might disregard if properly challenged, with the result that MERS mortgages would be unperfected.[209]

MERS was the creation of the sell-side of the securitization industry, not MBS investors (the "buy-side"). MERS's purpose was to facilitate securitization on the front end by reducing the cost and time of recording mortgage transfers. Disregard of or corner cutting on agency-law principles helped further accomplish these cost and time savings. Though MERS accomplished up-front cost and time savings, it came at the cost of less clarity in terms of property rights

208. *See* Defendants' Opening Brief in Support of Their Motion To Dismiss the Verified Complaint for Lack of Jurisdiction and Failure To State a Claim upon Which Relief Can Be Granted at 11, Delaware v. MERSCORP, Inc., 2012 WL 1949867 (No. 6987-CS), 2012 WL 168257.

209. UCC § 9-313 cmt. 3 ("The fact of dual agency is not of itself inconsistent with the secured party's having taken possession . . . . The debtor cannot qualify as an agent for the secured party for purposes of the secured party's taking possession. And, under appropriate circumstances, a court may determine that a person in possession is so closely connected to or controlled by the debtor that the debtor has retained effective possession, even though the person may have agreed to take possession on behalf of the secured party. If so, the person's taking possession would not constitute the secured party's taking possession and would not be sufficient for perfection."). As a "secured party" and "debtor" are defined in UCC Article 9 as respectively including a buyer and a seller of a promissory note, *id.* §§ 9-102(a)(72)(D), 9-102(a)(28)(B), the comment can be read as "The fact of dual agency is not itself inconsistent with the buyer of the promissory note having taken possession . . . . The seller of the note cannot qualify as an agent for the buyer of the note for purposes of the buyer's taking possession. And under appropriate circumstances a court may determining that a person in possession is so closely connected to or controlled by the seller that the seller has retained effective possession, even though the person may have agreed to take possession on behalf of the buyer. If so, the person's taking possession would not constitute the buyer's taking possession and would not be sufficient for giving the buyer superior title to competing parties." Thus, even if one were to take the agency of MERS's corporate signing officers seriously, they only complicate the agency structure underlying MERS. MERS is the common agent of mortgage servicers, but the servicers' employees are then the agents of MERS. Can a principal be an agent's subagent? Or is this recursivity equivalent to the song "I'm My Own Grandpaw"? LONZO AND OSCAR, *I'm My Own Grandpaw*, *on* THE VERY BEST OF (Vintage Masters Inc. 2012) (1947). A separate set of dual agency issues exists with respect to document custodians and bailees in securitizations.

There is not an explicit "merger" doctrine in agency law providing that recursive agency arrangements can be disregarded, but it is not hard to imagine a court adopting such a principle. Similar merger doctrines exist in other areas of law. For example, when a party is both an owner and mortgagee on a property, the law treats it solely as an owner. *See, e.g.*, 31 C.J.S. *Estates* § 153 (2008) ("Whenever a greater and a less estate coincide and meet in one and the same person, without any intermediate estate, the less is immediately merged in the greater, and thus annihilated.").

(not to mention perhaps the most extreme case of stretching corporate formalities), resulting in enormous problems on the back end for collections, a cost borne by the buy-side, not the sell-side.

B. Revised UCC Articles 1 and 9

Since 2001, an additional method of transferring notes and mortgages has been available, known only to a handful of cognoscenti within the securitization industry. Articles 1 and 9 of the UCC were revised in 2001 and now operate to provide a mechanism for a sale of promissory notes and mortgages with no more formalities than an enforceable written sale contract.

Lawyers typically think of UCC Article 9 as providing "a comprehensive scheme for the regulation of security interests in personal property and fixtures."[210] Article 9, however, also governs some types of sales. This is because the definition of "security interest," which appears in Article 1, includes not only liens—contingent transfers of ownership—but also certain sales—outright transfers of ownership.[211]

In 1998, the American Law Institute and Uniform Law Commissioners approved a model version of a major revision of UCC Articles 1 and 9.[212] Every state except for South Carolina adopted the Article 1 revision, whereas all fifty states adopted the Article 9 revision. The Article 9 revisions were effective in most states as of July 1, 2001, and in all states by January 1, 2002.[213] One of the goals of the revision was to "bring the commercial law setting for securitization into the twenty-first century"[214] or, as a history of the

210. *See* U.C.C. § 9-101 cmt. 1 (2001).

211. U.C.C. § 1-201(b)(35) (2011). UCC Article 9 has always covered sales of chattel paper but required filing for perfection. *See id.* §§ 9-109(a)(3), 9-310(a).

212. Harry C. Sigman & Edwin E. Smith, *Revised U.C.C. Article 9's Transition Rules: Insuring a Soft Landing—Part II*, 55 BUS. LAW. 1763, 1763 n.1 (2000).

213. *See* U.C.C. § 9-701. For example, Article 9 went into effect in Connecticut on October 1, 2001, and in Alabama, Florida, and Mississippi on January 1, 2002. Rod Clement, *The Proposed Amendments to Article 9 of the UCC and Mississippi Law: Changes to Individual Names, Registered Organizations and Trusts*, MISS. BUS. LAW. REP., Fall 2011, at 4, 10 n.3, *available at* https://msbar.org/media/268261/Business%20Law%20Reporter%20Fall%202011.pdf.

214. *See* Steven L. Schwarcz, *The Impact on Securitization of Revised UCC Article 9*, 74 CHI.-KENT L. REV. 947, 947 (1999).

revisions describes the process, it was about "Making Revised Article 9 Safe for Securitizations."[215]

As revised, Article 1 defines a "security interest" to include the interest of a buyer of a promissory note: "'[s]ecurity interest' means an interest in personal property or fixtures which secures payment or performance of an obligation. *'Security interest' includes any interest of . . . a buyer of* accounts, chattel paper, a payment intangible, or *a promissory note* in a transaction that is subject to Article 9."[216]

Revised Article 9 now also defines a "debtor" to include "a seller of . . . promissory notes,"[217] a "secured party" to include "a person to which . . . promissory notes have been sold,"[218] and "collateral" to include "promissory notes that have been sold."[219] Thus, in this new commercial cant, a debtor means a seller; a secured party means a buyer; collateral means promissory notes sold; a security interest is a sale; and a security agreement is a sale contract.

The result of these definitions is that the mechanism for creating an enforceable security interest is now also the mechanism for the sale of promissory notes.[220] Article 9 provides that

> a security interest is enforceable against the debtor and third parties with respect to the collateral only if
>
> (1) value has been given,
>
> (2) the debtor has rights in the collateral . . . and
>
> (3) . . .
>
> (A) the debtor has authenticated a security agreement that provides a description of the collateral . . . [or]
>
> (B) the collateral . . . is in the possession of the secured party . . . pursuant to the debtor's security agreement . . . .[221]

On its face, this provision is about the enforceability of security interests. Yet when read using the alternative definitions of "security

215. *See* Paul M. Shupack, *Making Revised Article 9 Safe for Securitizations: A Brief History*, 73 AM. BANKR. L.J. 167 (1999).

216. U.C.C. § 1-201(35) (emphasis added).

217. *Id.* § 9-102(28)(B).

218. *Id.* § 9-102(73)(D).

219. *Id.* § 9-102(12)(B).

220. South Carolina is an exception because it has not adopted the revised definition of security interest in Article 1.

221. *Id.* § 9-203(b).

interest," "debtor," "security agreement," and "secured party," the provision also provides that

> a sale is enforceable against the seller and third parties with respect to the promissory note sold, only if
>
> (1) value has been given,
>
> (2) the *seller* has rights in the *promissory note* . . . and
>
> (3) . . .
>
> (A) the *seller* has signed a *sale* agreement that provides a description of the *promissory note* . . . [or]
>
> (B) the *promissory note* . . . is in the possession of the *buyer* . . . pursuant to the *seller*'s *sale contract*.

Thus, through alternative definitions, the 2001 UCC revisions transformed a provision regarding the creation of security interests into a provision regarding the sale of promissory notes. All that Article 9 requires is that the seller sell a note to the buyer for value pursuant to a signed sale agreement with the notes covered being indicated either by delivery to the buyer or through description in the sale agreement. In other words, Article 9 merely requires an enforceable sale contract that complies with the Statute of Frauds.

The UCC further provides that a "security interest"—here, a sale of the note—"attaches to collateral when it becomes enforceable against the debtor with respect to the collateral."[222] This is important because attachment is the term that triggers a separate UCC provision specifying that a sale of a promissory note includes a sale of any associated mortgage:

> The attachment of a security interest in a right to payment or performance secured by a security interest or other lien on personal or real property is also attachment of a security interest in the security interest, mortgage, or other lien.[223]

Translated:

> The *enforceability* of a *sale* of a right to payment or performance secured by a security interest or other lien on personal or real property is also *an enforceable sale* of the security interest, mortgage or other lien.

222. *Id.* § 9-203(a).
223. *Id.* § 9-203(g).

In other words, UCC Article 9 codifies (but only for UCC Article 9 sales) the common-law doctrine that "the mortgage follows the note."[224] Article 9 thus creates a system for transfer and title of both promissory notes and mortgages.

The Article 9 sales provisions are drafted in an unusually misleading way that makes it virtually a secret, private law, known only to securitization-industry insiders. Article 9 creates a transfer method for negotiable notes that parallels, but does not supplant, Article 3, all without even labeling itself as a note transfer method. Someone searching for the law governing either note or mortgage transfers would be unlikely to discover the relevance of UCC Article 9. Someone looking for the law of notes would turn to Article 3, and one looking for the law of mortgages would turn to real-property law, not Article 9.

If, by chance, this intrepid researcher found the Article 1 definition as the result of say, a word search of a state code for "promissory note," its effect would not be obvious. The researcher would have to know that the UCC Article 1 definition of "security interest" is what controls the scope of UCC Article 9 and would then have to work through the other nonintuitive definitions in Article 9, such as "debtor" meaning "seller." Even then, the Article 9 "mortgage follows the note" provision is not obvious on its face. In short, although public law, the promissory-note sale provisions of UCC Articles 1 and 9 are drafted in a manner that has kept them in the private preserve of a small cadre of securitization deal lawyers. Beyond these cognoscenti, the Article 9 transfer method is all but unknown. Foreclosure lawyers for both banks and consumers remained unaware of the provision for nearly a decade. Indeed, prior to 2011 there was but one reported opinion that even referenced the UCC Article 9 provision for sale of a promissory note, and to date there have been fewer than a dozen opinions referencing the provision, even though the securitization industry claims that both Article 9 and Article 3 are used to transfer mortgage notes.[225]

Why would UCC Article 9 be drafted so strangely? Why go through linguistic contortions to seemingly reinvent what looks like a simple sale contract subject to the Statute of Frauds?

224. *See id.* § 9-203 cmt. 9 ("Subsection (g) codifies the common-law rule that a transfer of an obligation secured by a security interest or other lien on personal or real property also transfers the security interest or lien.").

225. AM. SECURITIZATION FORUM, *supra* note 106, at 3, 10, 15–16.

The answer can be found in another part of Revised Article 9, namely, the provisions dealing with "perfection" of security interests. The rights of a secured party in collateral vis-à-vis competing claimants, such as purchasers, creditors, or trustees in bankruptcy (who have the rights of various hypothetical purchasers and creditors[226]) are determined by the "priority" of their interests. Senior-most priority creates freedom from claims.

The priority of a security interest is generally determined by the earlier of the interest's filing or perfection.[227] Filing refers to the filing of a financing statement listing the name of the debtor and the secured party or its representative and describing the collateral in the appropriate public recording office. The requirements for perfection depend on the type of collateral,[228] but for security interests in (that is, the sales of) promissory notes, *perfection is automatic upon attachment*.[229] Perfection of the security interest in (that is, the sale of) any mortgage associated with the note is also automatic.[230]

All that is needed, then, for the sale of a promissory note and associated mortgage to be insulated against competing claims is the provision of value sufficient to support a simple contract,[231] a signed sale agreement, and either delivery or a sufficient description of the note. A generic description (for example, "notes") suffices.[232] No

226. *See* 11 U.S.C. § 544(a) (2012) (detailing the strong-arm powers of a trustee in bankruptcy).

227. U.C.C. § 9-322(a)(1); *see also id.* § 9-317(a)(1) ("A security interest . . . is subordinate to the rights of a person entitled to priority under Section 9-322 . . . .").

228. *Id.* § 9-308(a).

229. *Id.* § 9-309(4). UCC section 9-312(a) permits perfection by filing for instruments, which include promissory notes, whereas UCC section 9-313(a) provides that perfection in an instrument may be achieved by taking possession of the instrument.

230. *Id.* § 9-308(e).

231. *Compare id.* § 1-204 (defining "value"), *with* U.C.C. § 1-201(44) (2001) (defining "value" in the same manner).

232. The requirements for sufficiency of description are unclear. UCC section 9-108(a) requires only that the description "reasonably identif[y] what is described," and section 9-108(b) provides that description by category, quantity, or collateral type is sufficient. U.C.C. §§ 9-108(a)–(b) (2011). This requirement makes sense for a notice-filing system, but not when there is automatic perfection on attachment. Thus, a security agreement that covers simply "mortgage loans" would seem to qualify under section 9-108(a)–(b), but it provides no help whatsoever in determining which mortgage loans were actually sold, especially if the seller engaged in other similar sales. Nor is it clear how this provision interfaces with state law on real-estate transfers. In title-theory states, the description of the notes might need to be sufficient to comply with the formalities for the transfer of land because the mortgage transaction is understood as a sale and repurchase of the land. *See* U.S. Bank Nat'l Ass'n v. Ibanez, 941 N.E.2d 40, 51 (Mass. 2011).

filing need actually be made in a public recording office. In other words, Article 9 has created "zipless" perfection.[233] Article 9 perfection of a sale of a promissory note jettisons the long-standing "paperization principle" for creating certainty in rights as an unnecessary transaction cost.[234] Thus, the revision of Article 9 is an attempt to achieve the bright-line efficiency of a recordation-race system without its formalities.

"Perfection" is a secured-financing term, not a sales term. Sales, however, are not always clearly distinct from financings or leases.[235] Economically, a sale-and-repurchase agreement can look identical to a secured loan or a finance lease agreement. One might distinguish between a sale and a financing regarding the allocation of risk and reward on the asset transferred.[236] But often there is a less-than-complete transfer of both risk and reward. For example, in a nonrecourse loan, the debtor retains the upside potential on the assets, while the creditor assumes the downside risk because the debtor will default if the value of the collateral (to the debtor) is less than the amount due on the loan. Similarly, both a sale-and-lease-back transaction and a sale-and-repurchase transaction (a "repo") are often economically equivalent to a nonrecourse secured loan. And

Notably, the UCC does provide that for certain types of transactions, including "consumer transaction[s]," a description only by collateral type is insufficient. U.C.C. § 9-108(e). The sale of consumer promissory notes and mortgages, however, is not a "consumer transaction," as defined by section 9-102(26). Although in practice securitization documents that purport to effect sales under Article 9 are supposed to include schedules identifying the collateral covered, the UCC does not appear to require such schedules, even though absent such schedules, it is impossible to say when and if a particular promissory note and mortgage was in fact sold under Article 9.

Moreover, even when schedules of notes and mortgages exist, they are not necessarily integrated into the sales agreement, raising evidentiary issues. Unlike with a negotiable instrument, there is no necessary integration of the sale agreement and its schedules, so permitting generic descriptions enables latent ambiguity along the lines of the two ships in the *Peerless* problem, *see* Raffles v. Wichelhaus, (1864) 2 H. & C. 906, 159 Eng. Rep. 375 (Ct. of Exch.), as we cannot be sure exactly which mortgage loans were sold and when, especially if there were multiple sales.

233. *Cf.* ERICA JONG, FEAR OF FLYING 10 (1973).

234. *See* Clark, *supra* note 32, at 476–79.

235. *See* U.C.C. § 1-203(a) ("Whether a transaction in the form of a lease creates a lease or security interest is determined by the facts of each case."); § *id.* 9-318 cmt. 2 ("Neither this Article nor the definition of 'security interest' in Section 1-201 provides rules for distinguishing sales transactions from those that create a security interest securing an obligation.").

236. *See, e.g.*, 11 U.S.C. § 101(54) (2012) (defining "transfer" to include "the creation of a lien" or "the retention of title as a security interest"); Meredith Jackson, *Contracting out of Article 9*, 40 LOY. L.A. L. REV. 281, 285–95 (2007) (discussing the factors that courts have used to distinguish between sales, leases, and financings).

even a simple sale with warranties shifts some risk back to the seller. All of this means that there is some degree of uncertainty regarding whether a particular transaction is a sale or a financing. No bright-line rules exist.

Securitization tries to deal with this uncertainty through the use of "true sale" and "nonconsolidation" opinion letters from counsel attesting that if the transaction is done as described in the letter, then courts "should" (or sometimes "would") deem it a true sale.[237] If the transferor ends up in an insolvency proceeding and the lawyers are wrong, then the transfer would be judicially recharacterized as a secured financing.[238] The question would then turn to whether the financing was perfected. Prior to the 2001 Article 9 revisions, the financing would not be perfected unless a financing statement had been properly and timely filed.[239] Prophylactic filing can be done to protect against the contingency of judicial recharacterization, but it adds expense and might not be done properly. If unperfected, however, then the security interest could be avoided by a trustee in bankruptcy or by the Federal Deposit Insurance Corporation (FDIC), leaving the trust with a general unsecured claim in the insolvency proceeding.[240] In other words, if recharacterized and unperfected, the securitization trust (and thus investors) would not have the freedom from competing claims on which they based their economic bargain.[241]

The Article 9 revisions were designed to protect against this potential outcome.[242] Under Revised Article 9, even if the transaction were deemed a secured financing, rather than a sale, the secured financing would be automatically perfected.[243] Therefore, if a trustee in bankruptcy or the FDIC were to challenge the sale transaction, the worst outcome would be the demotion of the securitization trust from

237. *See* Steven L. Schwarcz, *The Limits of Lawyering: Legal Opinions in Structured Finance*, 84 TEX. L. REV. 1, 2–3 (2005) (discussing the function of securitization opinion letters).

238. *See* U.C.C. § 9-109 ("[T]his article applies to . . . a transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract . . . .").

239. Donald J. Rapson, *"Receivables" Financing Under Revised Article 9*, 73 AM. BANKR. L.J. 133, 137–38 (1999).

240. *See* 1 SECURITIZATION OF FINANCIAL ASSETS §§ 5.01, 5.06 (Jason H.P. Kravitt ed., 2d ed. Supp. 2007).

241. *Id.* § 3.04. Whether a transaction is in fact a sale or a security interest is not determined by the UCC.

242. *Id.* § 5.02[G][2]; *see* U.C.C. § 9-318.

243. Perfection would also create a perfected security interest in proceeds of the notes. U.C.C. §§ 9-203(f), 9-315(a)(2).

a buyer to a secured creditor; its claim to the collateral would come ahead of that of the trustee in bankruptcy or the FDIC, so freedom from competing claims would be preserved. In other words, although the sale-versus-security-interest question is still not decided by the UCC, the distinction may not particularly matter for promissory notes. By defining a "security interest" to include a "sale," the UCC created a legislative safety net for securitizations.

Article 9 creates freedom from claims without requiring the formalities of negotiation or recording. Because of the Article 9 "mortgage follows the note" provision,[244] transfers of mortgages that previously would have involved the recording of assignments in land records are now automatically perfected along with the perfection of the note.[245] By avoiding demonstrative formalities, Article 9 reduces the transaction costs involved in securitizing mortgages. In short, Article 9 created a securitization-friendly procedure that enabled freedom from competing claims to be achieved through a simple sale contract without requiring either formalities or filing. Significantly, however, as we shall see, Article 9 has no provisions for the enforcement of a promissory note.[246] Thus, although Article 9 facilitated the transfer of mortgage notes, it reduced the certainty in property rights in the notes needed for enforcement.

The expansion of UCC Article 9 to cover the transfer of mortgage notes raises another problem: interaction with state real-property law. No attempt was made to harmonize Article 9 with state law on real-property conveyances. For example, a generic description of mortgage notes by category (for example, "mortgage notes") or quantity (for example, "5000 mortgage loans") would appear to suffice under Article 9,[247] but state real-property law is likely to require a more specific description of property conveyed. Article 9 does not explicitly supersede other state law.[248] Article 9's interaction

244. *Id.* § 9-203(g).

245. *Id.* § 9-308(e).

246. Article 9 self-help repossession does not apply because, in Article 9 terms, the collateral is the promissory note itself, not the real property. *Id.* § 9-609.

247. *See supra* note 232.

248. The Official Commentary to Article 9—not enacted as law in most states—is of two minds. On the one hand, it sets forth that "an attempt to obtain or perfect a security interest in a secured obligation by complying with non-Article 9 law, as by an assignment of record of a real-property mortgage, would be ineffective," thereby implying that Article 9 controls. U.C.C. § 9-109 cmt. 7. On the other hand, the UCC itself provides that Article 9 "does not apply to the extent that . . . another statute of this State expressly governs the creation, perfection, priority, or enforcement of a security interest." *Id.* § 9-109(c). Whether the term "security interest" here

with state real-estate law is unclear, but it is hard to imagine that when states adopted the Article 9 revisions that *any* member of a state's legislature thought that the revision was changing state real-property-conveyance law.

Through its automatic perfection of mortgage assignments, the 2001 revision of UCC Article 9 purported to radically change real-estate law as practiced by obviating the need to record mortgage assignments to ensure perfection. The revision was done in such an under-the-radar manner, however, that only the lawyers who helped create securitization transactions—sell-side lawyers—were aware of it. Not only does this raise troubling questions about the legitimacy of the uniform lawmaking process, and the UCC Article 9 revisions in particular,[249] but because the UCC revisions were done so

should be read to include a lien on real property is unclear. The Official Commentary states that Article 9 "does not determine who has the power to release a mortgage of record." *Id.* § 9-308 cmt. 6.

249. There is a large body of literature about the political economy of the uniform lawmaking process. *See generally, e.g.*, Peter A. Alces & David Frisch, *Commercial Codification as Negotiation*, 32 U.C. DAVIS L. REV. 17 (1998); Peter A. Alces & David Frisch, *On the UCC Revision Process: A Reply to Dean Scott*, 37 WM. & MARY L. REV. 1217 (1996); Larry T. Garvin, *The Changed (and Changing?) Uniform Commercial Code*, 26 FLA. ST. U. L. REV. 285 (1999); Clayton P. Gillette, *Politics and Revision: A Comment on Scott*, 80 VA. L. REV. 1853 (1994); Gail Hillebrand, *What's Wrong with the Uniform Law Process?*, 52 HASTINGS L.J. 631 (2001); Edward J. Janger, *Predicting When the Uniform Law Process Will Fail: Article 9, Capture and the Race to the Bottom*, 83 IOWA L. REV. 569 (1998); Fred Miller, *Realism Not Idealism in Uniform Laws—Observations from the Revision of the UCC*, 39 S. TEX. L. REV. 707 (1998); A. Brooke Overby, *Modeling UCC Drafting*, 29 LOY. L.A. L. REV. 645 (1996); Kathleen Patchel, *Interest Group Politics, Federalism, and the Uniform Law Process: Some Lessons from the Uniform Commercial Code*, 78 MINN. L. REV. 83 (1993); Iain Ramsay, Commentary, *The Politics of Commercial Law*, 2001 WIS. L. REV. 565; Donald J. Rapson, *Who Is Looking Out for the Public Interest? Thoughts About the UCC Revision Process in the Light (and Shadows) of Professor Rubin's Observations*, 28 LOY. L.A. L. REV. 249 (1994); Edward L. Rubin, *Efficiency, Equity and the Proposed Revision of Articles 3 and 4*, 42 ALA. L. REV. 551 (1991); Edwin L. Rubin, *The Code, the Consumer, and the Institutional Structure of the Common Law*, 75 WASH. U. L. REV. 11 (1997); Edward L. Rubin, *Thinking Like a Lawyer, Acting Like a Lobbyist: Some Notes on the Process of Revising UCC Articles 3 and 4*, 26 LOY. L.A. L. REV. 743 (1993); Edward L. Rubin, *Uniformity, Regulation, and the Federalization of State Law: Some Lessons from the Payment System*, 49 OHIO ST. L.J. 1251 (1989); Steven L. Schwarcz, *A Fundamental Inquiry into the Statutory Rulemaking Process of Private Legislatures*, 29 GA. L. REV. 909 (1995); Alan Schwartz & Robert E. Scott, *The Political Economy of Private Legislatures*, 143 U. PA. L. REV. 595 (1995); Robert E. Scott, *Is Article 2 the Best We Can Do?*, 52 HASTINGS L.J. 677 (2001); Robert E. Scott, *The Mythology of Article 9*, 79 MINN. L. REV. 853 (1995); Robert E. Scott, *The Politics of Article 9*, 80 VA. L. REV. 1783 (1994); Robert E. Scott, *The Truth About Secured Financing*, 82 CORNELL L. REV. 1436 (1997); David V. Snyder, *Molecular Federalism and the Structures of Private Lawmaking*, 14 IND. J. GLOBAL LEGAL STUD. 419 (2007); David V. Snyder, *Private Lawmaking*, 64 OHIO ST. L.J. 371 (2003).

surreptitiously, they also leave unresolved questions about the interaction with state real-property law.

C. Pooling and Servicing Agreements

We have now seen that there are two possible methods of transferring notes[250] and four methods for transferring mortgages.[251] The interaction between these different legal methods is not clear, but just because multiple methods of transfer might be possible, it does not follow that they are all implicated in actual transactions. Which method is actually used in deals?

The key transactional document in a securitization is the Pooling and Servicing Agreement (PSA). The PSA is usually a single document that (1) creates the securitization trust; (2) transfers the mortgage loans from the depositor to the trust (*C*→*D*, per Figure 1); (3) often also transfers the mortgage loans from the seller to the depositor (*B*→*C*); (4) serves as the trustee's contract; (5) serves as the loan servicer's contract; and (6) provides for the issuance of the MBS.

PSA language varies, but almost all PSAs contain a section dealing with "conveyance of mortgage loans" or the like. This section contains two relevant transfer provisions. First, there is a recital of transfer. For example:

> Section 2.01. Conveyance of Mortgage Loans to Trustee. (a) The Depositor, concurrently with the execution and delivery of this Agreement, sells, transfers and assigns to the Trust without recourse all its right, title and interest in and to . . . the Mortgage Loans identified in the Mortgage Loan Schedule . . . .[252]

This language basically tracks the requirements of an Article 9 sale. The PSA itself serves as the security agreement (the sale document). If it is signed by the depositor (the seller of the loans, or *C*) and contains an adequate description of the loans being sold (found in the attached loan schedules), it will meet the requirements for a sale of the promissory notes under Article 9, and the sale of the

250. These are Article 3 negotiation and Article 9 sale. There is potentially an additional common-law sale method, arguably superseded by the codification of Article 9 sales, which need not be of concern here.

251. These are Article 3 negotiation of the note combined with the common-law mortgage-follows-the-note doctrine, recordation of the assignment in land records, entry of a transfer in the MERS database, and Article 9 sale of the note.

252. Pooling and Servicing Agreement, Bear Stearns Mortg. Funding Trust 2006-AR2, § 2.01 (Sept. 1, 2006), *available at* http://www.secinfo.com/d1zj61.vvh.c.htm.

mortgages will accordingly happen automatically under the UCC Article 9 "mortgage follows the note" provision.[253]

Immediately following the recital of sale, however, PSAs have language stating, "In connection with the transfer and assignment of each Mortgage Loan" the depositor has "delivered" or "hereby delivers" the original mortgage notes to the trust indorsed in a particular manner. The indorsement requirement invokes a UCC Article 3 transfer by negotiation. For example:

> In connection with the transfer and assignment of each Mortgage Loan, the Depositor has delivered or caused to be delivered to the Trustee for the benefit of the Certificateholders the following documents or instruments with respect to each Mortgage Loan so assigned:
>
> (i) the original Mortgage Note bearing all intervening endorsements **showing a complete chain of endorsement from the originator to the last endorsee**, endorsed '*Pay to the order of ____________, without recourse*' and signed (which may be by facsimile signature) in the name of the last endorsee by an authorized officer.[254]

Shaun Barnes, Kathleen Cully and Professor Steven Schwarcz, the latter two of whom previously worked as sell-side securitization attorneys, argue that the recital of sale is what accomplishes the transfer and that the delivery instructions are not conditions to the closing of the transaction, but merely provisions to protect the trust and its investors.[255] Therefore, in their view, noncompliance with the indorsement and delivery requirements in PSAs does not defeat transfers but instead creates a possible breach of contract.[256]

This means that even if the indorsement and delivery did not occur, the trust would still have standing to foreclose. It would also have a breach-of-contract claim against the depositor, but that is not a foreclosure issue. Yet if Barnes, Cully, and Schwarcz are correct, why would PSAs even contain indorsement language? What work is this language doing?

253. *See* U.C.C. § 9-203(g).

254. Pooling and Service Agreement, Sec. Asset Backed Receivables LLC Trust 2005-FR3, § 2.01(b) (July 1, 2005), *available at* http://www.secinfo.com/dRSm6.z1Fa.d.htm#412u (bold emphasis added).

255. Shaun Barnes, Kathleen G. Cully & Steven L. Schwarcz, *In-House Counsel's Role in the Structuring of Mortgage-Backed Securities*, 2012 WIS. L. REV. 521, 529.

256. *Id.* at 529 n. 28.

The answer might in part be path dependence. PSAs from post-2001 are identical to those from pre-2001, which suggests that Article 3 is really the transfer provision, as it has been all along. Alternatively, the answer might be that post-2001, PSAs became a belt-and-suspenders operation with both Article 3 and Article 9 transfer provisions. Article 9 was crafted to work without any change in the deal documents, but risk-averse attorneys retained the Article 3 indorsement-and-delivery provision because of the uncertainty of Revised Article 9 jurisprudence.

Yet there were also good business and legal reasons to continue using Article 3 as the transfer mechanism. First, Article 9 transfers do not create holders in due course. Only Article 3 negotiations can do this. The resultant avoidance of assignee liability and freedom from defenses are important benefits that MBS investors would have wanted to retain.

Second, Article 9 says nothing regarding the enforcement of notes. This suggests that for negotiable notes, at least, Article 3 still controls. If so, then the trust cannot enforce the notes unless it is a person entitled to enforce under Article 3, which, in most cases, requires indorsement and delivery. Article 3, in other words, creates a statutory standing requirement that Article 9 does not excuse.

Third, the requirement of indorsement and delivery is necessary to ensure that the securitization trust takes the mortgage notes free from competing claims. Article 9 provides that an Article 3 sale has priority over an Article 9 security interest.[257] It is not clear if this provision is meant to apply only to true security interests and not sales included under the Article 1 definition of security interest. The provision largely tracks one in prerevision Article 9 that only covered the contest between an Article 3 negotiation and a true security interest.[258]

Yet if we take seriously the Article 1 definition of "security interest" to include a "sale" of promissory notes, then an Article 3 sale has priority over an Article 9 sale. Therefore, if a note is first sold under Article 9 without delivery and then sold by the same seller through an Article 3 negotiation to a party that becomes a holder in due course, the subsequent Article 3 purchaser would actually take

257. *See* U.C.C. § 9-331(a) (granting priority to Article 3 holders in due course); *id.* § 9-102(a)(47) (defining "instrument" as a "negotiable instrument or any other writing that evidences a right to the payment of a monetary obligation").

258. *See* U.C.C. § 9-309 (1951).

free of the Article 9 purchaser's claim.[259] The Article 9 purchaser would have no rights in the note; at most, the purchaser would have a litigation claim against the seller. Thus, the only way the MBS investors could be completely sure that the securitization trust has no competing claimants would have been to insist on Article 3 transfer.

Fourth, even if Article 3 sales do not trump Article 9 sales, there would still be a logic for requiring Article 3 negotiation, namely, that the Article 9 transfer method is too easy to consummate and hence does not lend itself to easy proof, unlike Article 3. Under the basic commercial-law rule of *nemo dat*, a transferor cannot transfer rights it does not have; I cannot sell you the Brooklyn Bridge. For Article 3, this is not a problem. Because of reification, the seller only has something to transfer if the seller can deliver the physical note, and the chain of title is built into the note itself through indorsements.[260] If there is no delivery, there is no transfer, so it is easy to verify if rights have been transferred.

Article 9 codifies the *nemo dat* rule by requiring the seller to have rights in the property sold for the transfer to be effective.[261] Unlike Article 3, however, determining if a seller has rights to transfer is difficult. It ultimately requires proving up a chain of title from the originator to the seller to the depositor or $A \rightarrow B \rightarrow C$. If this chain cannot be proven, then the transfer from the depositor to the trust ($C \rightarrow D$) is a manqué transaction.

The lack of solid evidence of transfers is particularly important given the occurrence of "warehouse fraud," wherein the same mortgage might be sold multiple times to different buyers by the same seller.[262] If the originator *A* already sold the mortgage, then the hapless subsequent buyer *B* has no rights in the mortgage to pass along, making the $B \rightarrow C \rightarrow D$ transfers meaningless; *B*, and therefore *C*, have nothing to transfer.

259. *See* U.C.C. § 9-331 cmt. 2 (2011) (explaining that "priority" contextually means taking "free" of the Article 9 security interest).

260. The 2002 revision to UCC section 3-309's lost-note provision undermines reification by enabling enforcement of notes that were lost in a mediate, rather immediate, transfer. As of 2012, only ten states have adopted this revised provision. *See supra* note 84.

261. U.C.C. § 9-203(b)(2) (requiring the seller to have rights in the collateral or the power to transfer rights in the collateral).

262. *See e.g.*, Provident Bank v. Cmty. Home Mortg. Corp., 498 F. Supp. 2d 558, 562 (E.D.N.Y. 2007); Charles L. Armstrong, Thomas H. McNeill & James E. Reynolds, *Warehouse Lending Losses Under the Financial Institution Bond*, 12 FIDELITY L.J. 1, 2 (2006); Brian F. Corbett, *Beware of Warehouse Lending Fraud*, POYNER SPRUILL (Nov. 19, 2008), http://www.poynerspruill.com/publications/Pages/BewareofWarehouseLendingFraud.aspx.

Using negotiation as the method of transfer shields against this problem in all cases except those in which the borrower signed duplicative original notes.[263] If there is only one original negotiable note, it can be transferred only once by any party through indorsement and delivery, and the party that takes physical possession with proper indorsement for value and in good faith will be a holder in due course and free from competing claims, thereby avoiding the warehouse-fraud problem.

Thus, there was a good business reason, at least from the perspective of MBS investors, to want transfers to occur through Article 3 negotiation rather than Article 9 contracts. That PSAs could also qualify as Article 9 transfers added a cherry on top of zipless automatic perfection, thereby relieving concerns about recharacterization of the transfers as unperfected secured loans which would be vulnerable to avoidance by the FDIC or a trustee in bankruptcy should the sponsor or depositor become insolvent. Article 9, then, it would seem, was never really meant to operate as the transfer mechanism, but as a shield against the FDIC and bankruptcy trustees.

Yet Barnes, Cully, and Schwarcz, the latter two of whom were involved in structuring MBS, insist that Article 9 was the real transfer method, and that Article 3 negotiation was optional. Failure to properly negotiate the notes[264] would create only a breach-of-contract claim for the trust, but leave the trust with standing to foreclose on the strength of the Article 9 transfer. And indeed, it appears from reported decisions that the securitization industry's own practices were often to ignore indorsement and delivery requirements. Frequently—although it is not clear how frequently—notes were not indorsed at the supposed time of the transfer and indorsed, if at all, only after litigation began.[265] Moreover, the official Rule 30(b)(6)

263. 1 SECURITIZATION OF FINANCIAL ASSETS, *supra* note 240, § 6.03[B][2].

264. There is a separate issue about whether a transfer by negotiation would be valid if it complied with Article 3 but not with the particular indorsement sequence required in the PSA. This issue, which involves questions of New York trust law and REMIC status, is beyond the scope of this Article.

265. *See, e.g.*, *In re* Foreclosure Cases, Nos. 1:07CV2282, 07CV2532, 07CV2560, 07CV2602, 07CV2631, 07CV2638, 07CV2681, 07CV2695, 07CV2920, 07CV2930, 07CV2949, 07CV2950, 07CV3000, 07CV3029, 2007 WL 3232430, at *2–3 (N.D. Ohio Oct. 31, 2007) (dismissing foreclosure actions for a lack of standing because the plaintiff-mortgagees did not have valid assignments of the notes and mortgages at the time the complaint was filed); U.S. Bank v. Coley, CV076001426, 2011 WL 2734603, at *3 (Conn. Super. Ct. June 10, 2011) (dismissing foreclosure for lack of standing because the mortgage assignment was four months subsequent

deponent of Countrywide Financial, the largest mortgage lender in the country during the housing bubble, testified in a bankruptcy case that it was customary for the securitization sponsor to remain in possession of the note and for indorsements to be prepared only when necessary for litigating foreclosures.[266] Postdefault indorsement makes it impossible for the securitization trust to be a holder in due course,[267] so the Article 3 benefits of freedom from claim and freedom from defenses are lost.

What, then, are we to make of this situation? On the one hand, we have a situation in which MBS investors would have had good reason to want Article 3 transfers and deal documents that seem to require Article 3 transfers. On the other hand, however, we have former securitization attorneys insisting that Article 9, rather than Article 3, was the operative transfer mechanism and evidence that the securitization industry frequently ignored the indorsement and delivery requirements of Article 3 and the deal documents. To make sense of this apparent tension, it is necessary to first ask why the title-system conflict was not resolved as part of the reforms undertaken to facilitate securitization.

D. The Political Economy of Title Systems

The creation of MERS and the revision of UCC Articles 1 and 9 show that the securitization industry spent considerable effort and political capital attempting to reshape the legal landscape in which

to the foreclosure suit's initiation); McLean v. JP Morgan Chase Bank Nat'l Ass'n, 79 So. 3d 170, 174–75 (Fla. Dist. Ct. App. 2012) (reversing a grant of summary judgment for the foreclosure plaintiff when the assignment of a mortgage occurred three days after the suit was initiated and the assignment of the note was undated); Lasalle Bank Nat'l Ass'n v. Ahearn, 875 N.Y.S.2d 595, 597 (App. Div. 2009) (holding that a mortgagee's assignee lacked standing to foreclose because the assignee did not own the mortgage at the time the complaint was filed); Wells Fargo Bank N.A. v. Jordan, No. 91675, 2009 WL 625560, at *5 (Ohio Ct. App. Mar. 12, 2009) (affirming the dismissal of a foreclosure action for a lack of standing because the putative mortgagee could not prove it owned the mortgage at the time the complaint was filed); Deutsche Bank Nat'l Trust Co. v. Byrams, 275 P.3d 129, 132–33 (Okla. 2012) (reversing and remanding summary judgment for the foreclosure plaintiff because standing did not exist at the time the action was instituted); U.S. Bank Nat'l Ass'n v. Kimball, 27 A.3d 1087, 1093 (Vt. 2011) (upholding the denial of standing to foreclose because the bank could not demonstrate that it was the holder of the note at the time the foreclosure action was initiated).

266. *See* Kemp v. Countrywide Home Loans, Inc., 440 B.R. 624, 628 (Bankr. D.N.J. 2010); Transcript of Hearing at 15–17, *Kemp*, 440 B.R. 624 (No. 08-18700), *available at* http://www.americanbanker.com/media/pdfs/CountrywideDiMartini112910.pdf.

267. *See* U.C.C. § 3-302(a)(2) (2011) (requiring a holder in due course to have taken "without notice that the instrument is overdue or has been dishonored").

securitization operated. Why, then, was the title-system conflict not resolved instead of muddied?

The answer might simply be that no one recognized the problem and thought to fix it. The relative rarity of foreclosures prior to the bursting of the housing bubble and the fact that they were typically default judgments meant that no problem had really emerged in practice. The prevalence of default judgments created a type of legal "leverage" for the mortgage industry, much the way debt creates financial leverage, enabling greater returns on equity. The assumption of lack of foreclosure litigation was fundamental to the mortgage industry's business model. Indeed, the ability to obtain default judgments in almost all debt-collection matters is essential to the business models of consumer credit in general. When this assumption failed in the aftermath of the housing bubble, the industry was ill-equipped to deal with it.[268]

The conceptual framework for UCC Article 3 also discouraged recognition of conflicting title systems. UCC Article 3 speaks in terms of enforcement rights, not ownership, so it is not generally thought of as a title system (when it is thought of at all).

Part of the answer may also reflect the increasingly specialized nature of legal practice: the attorneys who arrange securitizations are not the same as those who do mortgage foreclosures. The former are engaged in transactional work at large, white-shoe law firms; the latter are litigators working as little more than debt collectors, far down on the profession's prestige ladder.[269] The securitization

268. By analogy, one might compare this situation to that of prosecutors' offices and police forces that are used to having almost all cases result in plea bargains and are therefore sloppy with the tendering of exculpatory evidence or with the custody of evidence. This sort of sloppiness is not a problem for the prosecutors as long as prosecutions result in plea bargains, but when a crack defense team chooses to litigate, these bad habits can seriously complicate the prosecution.

269. For a sense of just how different the nature of the legal practice is in the foreclosure bar, the case of *In re Taylor*, 407 B.R. 618 (Bankr. E.D. Pa. 2009), *aff'd*, 655 F.3d 274 (3d Cir. 2011), is illustrative. In *Taylor*, the Third Circuit reversed the district court's reversal of a bankruptcy court's sanctions on a foreclosure law firm. *In re* Taylor, 655 F.3d 274, 288 (3d Cir. 2011). The law firm had no personal contact with or phone number for the client, or the ability to communicate with the client about the case. *Id.* at 279. Instead, the firm received its work orders via a computer system along with the supporting documents that the client deemed necessary for prosecuting the foreclosure. *Id.* The law firm was required to file particular legal documents on a preset time line or have its compensation docked. *Id.* Although it is not clear if the lack of communication ability is unusual, Fannie Mae and Freddie Mac have state-by-state foreclosure time lines that servicers (and hence servicers' attorneys) must meet to avoid financial penalties, and these time lines are often used as industry standards. *See generally*

attorneys who contributed to the creation of MERS and Revised Article 9 were focused on getting the securitization deals done and, secondarily, achieving bankruptcy remoteness—freedom from claims. Enforcement of the mortgages was someone else's dirty, untoward problem, especially as none of the myriad opinion letters involved in securitization put the attorneys on the hook for enforceability issues regarding the mortgages.[270] In a nutshell, the development of MERS and Revised Article 9 is captured by a Tom Lehrer couplet about Wernher von Braun, the infamous rocket scientist: "'Once the rockets are up, who cares where they come down? That's not my department,' says Wernher von Braun."[271]

Yet there is also a consistent political-economy story that explains the developments of MERS and UCC Article 9. Different property-rights verification regimes benefit different parties in securitizations. The securitization industry has a myriad of different players, but they can largely be characterized as sell-side and buy-side institutions. Some institutions are active on both sides, but with little apparent coordination.[272] Securitization deals are assembled and sold by the sell-side institutions, whereas the buy-side institutions are fixed-income investors that generally treat MBS as one of many potential investments.

MERS and UCC Article 9 were attempts to shift property-rights verification regimes away from public, demonstrative regimes replete with formalities toward simple, bilateral contractual allocation of

Dustin A. Zacks, *Robo-Litigation*, 60 CLEV. ST. L. REV. 867 (2013) (describing the structure and economics of foreclosure mills).

270. The opinion letters that accompany the SEC shelf registration for securitizations typically note that the opinions expressed are based on the attorneys having "assumed . . . the truth, accuracy and completeness of the information, representations and warranties contained in the records, documents, instruments, and certificates [they] have reviewed." Opinion Letter from Orrick, Herrington & Sutcliffe LLP to Residential Asset Mortgage Products, Inc., (Jan. 20, 2006), *available at* http://www.sec.gov/Archives/edgar/data/1099391/000106823806000048/exhibit5-1.htm; *see, e.g.*, Opinion Letter from Thacher Proffitt & Wood LLP to Residential Asset Mortgage Products, Inc., Re: Residential Mortgage Products, Inc. Registration Statement on Form S-3 (Nov. 12, 2003), *available at* http://www.sec.gov/Archives/edgar/data/1099391/000109939103000337/exh52.txt ("In rendering this opinion letter, . . . we . . . assume no responsibility with respect to (a) the accuracy of and compliance by the parties thereto with the representations, warranties and covenants as to factual matters contained in any document . . . ."). Securitization opinion letters thus do not typically express any opinion about the enforceability of the underlying mortgage loans; enforceability of the mortgages is an assumption on which opinion letters are founded.

271. TOM LEHRER, *Wernher von Braun*, *on* THAT WAS THE YEAR THAT WAS (Reprise Records 1965).

272. Levitin & Wachter, *supra* note 27, at 18–19.

rights. Shifting from more formal to less formal and from more public to less public verification regimes had the advantage of lowering transaction costs for putting together securitizations. Lower transaction costs benefitted sell-side institutions. Sell-side institutions' revenue is largely fee based and thus depends not on deal performance but on deal volume.[273] Lower transaction costs enable greater deal volume. Accordingly, "contracting" regimes for rights verification were more attractive for the sell-side financial institutions and their attorneys who assembled securitizations. The sell-side was not concerned about fraud costs, uncertainty costs, and adjudication costs—the costs reduced through the "paperization principle"[274]—because they are all borne by the buy-side.

MERS was a creation of and is owned by sell-side firms. The Article 9 drafting process is harder to characterize, but the push to make the world safe for securitization appears to have been a sell-side, rather than buy-side, initiative; by definition the buy-side has other investment options, so it is not focused on facilitating securitization.

From the buy-side's perspective, a critical feature of what makes MBS attractive is the apparent security of property rights in the underlying mortgages—freedom from claims and freedom from defenses. Buy-side institutions bear the risk of any problem in mortgage title, most notably the risk of the securitized assets getting pulled into the bankruptcy estate of the transferor, the risk of being subject to two levels of taxation because the mortgages are treated as property of the transferor, rather than the pass-through securitization Real Estate Mortgage Investment Conduits (REMIC) vehicle,[275] and the risk that standing cannot be proven for enforcement purposes. Accordingly, from a buy-side perspective there is a strong interest in ensuring absolute certainty in the property rights transferred. All of this militates toward the buy-side preferring public demonstration regimes like Article 3 and land records because they lend themselves to easier verification of rights than bilateral contracting regimes.

In a transparent, well-functioning market, MBS buyers would have demanded a discount for the use of the contracting regime and

273. Levitin & Wachter, *supra* note 151, at 1230.

274. *See* Clark, *supra* note 32, at 476 ("By requiring a writing between the parties to a transaction, unfixity [i.e. uncertainty] costs are significantly reduced. Fraud costs ought also to be reduced, in that fraud by one of the parties on the other is made somewhat more difficult.").

275. *See supra* note 146.

its heightened risk for both bankruptcy remoteness and enforcement of mortgages.[276] But this would have required MBS investors to see the problem and anticipate its impact.

Accordingly, we might hypothesize a lulling story: Investors need to feel sufficiently confident about the rights they are receiving if they are to be induced to buy MBS. The MBS market was established using negotiation and land-record recording. Although expensive, these methods of transfer established a high degree of certainty about freedom from claim and ability to enforce. Once the market was established in the 1990s, however, MBS investors stopped being concerned with the technical details of transfers, relying on rating agencies—compensated by the sell-side—to flag any problematic legal changes via ratings. Just as the rating agencies failed to flag problems in the mortgage underwriting, they also failed to flag problems in the legal structure, which enabled the sell-side to shift to less formal and less expensive systems like MERS and UCC Article 9 that benefitted them, not the MBS investors. The cost-shifting implications became apparent to investors only after the bubble burst and foreclosures became difficult to prosecute because of standing problems.

Even now, it is impossible for MBS investors to gauge the impact of the regime shift. MBS investors receive very little information about deal performance. They receive monthly reports from MBS trustees that detail delinquency rates and realized losses but not the factors involved in the losses. Therefore, absent further investigation, it is impossible for MBS investors to determine whether losses are caused by poor underwriting, property value declines, or delayed or prevented foreclosures due to inability to prove standing.

The representations and warranties that accompany most securitized loans can reasonably be read to warrant the enforceability of the mortgage and the completeness and appropriateness of the documentation.[277] Enforcement of these representations and

276. It is not clear how much, if any, of the transaction-cost savings were captured by homeowners.

277. Common representations and warranties include a representation and warrant from the seller to the depositor, master servicer, and trustee that "[i]mmediately prior to the assignment[,] . . . [the seller] had good title to, and was the sole owner of, [the loan] free and clear of any pledge, lien, encumbrance or security interest and had full right and authority . . . to sell and assign the [loan] pursuant to the Pooling and Servicing Agreement." Pooling and Servicing Agreement, Alternative Loan Trust 2005-35CB, *supra* note 203, sched. III-B(1). Other typical seller representations and warranties to the depositor, master servicer, and trustee are

warranties, however, depends upon MBS trustees and servicers. This is a problem because neither trustees nor servicers are looking out for MBS investors. MBS trustees do not represent the investors' interests in any meaningful way.

MBS trustees are a distinct type of trustee. They are not donative trustees. They are not (usually) indenture trustees,[278] but like indenture trustees, their duties are primarily contractually defined rather than springing from a fiduciary penumbra. MBS trustees are compensated only for ministerial functions; they are typically paid less than a basis point annually on the outstanding principal balance of the mortgage loans held by the trust.[279] MBS trustees are not required to undertake anything more than their normal ministerial functions unless an expressly defined event of default has occurred.[280] When an event of default occurs, however, the trustee is held to a prudent-person standard of care.[281] As a result, the trustee may have to assume additional duties. Additionally, if prudence or a requisite

that "[e]ach Mortgage is a valid and enforceable first lien on the Mortgaged Property," and that "[t]here is no valid offset, defense or counterclaim to any Mortgage Note or Mortgage, including the obligation of the Mortgagor to pay the unpaid principal of or interest on such Mortgage Note." *Id.* sched. III-A(4), (6).

The depositor makes more limited representations and warranties, namely that "[t]he Depositor hereby represents and warrants to the Trustee with respect to each [loan] . . . that as of the Closing Date, and following the transfer of the [loans] to it by each Seller, the Depositor had good title to the [loans] and the Mortgage Notes were subject to no offsets, defenses or counterclaims." *Id.* § 2.04.

278. Some MBS are issued pursuant to indentures, and, even when not, MBS trustees may still be subject to the Trust Indenture Act of 1939, 15 U.S.C. §§ 77aaa–bbbb (2012), and state trust indenture laws, but unlike a classic bond indenture trustee, an MBS trustee does hold title to an actual trust corpus and typically has different duties than an indenture trustee, such as ensuring that the required mortgage loan documentation has been delivered to the trust, protecting the trust corpus, supervising the servicer of the loans, and acting as a financial backstop to the servicer.

279. *See, e.g.*, Pooling and Servicing Agreement, Alternative Loan Trust 2005-35CB, *supra* note 203, Article I ("Trustee Fee: As to any Distribution Date, an amount equal to one-twelfth of the Trustee Fee Rate multiplied by the sum of (i) the Pool Stated Principal Balance plus (ii) any amounts remaining in the Supplemental Loan Account (excluding any investment earnings thereon) with respect to such Distribution Date."); *id.* ("Trustee Fee Rate: With respect to each Mortgage Loan, 0.009% per annum.").

280. *See, e.g.*, Pooling and Servicing Agreement, Alternative Loan Trust 2005-35CB, *supra* note 203, § 8.01 ("The Trustee, prior to the occurrence of an Event of Default and after the curing of all Events of Default that may have occurred, shall undertake to perform such duties and only such duties as are specifically set forth in this Agreement.").

281. *See, e.g.*, *id.* ("In case an Event of Default has occurred and remains uncured, the Trustee shall exercise such of the rights and powers vested in it by this Agreement, and use the same degree of care and skill in their exercise as a prudent person would exercise or use under the circumstances in the conduct of such person's own affairs.").

majority of investors requires the termination of the servicer (often called the "master servicer"), then the trustee is typically required to assume the duties of the servicer.[282] The trustee thus serves as a backup servicer, placing it in a potentially costly guarantor role should the servicer fail to fulfill its duties and be terminated.

MBS trustees have three major adverse incentives to being proactive and investigating losses. First, trustees risk being held to a higher standard of care (and possibly losing their indemnification from the servicer[283]) if they are proactive prior to an expressly defined event of default. Second, a trustee's diligence may result in an event of default and the trustee being subject to a prudent-person standard of care and greater duties (including potentially the assumption of the servicer's duties). And third, trustees do not want to jeopardize their business relationships with sell-side firms because trustees receive their business from from sell-side firms affiliated with servicers rather than from MBS investors.[284] These sell-side firms face representation and warranty liability to the trust on the quality and enforceability of the loans sold, and the servicers themselves face servicing covenant liability if they fail to enforce these representations and warranties. As a result, MBS trustees are willfully blind to representation and warranty problems, including those relating to mortgage loan documentation, lest they notice that servicers are not providing notice

282. *See, e.g.*, *id.* §§ 7.01–7.02 ("If an Event of Default . . . shall occur, then, and in each and every such case, so long as such Event of Default shall not have been remedied, the Trustee may, or [if directed by a group of Certificate Holders with two thirds of the voting rights in the trust] shall . . . terminate all of the rights and obligations of the Master Servicer under this Agreement and . . . all authority and power of the Master Servicer hereunder, whether with respect to the Mortgage Loans or otherwise, shall pass to and be vested in the Trustee. . . . On and after the time the Master Servicer receives a notice of termination . . . the Trustee shall . . . be the successor to the Master Servicer in its capacity as master servicer under this Agreement and the transactions set forth or provided for herein and shall be subject to all the responsibilities, duties and liabilities relating thereto placed on the Master Servicer by the terms and provisions hereof and applicable law including the obligation to make Advances . . . .").

283. *See, e.g.*, *id.* § 8.05 ("The Trustee and any director, officer, employee or agent of the Trustee shall be indemnified by the Master Servicer and held harmless against any loss, liability or expense (including reasonable attorney's fees) (i) incurred in connection with any claim or legal action relating to (a) this Agreement, (b) the Certificates or (c) in connection with the performance of any of the Trustee's duties hereunder, other than any loss, liability or expense incurred by reason of willful misfeasance, bad faith or negligence in the performance of any of the Trustee's duties hereunder or incurred by reason of any action of the Trustee taken at the direction of the Certificateholders . . . .").

284. Levitin & Twomey, *supra* note 199, at 58–63.

of breaches of representations and warranties and are violating their servicing covenants, which could be the basis for an event of default.[285]

Securitization investors face significant obstacles to forcing trustees to fulfill their obligations. Investors in securitizations typically have the right to enforce the duties of the servicer or the representations and warranties of the sponsor through a demand on the trustee to act. Such a demand, however, typically requires compliance with a collective-action clause that mandates that it be supported by 25 percent of the voting rights of the MBS certificates, sometimes in each class of certificates. The trustee controls the list of the certificate holders who are otherwise anonymous to each other, unless the requisite number of certificate holders gather to demand the list from the trustee. The certificate holders must also offer the trustee indemnity for its actions taken in response to their direction. Only if the trustee refuses to act for sixty days following notice and indemnity may a certificate holder bring suit itself to enforce the securitization contract, and even then, the certificate holder cannot easily remove the recalcitrant trustee: the trustee is usually removable only upon the action of certificate holders representing 51 percent of the voting rights of the certificates. Securitization trustees are usually do-nothing entities that are not inclined to look out for MBS investors. Accordingly, they are unlikely to take any action to determine why losses are occurring on mortgages.

MBS servicers, in contrast, may very well know why losses are occurring. MBS servicers are loath to enforce representations and warranties because they are frequently affiliates of the sell-side firms.[286] Servicers do not want to force their affiliates to pay out on representations and warranties, particularly because MBS include liquidated damages clauses for breaches of representations and warranties that require the sponsor to repurchase the loan from the trust for its remaining balance, rather than for the diminution in the

285. *See* Marcel Kahan, *Rethinking Corporate Bonds: The Trade-Off Between Individual and Collective Rights*, 77 N.Y.U. L. REV. 1040, 1063–64 (2002) (noting the trustee's lack of incentives to function as an "effective representative" for the bondholders); Steven L. Schwarcz & Gregory M. Sergi, *Bond Defaults and the Dilemma of the Indenture Trustee*, 59 ALA. L. REV. 1037, 1042–43 (2008) (advocating that the business judgment rule for corporate directors should be superimposed over the indenture trustee's prudent-man standard to correct deficiencies in the current system); Steven L. Schwarcz, *Keynote Address: The Conflicted Trustee Dilemma*, 54 N.Y.L. SCH. L. REV. 707, 708–09 (2009) (discussing the dilemma faced by trustees who represent groups of investors that have conflicting interests).

286. *See supra* note 162.

value of the loan.[287] Accordingly, even though MBS investors purchased mortgages that were represented and warranted to be properly documented and enforceable, they have little recourse when servicers are unable to foreclose because the investors cannot prove standing due to documentation problems. The investors lack information on individual loans and cannot easily obtain it, much less force trustees and servicers to act. Doing so requires the investors typically holding 25 percent of the voting rights in a securitization deal to notify the trustee of an event of default and indemnify the trustee before the trustee undertakes any actions in response to an investor demand. The former requirement is a problem because investors do not know the identity of each other; most MBS do not have publicly available bondholder lists, so achieving the threshold to make a collective demand on the trustee can be difficult.[288] Investors then need to have sufficient facts to credibly allege an event of default—but investors generally lack this information. Moreover, the indemnification can then be costly, and, because of credit tranching, many investors may not especially care about representations and warranty violations in any particular deal because the losses are borne by other investors in lower-priority tranches.

Investor action has resulted in what is proposed to be the largest private settlement in history, an $8.5 billion proposed settlement between the Bank of New York Mellon as trustee for some 530 MBS trusts and Bank of America, covering, among other things, loan documentation issues.[289] Yet it was difficult for investors to even get Bank of New York Mellon to act once they alleged an event of default, and Bank of New York Mellon still never performed a substantive investigation of any of the documentation problems alleged, but merely settled them.[290] The private-label securitization

287. The liquidated damages clauses are known as "putback" provisions because a loan that fails to conform with the seller's representations and warranties is put back to the sponsor. Technically the putback is "enforced" by the trustee after receiving notice from the servicer, seller, depositor, or itself of the breach of representation or warranty, but the servicer's notice is the key to the action. Pooling and Servicing Agreement, Alternative Loan Trust 2005-35CB, *supra* note 203, § 2.03(c).

288. Some PSAs entitle groups of investors (but not single investors) to obtain information about the identity of other investors. *E.g., id.* § 5.05 (requiring trustee to provide the most recent certificateholders list in response to a petition by at least three certificateholders).

289. *See* Verified Petition at 1, *In re* Bank of N.Y. Mellon, No. 651786/2011 (N.Y. Sup. Ct. June 28, 2011), NYSCEF Doc. No. 1.

290. Full disclosure: I am retained as an expert witness on behalf of American International Group (AIG) as an intervenor opposing court approval of the proposed settlement. Although

market turns out to have been a lemons market not just on mortgage underwriting but also on legal transfer regime.[291]

Today, the more sophisticated buy-side firms understand that the enforcement problem exists, even if they do not fully understand why. This is one reason why the private-label securitization market remains moribund. After the bubble, investors are understandably concerned about the probability of default on securitized mortgages. They also cannot estimate loss-given-default because of legal uncertainty. Accordingly, they are staying away from any deals in which they bear credit risk because it cannot be priced.[292] The only securitization that is now occurring is with the federal government bearing all credit risk. The collapse of the securitization market is exactly what Professor George Akerlof's model of the lemons market predicts, and as long as it remains a lemons market, including for legal transfer regime, private-label securitization will not be resurrected.

IV. THE REFORM OF MORTGAGE TITLE SYSTEMS

A. *Existing Reform Proposals*

The existence of a problem in the enforcement of mortgages has been widely recognized by scholars as well as practitioners. None of the scholarly treatments of the issue, however, has recognized the enforcement difficulties as being driven by a problem of conflicting title systems. Though some of the scholarship has recognized that there is a tension between the UCC and real-property systems,[293] none has identified this as the core problem.

UCC issues have not been specifically raised in the proposed settlement, it does cover some issues related to the documentation of notes and security interests to the securitization trusts. *See* Exhibit B at 34, *In re* Bank of N.Y. Mellon, No. 651786/2011 (N.Y. Sup. Ct. June 29, 2011), NYSCEF Doc. No. 3. Loans registered on MERS are excluded from coverage in this provision of the settlement. *Id.* at 29.

291. *See generally* Akerlof, *supra* note 148 (hypothesizing lemons markets).

292. Adam J. Levitin, Andrey D. Pavlov & Susan M. Wachter, *The Dodd-Frank Act and Housing Finance: Can It Restore Private Risk Capital to the Securitization Market?*, 29 YALE J. ON REG. 155, 157–58 (2012).

293. *See, e.g.*, Whitman & Milner, *supra* note 19, at 60 ("[I]n a number of nonjudicial-foreclosure states, the requirements of UCC Article 3 and the corresponding statutory foreclosure procedures seem to exist in different universes."); John Patrick Hunt, Richard Stanton & Nancy Wallace, *Rebalancing Public and Private in the Law of Mortgage Transfer* 29 (UC Davis Legal Studies Research Paper No. 327, 2013), *available at* http://ssrn.com/abstract=2117555 ("Article 9 [of the UCC] and real property recording law may be in conflict, at least in some states.").

Instead, the existing scholarship tends to focus on either the mortgages or the notes, but not on their interaction. Thus, proposals have been made to reform land recordation systems,[294] require record-of-ownership requirements to foreclosure statutes,[295] fix MERS so that it tracks[296] or holds notes,[297] create a national lien registry,[298] eliminate negotiability,[299] or merge the note and mortgage into a single document.[300]

1. *Reformation of Land Recordation Systems.* All of these proposals have shortcomings, but their fundamental problem is that they diagnose the problem with mortgage title too narrowly. Land recordation systems could stand to be modernized, but their antiquated features are not the cause of the problems relating to foreclosure. Similarly, requiring records of mortgage ownership would help clarify standing for nonjudicial foreclosures, but by itself it does not resolve how ownership records are to be established.

2. *Reformation of MERS.* A reformation of MERS so that it would either definitively track or hold notes would bring it closer in line with the DTC model of immobilized title for both notes and mortgages.[301] MERS, however, previously rejected holding notes,[302]

294. *See* Tanya Marsh, *Foreclosures and the Failure of the American Land Title Recording System*, 111 COLUM. L. REV. SIDEBAR 19, 19–21 (2011) ("An ideal system will deal with the fundamental problem with the American land title system. It is a paper-based system that has been awkwardly translated to computers."); Hunt et al., *supra* note 293 (proposing upgrading local recording systems to handle electronic mortgage assignments).

295. *See* Timothy A. Froehle, Note, *Standing in the Wake of the Foreclosure Crisis: Why Procedural Requirements Are Necessary To Prevent Further Loss to Homeowners*, 96 IOWA L. REV. 1719, 1740–41 (2011).

296. *See* Robert Hockett, *Six Years on and Still Counting: Sifting Through the Mortgage Mess*, 9 HASTINGS BUS. L.J. 373, 406 (2013) (suggesting "reform of the current mortgage and note recording system, ideally in the form of a readily accessible and editable electronic registry system—e.g., a fully generalized MERS system"); Dustin A. Zacks, *Standing in Our Own Sunshine: Reconsidering Standing, Transparency, and Accuracy in Foreclosures*, 29 QUINNIPIAC L. REV. 551, 600–09 (2011).

297. Whitman, *supra* note 49, at 757–66.

298. Hunt, Stanton & Wallace, *supra* note 293.

299. Whitman, *supra* note 49, at 769.

300. White, *supra* note 168, at 498.

301. Such a reformation could also involve a nationalization of MERS; private recording databases will inevitably suffer from questions of credibility and reliability to the extent they are relied upon for judicial evidence. *See* Langin, *supra* note 20, at 7–8 (discussing a case in which testimony and evidence regarding the global debt-registry process was admitted by a court to establish chain of title to a debt). Unlike recording systems for consumer debt, DTC and other

which would vastly increase its duties and liabilities. More importantly, there is a stronger public interest in clarity and transparency of mortgage title than for securities; holding mortgages in "street name" can cause many greater problems than doing so for securities. And given the current state of the law on MERS, a statutory framework equivalent to UCC Article 8 would be necessary for a revamped MERS to operate.

3. *Creation of a National Lien Registry*. A national lien registry, especially one operated by the government, rather than by a private party like MERS, is a sensible idea, but a lien registry alone is insufficient to solve the standing problem, and raises other operative and legal questions. Although there are problems with the accuracy of MERS's database, the fundamental problem is a question of which title system controls. A national lien registry could work if the right to foreclose were determined by lien registration; that would have the effect of essentially choosing mortgage recordation in a public system as controlling over other title systems. This is a sensible approach, but it would require major law revision and would face a political-economy problem of shifting recording revenue from local governments to the federal government. There is also a question about whether there is constitutional authority for the federal government to interfere with real-estate recordation, which is traditionally a local right.

Federal housing-finance reform legislation proposed in 2013 contemplates creating a privately operated national registry for consensual mortgage liens.[303] The logic to a national mortgage title system is that it would match the national housing-finance market.

book-entry systems for investment securities are not frequently used to provide evidence in judicial proceedings.

302. *See generally* R.K. Arnold, *Yes, There Is Life on MERS*, PROB. & PROP., July–Aug. 1997, at 33 (describing the decisions involved in the creation of MERS).

303. Such a registry has been proposed in two housing-finance-system reform bills pending in Congress: the Protecting American Taxpayers and Homeowners Act of 2013, H.R. 2767, 113th Cong. §§ 331–335 (2013), and the Housing Finance Reform and Taxpayer Protection Act of 2013, S. 1217, 113th Cong. §§ 224–225 (2013) (the "Corker-Warner bill"). Although as a generic matter a national lien registry makes some sense, I have criticized these legislative proposals on account of their motivation and their inadequate consideration of the complexities of making a national system fit with local real-property law. *See A Legislative Proposal To Protect American Taxpayers and Homeowners by Creating a Sustainable Housing Finance System: Hearing Before the H. Fin. Servs. Comm.*, 113th Cong. 3–4 (2013) (statement of Professor Adam J. Levitin), *available at* http://financialservices.house.gov/uploadedfiles/hhrg-113-ba00-wstate-alevitin-20130718.pdf.

There are several problems, however, with the idea as proposed in the legislation.

First, clarity of real-property title is a public good and should be provided by the government, rather than by private parties, as is already done by the federal government for other types of property, such as patents, trademarks, copyrights, broadcast spectrum, aircraft, and some nautical vessels.

Second, it is not clear how the national system would interact with local land records. Currently, a variety of types of property interests are recorded in local land records, including deeds, consensual liens, and involuntary liens. The fact that all of these interests are recorded in one system enables the law to easily prescribe priority among them and for someone investigating title to have a relatively simple search. The MERS system, for all of its flaws, does not fundamentally reject this common system, as MERS is inserted in the local land records as a type of a bookmark. Thus, if there were a MERS mortgage, it would show up in the local land records and give a title searcher notice of an encumbrance. The searcher would have to then look in the MERS database to determine the identity of the parties with an interest in that mortgage. At that point problems might ensue, but it would be clear to the title searcher that there was some sort of voluntary encumbrance on the property that needed to be further investigated.

This process would not work with a separate national mortgage registry. The national system would contain recordations of a subset of voluntary liens—those granted to institutional lenders. Other voluntary liens, all involuntary liens such as tax liens, homeowner-association liens, construction liens, and judgment liens, and all other property interests would remain in the local land records. Creating two parallel systems would raise a host of thorny questions about how the systems would interact.[304] Which law would control, federal or state? And how would the property interests in the two systems be reconciled? How would priority of interests be determined? How would legal requirements from title-theory states apply to mortgages in a federal system? Absent serious work reconciling fifty state real-property systems with a federal registry, local land records would cease to provide definitive sources of clear title but would also

304. Neither the Supremacy Clause nor federal-preemption doctrine provide much guidance because there is not a conflict between federal and state law, so much as a question about the priorities of the mortgages recorded under these laws.

continue to exist and be relevant for determining title. The result would undermine the very goal of a national system, as it would only add a title system, rather than consolidate existing ones.

A simpler solution to lack of consistency of mortgage title procedures among the states would be to recreate a federally owned and operated MERS-type system that would sit as a superstructure on local land records. Such a system would easily interface with existing land records, local real-property law, and lien-priority rules. Further, with any federal MERS system, it would be simple to correct the major failings of the MERS system: failure to properly and timely register transfers could have definite legal effects, thereby ensuring the accuracy of the database; foreclosures could be required to be undertaken in the name of the real party in interest; and transfers within the database could only be made by properly registered and vetted agents of lenders, rather than by MERS's poorly supervised and much-criticized system of "signing agents," none of whom actually work for MERS.[305]

A farther-reaching approach would involve the federalization of all land records in a Torrens-type registry, such as that used in several states and other countries.[306] This approach would make sense if designing a land record system on a blank slate, but it would be an expensive undertaking with questionable constitutional authority.

4. *Elimination of Negotiability*. Elimination of negotiability raises a range of potential problems. It would expose mortgage investors to the risk of double selling (warehouse fraud),[307] thereby undermining the freedom from claims that is a basic assumption for most MBS investment. Indeed, warehouse lending, which provides the financing for most mortgage banks, relies on negotiability: many warehouse-lending arrangements involve a bailment of mortgage notes with the bailee (such as Fannie Mae or Freddie Mac) having the option to purchase the notes. This option can be easily executed if the notes held by the bailee are indorsed in blank. The ambiguous nature of title to a bailment of bearer property is precisely what lubricates the system.

Eliminating negotiability would also eliminate the possibility of a mortgagee being a holder in due course, again affecting freedom from

305. *See supra* note 171 and accompanying text.
306. *See supra* note 118.
307. Whitman, *supra* note 49, at 768–69.

claims and freedom from defenses. Although assignee liability might not be a bad thing,[308] elimination of negotiability also makes enforcement more difficult—the terms of a mortgage would need to be proven separately from the note. In any event, the market could abandon negotiability by itself if the benefits outweigh the costs. Yet the market has cleaved to what it believes to be a negotiable instrument for the note.

5. *Merger of Note and Mortgage*. The idea behind merging the note and mortgage into a single instrument is to eliminate the possibility of the noteholder being different from the mortgagee. By itself, however, all merger accomplishes is to make the mortgage-follows-the-note doctrine literal. It does not resolve how the instrument is supposed to be transferred and therefore who has enforcement rights. Moreover, a merged instrument would present privacy problems for borrowers. Not all individuals want their neighbors to know that they have bad credit and can only get a subprime loan. The current separation of the note and mortgage means that only the mortgage is a public document. The terms of the note stay private, protecting the borrower's (and the lender's) privacy interest in the terms of the loan, which may reveal the borrower's overall financial condition. Merger of note and mortgage into a single instrument would come at the expense of borrower privacy absent some way of splitting the recorded instrument into a public portion and a portion available only to litigants and the recording-office officials.

* * *

Ultimately, the deficiencies of existing reform proposals all stem from the overly narrow nature of their diagnoses of the problem as either one of real-estate recordation systems,[309] negotiability,[310] or consumer protection.[311] The mortgage-title-system problem implicates all of these issues, but it is fundamentally a problem about competing title systems. Once the nature of the problem is recognized, a

308. *See* Kurt Eggert, *Not Dead Yet: The Surprising Survival of Negotiability*, 66 ARK. L. REV. 145, 171–73 (2013) (identifying the holder-in-due-course doctrine as the real problem with negotiability).

309. *See* Marsh, *supra* note 294, at 19–24; Zacks, *supra* note 296, at 551–55.

310. *See* Whitman, *supra* note 49, at 741–54.

311. *See* White, *supra* note 300, at 494–96.

solution—reconciling title systems—readily presents itself. Importantly, however, system reconciliation would only help prospectively; it would not solve the legacy problem of existing mortgages.

B. Reconciling Title Systems

There are several possible ways to reconcile mortgage title systems. As an initial matter, however, it is important to note that the standard property-law move for dealing with competing claims, namely, establishing a system of priorities, is inapplicable to a problem of competing systems used to establish rights against nonclaimants. The issue is one of system validity, not priority.

Were one creating a mortgage title system from scratch, it is likely that such a system would be integrated with land records. It would also be a federal-level system; only historical development explains why state and local law still shape a national (and international) real-estate finance market. There also would be no particular reason for having mortgage title separate from other types of security interests. In short, if working on a blank slate, a unified federal system for recording of a range of intangible and tangible property interests might make sense; realistically, however, any reforms must work within the existing institutional framework of county-level land records and state-level law.

Working within the existing institutional framework, the simplest approach would be to pick a system and have it be the sole determinative system. Thus, we could decide that Article 3 negotiation, Article 9 sale, MERS, or land records control. If the concern is establishing clarity of property rights, then public recordation—land records—would seem to be the optimal system because it gives the best evidentiary certainty, and because virtually all mortgages are recorded as a matter of practice.[312] But mortgage recordation is not mandatory, and the mortgage is an ancillary right to the note—a mortgage without a note has little meaning. State real-property law would need to be amended in some cases to make such a system work well.

Alternatively, we could create a hierarchy among existing title systems, in which all would be valid ways of creating title, but title in

312. One could envision a grace period for transferring mortgages recorded in MERS's name to the name of the real economic lender.

one system would trump title in another system if there were a conflict. For example, we could have a system in which Article 9 sales trump MERS, negotiation trumps Article 9 sales, and mortgage recordation trumps negotiation. Thus, if there were a conflict between, say, Article 9 and recordation, the recorded title would be treated as controlling. There is a potential recursivity problem here as long as recordation can be done in MERS's name. To wit, in the example above, if recordation trumps Article 9, but the mortgage is recorded in MERS's name, then what has really happened is that MERS has trumped Article 9, which upends the intended hierarchy. But conceptually, the idea of establishing a hierarchy is another way to deal with competing property-title regimes.

A further approach would be to return to presecuritization systems, which worked well in terms of keeping title clear. This could be done via a partial repeal of the UCC Article 1 and 9 revisions and a prohibition of property recordation in the name of agents, thereby making MERS inoperable. This approach would require recordation of every mortgage transfer in a securitization, as well as cumbersome indorsement and delivery of thousands of notes, but these demonstrative formalities would be the price tag for clear property rights.

Another approach would be that adopted by the Massachusetts Supreme Judicial Court in *Eaton*, namely, requiring that note and mortgage systems match as a prerequisite for foreclosure.[313] A party would need to prove that it was both the owner (or holder) of the note and the mortgagee in order to foreclose. Although such an approach clarifies foreclosure standing issues, it does not clarify the ownership of notes or mortgages, which is important for mortgage financing markets.

An alternative approach would be to create a county- or state-level system for registering ownership of mortgage notes that would be linked to land records through unique identifiers. A note registry would not establish conclusive title to the note.[314] But it would provide strong presumptive evidence of title, much like mortgage recordation. It could also establish priority of claims to notes, thereby avoiding warehouse-fraud problems. Note registration could then be combined with the Massachusetts approach by making matching registration of

313. For discussion of *Eaton*, see *supra* notes 10, 16 and accompanying text.

314. One could imagine a Torrens registration system for notes, *cf. supra* note 118, but it would add significant costs.

the note and recordation of the mortgage prerequisites for foreclosure. The result would be reduced fraud costs, uncertainty costs, and adjudication costs.[315] Moreover, a note registration system would not require the recording of the actual notes, as registration would not be evidence of the terms of the notes, only of ownership of the note. A note registry need only be a grantor-grantee index and could be adopted by local governments at comparatively low cost given their existing mortgage recordation systems. This means that registration could preserve borrowers' privacy interest in the terms of the note.

Note registration and a requirement of matching notes and mortgages for foreclosure would solve the problem of which title system controls while leaving undisturbed the operation of either land records or UCC Article 3 or Article 9. Registration would be required only for mortgage notes and only as a prerequisite to foreclosure. UCC Articles 3 and 9 would still operate as before for nonmortgage notes, whereas mortgage notes would simply require an additional formality for foreclosure, which could also be used as a type of notice filing to achieve extra security for those lending against the security of mortgage notes. Similarly, a note registry does not interfere with the operation of the current land recordation system, which enables prospective lenders to engage in tract searches to find out if there are any existing encumbrances on the property.

Adopting a note registration system is the most natural outcome of the increased transfers of mortgage loans. Registration systems are frequently used for other types of readily traded debt instruments because of concerns such as problems of lost or forged instruments, the costs of physical delivery and indorsement, and interest in reducing litigation by clarifying rights. Treasury securities are tracked in a central registry maintained by the Federal Reserve Banks known as a "book-entry" system.[316] Fannie and Freddie MBS are also issued using a book-entry system.[317] Some cross-border trades of goods use

315. *See* Clark, *supra* note 32, at 478 (discussing the benefits of recordation).

316. *See Book-Entry Procedure*, FED. RES. BANK N.Y., http://www.newyorkfed.org/aboutthefed/fedpoint/fed05.html (last visited Oct. 20, 2013) (noting the difficulties in making actual physical deliveries of securities and that "[s]ecurities in book-entry form are less vulnerable to theft and loss, can't be counterfeited and don't require counting or recording by certificate number").

317. *Id.*

the Bill Of Lading Electronic Registry Organization (BOLERO).[318] And most corporate and municipal debt and equity securities utilize the DTC.[319]

MERS represented another type of registration system for debt instruments, albeit one that was poorly designed and executed. MERS's legitimacy suffered because of the errors in its database and abuse of corporate formalities. But the concern with MERS is also acute because the public policy interest in land title is different than the public policy interest in securities, and yet MERS lacks a statutory framework comparable to the UCC Article 8 and SEC regulation framework in which the DTC operates. Clouded property title affects neighboring properties and household balance sheets in a way that ownership of securities or bills of lading do not.

The technical work of creating a note registry that interfaces with land records should not be a particularly onerous undertaking. The expense of operating such a system should be fairly modest, and much of the work could be automated. Although the system would be built around bright-line rules permitting foreclosure only to registered note owners-mortgagees, some standards-based safeguards need to be built to provide flexibility to the system, particularly to deal with problems of mistake or abuse.[320]

A note registration system could obviously process mortgage notes executed after the registry's operational date. Legacy mortgage notes—those executed before the registry's operational date—would present a challenge, however. Registration of existing mortgage notes would be expensive and would upset parties' settled expectations about cost frameworks in mortgage lending. There would also be the question of how to prove ownership of mortgage notes that have already been transferred. Although optimally all legacy mortgage notes would be registered, a more feasible and fairer solution would be to permit, but not require, registration for legacy notes. Legacy-title problems will have to be resolved slowly and messily, as courts

318. *See generally* Miriam Goldby, *Electronic Bills of Lading and Central Registries: What Is Holding Back Progress?*, 17 INFO. & COMM. TECH. L. 125 (2008) (noting that central registry systems like BOLERO have not been widely adopted because of membership requirements, confidentiality concerns, and liability for system malfunction).

319. *Responding to Wall Street's Paperwork Crisis*, DTCC, http://www.dtcc.com/about/history (last visited Oct. 20, 2013).

320. *See* Joseph William Singer, *The Rule of Reason in Property Law*, 46 U.C. DAVIS L. REV. 1369, 1420–35 (2013).

experiment with ways of upholding the law while limiting the systemic effects.

Ultimately, the key question with a mortgage note registry is whether it is worthwhile. The costs and benefits are hard to immediately quantify in dollar terms. On the one hand, the costs are operation costs of creating and maintaining a registry and the cost to mortgagees of registering the notes. For local governments that already operate mortgage recordation systems, the costs of creating and operating a parallel note registration system seem fairly low—registration is not a particularly complex task. Requiring matching registration and recordation as a prerequisite to foreclosure would increase the costs of mortgage lending, and those costs might get passed on to mortgage borrowers in part or in whole.

Against these costs we must weigh the benefits. Registration benefits the homeowner in the event of a foreclosure by ensuring that procedural rights will be respected. Requiring matching registration and recordation is in essence a form of mandatory insurance for borrowers.[321]

321. In theory, private title insurance would serve as a solution to questions about mortgage title. If mortgage title is in doubt, private title insurers will assume the risk in exchange for an acceptable premium, and, if risks become too great, then title insurers simply will not insure. In practice, however, private title insurance is incapable of dealing with the mortgage chain-of-title problem. This is because private title insurers have already written numerous policies on properties in which title may not be clean. The title insurers' business model anticipates only unique, one-off insurable events. *See* Joyce D. Palomar, *Bank Control of Title Insurance Companies: Perils to the Public That Bank Regulators Have Ignored*, 44 SW. L.J. 905, 928–29 (1990) (explaining why an attorney or abstractor is only expected to exercise reasonable care in conducting a title search, and may not be held liable for failing to detect a title defect that would be undetectable by a reasonable search); David E. Woolley & Linda D. Herzog, *MERS: The Unreported Effects of Lost Chain of Title on Real Property Owners*, 8 HASTINGS BUS. L.J. 365, 393–94 (2012) (discussing scenarios presenting unique problems to title insurance). Accordingly, they are simply not capitalized to be able to handle a systemic title problem. *See* JOYCE PALOMAR, *Limits on Size of Single Risks Assumed*, *in* 2 TITLE INSURANCE LAW § 18:34 (2012), *available at* Westlaw TITLEINSL (examining statutory limits on liability that title insurance underwriters may assume, as well as related exceptions to that rule); Suzanne M. Garcia, *A Glance at the Impact of the Subprime Mortgage Crisis on the Title Insurance Industry*, 30 PACE L. REV. 233, 235–41 (2009) (discussing the impact of the subprime mortgage crisis on title insurance companies); Quintin Johnstone, *Title Insurance*, 66 YALE L.J. 492, 502 (1957) (noting the small or nonexistent reserves maintained by most title insurers). If such a problem exists, title insurers are functionally insolvent and have nothing to lose by continuing to write new policies. Indeed, even if there were a systemic title problem, title insurers would have to continue writing new policies in order to continue operating because they are usually paid in single, up-front premiums, so if they cease writing new policies, their cashflow, and hence their ability to operate, will cease. *See* H. Lee Roussel & Moses K. Rosenberg, *The High Price of "Reform": Title Insurance Rates and the Benefits of Rating Bureaus*, 48 J. RISK & INS. 638, 642–43 (1981) (noting that title insurance, unlike other types of insurance, depends on a single

Registration also benefits the courts by preserving their jurisdictional integrity and creating adjudicative efficiency. Foreclosure is a severe remedy that invokes the coercive power of the state to deprive a resident of his or her home—a property interest that receives particular solicitude in the law. This is precisely the sort of circumstance in which there is a societal interest in ensuring that the coercive machinery of state is used appropriately, which necessitates adopting a more reliable source for verifying property rights.

There are also positive externalities on society at large from clarity of title that registration helps capture. Clarity of title enables greater alienability of realty, including of neighboring realty. Absence of title clarity conversely creates negative social externalities. Registration would help create the positive externalities and avoid the negative ones.

Registration could also lower the cost of mortgage lending. Warehouse lenders would have to do less diligence, resulting in cost savings in the financing system that might benefit borrowers. More importantly, registration could ultimately reduce foreclosure costs by reducing uncertainty in the legal system and reducing litigation costs. Lower foreclosure costs might result in lower mortgage rates and greater credit availability.[322]

The cost-benefit tradeoff from mandating note registration as a prerequisite to foreclosure is not quantifiable and is ultimately uncertain, as are its distributional impacts. Yet there is a plausible case that it would create a more efficient mortgage financing system from a Kaldor-Hicks, if not a Pareto, perspective, which is sufficient given the ability of parties in the mortgage finance system to reallocate costs among themselves. Even if registration did not create a more efficient system, however, the distributional adjustments and jurisdictional integrity benefits might themselves be sufficient to make the system appealing. Indeed, we already impose similarly mandated procedural insurance through existing foreclosure

purchase to raise revenue); Peter Soskin, *Protecting Title in Continental Europe and The United States—Restriction of a Market*, 7 HASTINGS BUS. L.J. 411, 425–33 (2011) (examining the history and characteristics of title insurance policies). Therefore, unless title insurers constantly underwrite new policies, they have no ongoing source of revenue. This means that private title insurers cannot be relied on to either bear the costs for or screen against systemic problems in title.

322. *See supra* note 37 and accompanying text.

procedures and the existence of the bankruptcy system.[323] Mandating this type of procedural insurance reflects the societal interest in ensuring clarity in real-property rights.[324]

Note registration is not the only possible way to reconcile competing mortgage title systems, but it would create the greatest certainty-of-rights benefits relative to its invasiveness. Adopting a registration-based, property-rights verification regime to govern mortgage notes and linking it to a public recording system for mortgages might also ultimately result not only in greater certainty of mortgage title, but also in more efficient mortgage lending, and even if not, may protect against potentially severe negative public externalities.

CONCLUSION

The problem of mortgage title stands as a lesson to the commercial-law community of getting away from the fundamentals of commercial law. This is not simply a doctrinal point, although part of this story told here is a perversion of doctrine in the service of a particular interest group. Nor is it even a point about the need to see the entire forest of commercial law instead of an atomized view that can quickly lead to conflicts within commercial law. Instead, it is about the fundamental purpose of commercial law, which is to facilitate transactions between parties by providing a legal framework for the transfer of property, be it goods or payment rights.

The standard move in the commercial-law playbook for transaction facilitation is Coasean: reduce transaction costs. Yet this move overlooks the importance of ownership and title in commercial law, perhaps, in part, because the UCC generally eschews these terms. Commercial-law semantics aside, however, parties' bargains are based on what is being transferred. Even if all other transaction costs are eliminated, parties will not transact if they do not know what it is they are buying or selling. Reduction of transaction costs is ultimately a second-order move for commercial law. The first-order move, so elemental it is easy to forget, is clarification of the property

323. *See generally* Joshua Goodman & Adam J. Levitin, *Bankruptcy Law and the Cost of Credit: The Impact of Cramdown on Mortgage Interest Rates* (Harvard Kennedy Sch. Working Paper No. RWP12-037, 2012), *available at* http://ssrn.com/abstract=2128841.

324. Note that the argument for mandatory "insurance" here is not because of adverse selection but because of externalities.

being transferred.[325] There are certainly moves in this direction within commercial law, such as implied warranties of merchantability.[326] Property law too moves in this direction through the *numerus clausus* principle.[327] Ultimately it is a property-law lesson that commercial law needs to internalize, namely, that certainty of property rights is a precondition for investment.[328] In a viable commercial-law system, the reduction of transaction costs cannot come at the expense of certainty of property rights.

The mortgage title system also presents a particularly vexing version of the too-big-to-fail problem. The legal questions raised by foreclosure standing litigation were not ones that were unanswered historically, but the answers were ones that were inconvenient for the housing-finance industry and ones that the industry chose to disregard. Normally, parties disregard the law at their own peril, but the calculus is different for a too-big-to-fail industry like housing finance. When a too-big-to-fail industry disregards the law on a wide scale, courts are faced with the choice of upholding the law and causing economic chaos or ignoring the law for the sake of economic stability.

Typically too-big-to-fail crises have economic or natural-disaster triggers, such as a slowing of expected housing price increases or a tsunami. They are not typically triggered by court decisions. Yet with mortgage title problems, courts are put in the position of being *themselves* the potential trigger for a too-big-to-fail crisis. In a case like mortgage title, in which there is seldom any question about the "right" result on the merits—the homeowner has defaulted on the mortgage—courts may be inclined to ignore the law and opt for economic stability. Doing so, however, ignores that procedural protections are part of the economic bargain of the mortgage loan, and also deprives a particularly vulnerable population of the procedural rights that are intended to protect them.

325. UCC Article 2, for example, will tolerate an open price term, an open delivery date, an open payment date, open delivery terms, and quantity terms based on outputs or requirements, U.C.C. §§ 2-304 to -310 (2011), but it does require agreement on *what* is being sold, *see id.* § 2-204.

326. *Id.* § 2-314.

327. *See* Thomas W. Merrill & Henry E. Smith, *Optimal Standardization in the Law of Property: The* Numerus Clausus *Principle*, 110 YALE L.J. 1, 9–11 (2000) (explaining that both civil and common-law courts treat classes of previously recognized property as modifiable only by the legislature).

328. *See supra* note 26.

The mortgage-title-system problem could, like all too-big-to-fail legal problems, be solved by enforcing the law and then letting the political system address the results. Courts, however, might shy from economically disruptive rulings, particularly if they have doubts about the ability of the political system to fix the ensuing chaos. This might well be the case in the aftermath of the bailouts of 2008–2009 and the federal debt-ceiling crises in 2011 and 2013. The mishandling of one round of crisis creates consequences for the next; bailouts are not single-stage games.[329]

Courts' behavior should not surprise legal realists. Courts are ruling with one eye on the economic consequences and accordingly are finding ways to preserve legal principles without triggering crises. The mortgage title issue's complex and arcane nature makes it especially easy to find ways to dispose of cases without issuing definitive rulings about which system of title-and-transfer controls, and it is easy to ignore compliance problems as isolated exceptions, rather than the rule. Moreover, because the subject of the litigation is standing, it is possible to dismiss cases without prejudice, theoretically enabling mortgagees to get their paperwork in order and restart the dismissed foreclosures.[330] Other courts have been more explicit about what they are doing. The Massachusetts Supreme Judicial Court, for example, heeded the pleas of the real-estate bar about the risk to clouded title if past foreclosures were subject to its ruling in *Eaton* and accordingly made its ruling prospective only, a sharp departure from its usual practice.[331] One way or another, cautious courts are likely to muddle through the legacy problems of existing mortgages.

Cautious muddling might be the best we can hope for in a bad situation, yet it is not clear that this is how we should want our court system to operate. The potential perversion of the law to accommodate too-big-to-fail industries, rather than the risk of financial bailouts, is perhaps the most threatening part of the too-big-to-fail phenomenon because of its corrosive institutional effect. Too-big-to-fail can hold all branches of government hostage.

Ultimately, the confusion over how mortgages are transferred represents a breakdown of our commercial-law and real-estate-law system. The mortgage title disaster represents "the greatest failure of

329. Adam J. Levitin, *In Defense of Bailouts*, 99 GEO. L.J. 435, 447 (2011).

330. *E.g.*, Fed. Home Loan Mortg. Corp. v. Schwartzwald, 979 N.E.2d 1214, 1216 (Ohio 2012); U.S. Bank Nat'l Ass'n v. Moore, 278 P.3d 596, 601–02 (Okla. 2012).

331. Eaton v. Fed. Nat'l Mortg. Ass'n, 969 N.E.2d 1118, 1120–32 (Mass. 2012).

lawyering in the last 50 years."[332] The law reforms pushed by the securitization industry in the name of efficiency undermined the legal foundation for a critical part of the economy. Going forward, rebuilding the U.S. housing-finance system must begin by reinforcing its legal infrastructure.

332. Gretchen Morgenson, *A Tornado Warning, Unheeded*, N.Y. TIMES, Feb. 5, 2012, at BU1 (quoting U.S. Bankruptcy Judge Robert D. Drain).

APPENDIX

This Appendix is meant to provide an illustrative range of foreclosure-standing cases as of June 2013, rather than a complete listing of all such cases. It is organized by the state law being applied.

Alabama

- Congress v. U.S. Bank, N.A., 98 So. 3d 1165 (Ala. Civ. App. 2012) (holding that a mortgagor could prevail in a wrongful-foreclosure action by showing lack of standing to foreclose if it could prove on a preponderance-of-the-evidence standard that the allonge to the mortgage note was fabricated, and remanding for trial on that basis)

Arizona

- *In re* Tarantola, 4:09-bk-09703-EWH, 2010 WL 3022038 (Bankr. D. Ariz. July 29, 2010) (denying a motion for relief from stay for lack of real interest in the property when the plaintiff could not prove valid assignment of the note)
- Varbel v. Bank of Am. Nat'l Ass'n, No. 1 CA-CV 12-0263, 2013 WL 817290 (Ariz. Ct. App. 2013) (holding that a nonjudicial foreclosure sale did not require the production of the note or its chain of custody)

California

- *In re* Hwang, 396 B.R. 757, 765 (Bankr. C.D. Cal. 2008) (holding that the noteholder plaintiff must join the owner of the note, the real party in interest, before it could seek relief from a stay), *rev'd*, 438 B.R. 661 (C.D. Cal. 2010)
- *In re* Vargas, 396 B.R. 511 (Bankr. C.D. Cal. 2008) (denying a motion for relief from a stay for lack of real interest in the property when the plaintiff could not prove valid assignment of the note)
- *In re* Urdahl, No. 07-07227-PB7, 2008 WL 8013408 (Bankr. S.D. Cal. June 9, 2008) (denying a motion for relief from stay for lack of real interest in the property when the plaintiff could not prove valid assignment of the note)

Connecticut

- U.S. Bank v. Coley, No. CV076001426, 2011 WL 2734603 (Conn. Super. Ct. June 10, 2011) (dismissing a foreclosure for lack of standing because the mortgage assignment was four months subsequent to the foreclosure suit's initiation)

Florida

- *In re* Canellas, 6:09-bk-12240-ABB, 2010 WL 571808 (Bankr. M.D. Fla. Feb. 9, 2010) (finding no evidence of a proper assignment of the mortgage or the note to the foreclosing party prior to foreclosure)
- McLean v. JP Morgan Chase Bank Nat'l Ass'n, 79 So. 3d 170 (Fla. Dist. Ct. App. 2012) (reversing a grant of summary judgment for a foreclosure plaintiff when the assignment of a mortgage occurred three days after the suit was initiated and the assignment of the note was undated)

Idaho

- *In re* Wilhelm, 407 B.R. 392 (Bankr. D. Idaho 2009) (denying a motion for relief from stay for lack of real interest in the property when the plaintiff could not prove valid assignment of the note)
- *In re* Sheridan, 08-20381-TLM, 2009 WL 631355 (Bankr. D. Idaho Mar. 12, 2009) (same)

Kansas

- U.S. Bank Nat'l Ass'n v. McConnell, 305 P.3d 1 (Kan. Ct. App. 2013) (holding that the formal assignment of the mortgage after the commencement of the foreclosure action did not vitiate standing because the mortgage follows the note)

Massachusetts

- *In re* Jones, 07-15662-JNF, 2008 WL 4539486 (Bankr. D. Mass. Oct. 3, 2008) (holding a putative mortagee lacked standing because the mortagee did not provide proof of valid assignment of the mortgage)
- *In re* Hayes, 393 B.R. 259 (Bankr. D. Mass. 2008) (same).
- Nosek v. Ameriquest Mortg. Co., 286 B.R. 374 (Bankr. D. Mass. 2008), *aff'd in part, rev'd in part sub nom. In re* Nosek, 406 B.R. 434 (D. Mass. 2009) (sanctioning the attorneys for the

putative mortgagees when the attorneys had claimed to be the holders of the mortgages and notes but had actually sold them five days after origination)

- *In re* Maisel, 378 B.R. 19 (Bankr. D. Mass. 2007) (finding no evidence of a proper assignment of the mortgage or the note to the foreclosing party prior to foreclosure)
- *In re* Schwartz, 366 B.R. 265 (Bankr. D. Mass. 2007) (finding no evidence of a proper assignment of the mortgage to the foreclosing party prior to foreclosure and no evidence that the note was assigned)
- Eaton v. Fed. Nat'l Mortg. Ass'n, 969 N.E.2d 1118 (Mass. 2012) (holding that a foreclosure sale was invalid because the foreclosing entity did not hold the promissory note at the time of sale)
- Bevilacqua v. Rodrigues, 460 Mass. 762 (Mass. 2011) (holding that an invalid foreclosure sale was ineffective to transfer title)
- U.S. Bank, Nat'l Ass'n. v. Ibanez, 458 Mass. 637 (Mass. 2011) (holding that a foreclosure sale was invalid because the foreclosing entity was not the mortgagee of record at the time of sale)

Michigan

- Davenport v. HSBC Bank USA, 739 N.W.2d 383, 385 (Mich. Ct. App. 2007) (holding that a foreclosure must be vacated when the bank "did not yet own the indebtedness that it sought to foreclose")
- Residential Funding Co, L.L.C. v. Saurman, 490 Mich. 909 (Mich. 2011) (holding that MERS had standing to foreclose nonjudicially)

Nevada

- Mortg. Elec. Registration Sys., Inc. v. Medina, No. 2:09-CV-00670-KJD-GWF, 2009 WL 4823387 (D. Nev. Dec. 4, 2009) (finding no evidence that the plaintiff was the agent of the owner of the note and therefore was not a real party in interest with standing)
- Mortg. Elec. Registration Sys., Inc. v. Chong, Nos. 2:09-CV-00661-KJD-LRL, BK-S-07-16645-LBR, 2009 WL 6524286 (D. Nev. Dec. 4, 2009) (same)

- Pasillas v. HSBC Bank USA, 255 P.3d 1281 (Nev. 2011) (holding that nonjudicial foreclosures could not proceed under the Nevada foreclosure-mediation statue when a party seeking foreclosure was neither the holder of the note nor the assignee beneficiary of the deed of trust)
- Leyva v. Nat'l Default Servicing Corp., 255 P.3d 1275 (Nev. 2011) (same)
- Edelstein v. Bank of N.Y. Mellon, 286 P.3d 249 (Nev. 2012) (holding that the party seeking to foreclose must demonstrate that it was both the holder of the promissory note and the beneficiary of the deed of trust)

New Jersey

- *In re* Kemp, 440 B.R. 624 (Bankr. D.N.J. 2010) (sustaining an objection to a proof of claim when the plaintiff could not prove an enforceable right to the note under state law)

New York

- *In re* Minbatiwalla, 424 B.R. 104 (S.D.N.Y. 2010) (dismissing a mortgagee's claim without prejudice for failure to provide documentation establishing the mortgagee's proof of claim upon a debtor's objection)
- Bank of N.Y. v. Silverberg, 926 N.Y.S.2d 532 (App. Div. 2011) ("[F]oreclosure of a mortgage cannot be pursued by one who has no demonstrated right to the debt.")
- Countrywide Homes Loans, Inc. v. Gress, 888 N.Y.S.2d 914 (App. Div. 2009) (holding that a mortgagee's assignee lacked standing to foreclose because it did not own the mortgage at the time the complaint was filed)
- Wells Fargo Bank, N.A. v. Marchione, 887 N.Y.S.2d 615 (App. Div. 2009) (finding no evidence of a proper assignment of the mortgage to the foreclosing party prior to foreclosure)
- Lasalle Bank Nat'l Ass'n v. Ahearn, 875 N.Y.S. 2d 595 (App. Div. 2009) (holding that a mortgagee's assignee lacked standing to foreclose because it did not own the mortgage at the time the complaint was filed)
- JP Morgan Chase Bank, Nat'l Ass'n v. Butler, 2013 WL 3359283 (Sup. Ct. July 5, 2013) (releasing the proceeds from a home sale to the defendant-mortgagor because the plaintiff

bank never owned the note and mortgage and therefore never had a right to foreclose)

- Wells Fargo Bank, N.A. v. Erobobo, No. 31648/2009, 2013 WL 1831799 (Sup. Ct. 2013) (denying a motion for summary judgment in a foreclosure because the assignment of the note and mortgage were void when they did not comply with the PSA)
- Deutsche Bank Nat'l Trust Co. v. Stevens, 911 N.Y.S.2d 691 (Sup. Ct. 2010) (holding that a mortgagee's assignee lacked standing to foreclose because the assignee did not hold the promissory note at the time the complaint was filed)
- JP Morgan Chase Bank, N.A. v. George, 910 N.Y.S.2d 762 (Sup. Ct. 2010) (same)
- Deutsche Bank Nat'l Trust Co. v. McRae, 894 N.Y.S.2d 720 (Sup. Ct. 2010) (finding no evidence of a proper assignment of the note to the foreclosing party prior to foreclosure)
- Citigroup Global Markets Realty Corp. v. Randolph Bowling, 906 N.Y.S.2d 778 (Sup. Ct. 2009) (holding that a mortgagee's assignee lacked standing to foreclose because the assignee did not hold the promissory note at the time the complaint was filed)
- HSBC Bank U.S.A. Nat'l Ass'n v. Miller, 889 N.Y.S.2d 430 (Sup. Ct. 2009) (same)
- Deutsche Bank Nat. Trust Co. v. Abbate, 901 N.Y.S.2d 905 (Sup. Ct. 2009) (same)
- HSBC Bank USA, N.A. v. Valentin, 873 N.Y.S.2d 512 (Sup. Ct. 2008) (dismissing a foreclosure action without prejudice due to discrepancies in affidavits as to the date of the assignment of the mortgage and failure to provide an affidavit from someone with a valid power of attorney regarding the assignment)
- Countrywide Home Loans v. Taylor, 843 N.Y.S.2d 495 (Sup. Ct. 2007) (holding that a mortgagee's assignee lacked standing to foreclose because it did not own the mortgage at the time the complaint was filed)

Ohio

- Novastar Mortg., Inc. v. Snyder, No. 3:07CV480, 2008 WL 4560794 (N.D. Ohio Oct. 10, 2008) (dismissing a foreclosure action without prejudice for lack of standing because there was no evidence that the mortgage had been transferred from MERS to the foreclosing entity)

- Deutsche Bank Nat'l Trust Co. v. Steele, 2008 WL 111227 (S.D. Ohio Jan. 8, 2008) (ordering a plaintiff to produce evidence that the plaintiff owned the note and mortgage when the complaint was filed before summary judgment could be granted)
- *In re* Foreclosure Cases, 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 WL 4589765 (S.D. Ohio Dec. 27, 2007) (dismissing foreclosure actions for lack of standing because the plaintiff-mortgagees did not have valid assignments of the notes and mortgages at the time the complaint was filed)
- *In re* 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) (same)
- Fed. Home Loan Mortg. Corp. v. Schwartzwald, 979 N.E.2d 1214 (Ohio 2012) (reversing a foreclosure judgment because the foreclosing party received the promissory note and mortgage after the commencement of foreclosure and therefore lacked standing, which could not be corrected by subsequent transfers of the note and mortgage)
- CitiMortgage, Inc. v. Patterson, 984 N.E.2d 392 (Ohio Ct. App. 2012) (holding that a bank had standing to foreclose despite not being the mortgagee at the time of foreclosure because it held the bearer paper note)[333]
- U.S. Bank Nat'l Ass'n v. Duvall, No. 94714, 2010 WL 5550257 (Ohio Ct. App. Dec. 30, 2010) (holding that a mortgagee's assignee lacked standing to foreclose because the assignee did not own the mortgage at the time the complaint was filed and was therefore not the real party in interest)
- U.S. Bank Nat'l Ass'n v. Perry, No. 94757, 2010 WL 5238626 (Ohio Ct. App. Dec. 16, 2010) (overturning summary judgment because the plaintiff's affidavit did not state that the plaintiff

333. The court did not address why holding a note gives standing to foreclose the homeowner's equity of redemption via a forced sale, rather than simply standing to sue for monetary damages.

owned both the note and the mortgage at the time the complaint was filed and a genuine issue of material fact remained as to whether the plaintiff was entitled to foreclose)
- Wells Fargo Bank, N.A. v. Jordan, No. 91675, 2009 WL 625560 (Ohio Ct. App. Mar. 12, 2009) (affirming a dismissal of a foreclosure action for lack of standing because the putative mortgagee could not prove that mortgagee owned the mortgage at the time the complaint was filed)
- Wells Fargo Bank, N.A. v. Byrd, 897 N.E.2d 722 (Ohio Ct. App. 2008) (same)

Oklahoma
- U.S. Bank, Nat'l Ass'n v. Moore, 278 P.3d 596 (Okla. 2012) (reversing a foreclosure judgment for lack of standing because the plaintiff was not the holder of the note and therefore not a person entitled to enforce the note)
- Deutsche Bank Nat'l Trust Co. v. Byrams, 275 P.3d 129 (Okla. 2012) (reversing and remanding summary judgment for a foreclosure plaintiff because standing did not exist at the time the action was instituted)
- Deutsche Bank v. Brumbaugh, 270 P.3d 151 (Okla. 2012) (reversing a grant of summary judgment to a foreclosure plaintiff because material issues of fact remained regarding standing to foreclose)

Oregon
- Niday v. GMAC Mortg., LLC, 284 P.3d 1157 (Or. Ct. App. 2012) (holding that a deed-of-trust beneficiary that used MERS could not undertake a nonjudicial foreclosure)

Vermont
- U.S. Bank Nat'l Ass'n v. Kimball, 27 A.3d 1087 (Vt. 2011) (upholding a denial of standing to foreclose because the bank could not demonstrate that it was the holder of the note at the time the foreclosure action was initiated)

Washington
- *In re* Jacobson, 402 B.R. 359 (Bankr. W.D. Wash. 2009) (holding that a servicer for a holder of a note, which had no

beneficial interest in the note, was not the real party of interest and thus was not entitled to relief from stay)

- Bain v. Metro. Mortg. Grp., Inc., 285 P.3d 34 (Wash. 2012) (holding that MERS could not utilize the Washington nonjudicial foreclosure procedure because it was not the lawful beneficiary of a deed of trust because it did not hold the note)