COMMONWEALTH OF MASSACHUSETTS
SUPREME JUDICIAL COURT

S.J.C. NO. 11041

HENRIETTA EATON

Plaintiff-Appellee

v.

FEDERAL NATIONAL MORTGAGE ASSOCIATION & ANOTHER

Defendants-Appellees

ON APPEAL FROM MASSACHUSETTS SUPERIOR COURT
CIVIL ACTION NO. 11-1382

AMICUS CURIAE BRIEF OF PROFESSOR ADAM J. LEVITIN

Adam J. Levitin
Professor of Law
Georgetown University Law Center
600 New Jersey Ave., NW
Washington, DC 20001
(202) 662-9234
adam.levitin@law.georgetown.edu

September 23, 2011

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I. Statement of Interest of Amicus Curiae

I am a Professor of Law at Georgetown University Law Center in Washington, D.C. I teach courses in commercial law, contracts, structured finance, consumer finance, and bankruptcy. I have written extensively on mortgage servicing and testified before Congress repeatedly on problems in the foreclosure process. I have also previously served as Special Counsel for Mortgage Affairs to the Congressional Oversight Panel Supervising the Troubled Asset Relief Program (TARP) and as the Scholar in Residence at the American Bankruptcy Institute. I have no affiliation with any party in this case. I write to the Court as *amicus* concerned with the case's implications for commercial law and the foreclosure process and urge the affirmation of the Superior Court's opinion.

II. Statement of the Issue

Whether a foreclosure prosecuted by the holder of a mortgage that does not also hold the affiliated note is valid?

III. Argument

This case calls on the Supreme Judicial Court to once again clarify what is required for a valid foreclosure under the laws of the Commonwealth. In its recent Ibanez decision, the Court made clear that a party that is not the mortgagee at the time the foreclosure is commenced lacks standing to prosecute the foreclosure. U.S. Bank Nat'l Ass'n v. Ibanez, 458 Mass. 637 (2011). In Ibanez, it was undisputed that the foreclosing entities possessed the notes. This Court rejected the argument, however, that a noteholder has the right to foreclose absent the mortgage. A beneficial interest in the mortgage was insufficient for foreclosure in Ibanez.

This case deals with the inverse of Ibanez, where a party holds a mortgage, but not the affiliated note. The issue is whether such a party may prosecute a foreclosure. The answer must clearly be no.[1]

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[1] The situation might be different if Green Tree were the agent for the noteholder at the time of the foreclosure and acting in its capacity as agent. In this case, no evidence has been adduced, however,

A. Well-Established Massachusetts Law Forbids Foreclosure by a "Naked Mortgagee"

Massachusetts law has long held that while a mortgage and a note may be separately transferred or assigned, they must be united for a foreclosure to be successfully prosecuted. See, e.g., Wolcott v. Winchester, 81 Mass. 461, 465 (1860) ("the possession of the debt [is] essential to an effective mortgage…without it [one cannot] maintain an action to foreclose the mortgage."); Crowley v. Adams, 226 Mass. 582, 585 (1917) ("possession of the note [is]

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proving an agency relationship between Green Tree and the noteholder, much less that the agency relationship authorizes the agent to prosecute a foreclosure and eviction. This Court's stricture in Ibanez makes clear that such a relationship must be established at the time of the foreclosure. Ibanez, supra, 458 Mass. at 653-54. An unresolved subordinate issue is whether the agent must physically possess the note in order to prosecute a foreclosure.

essential to an enforceable mortgage without which [no] mortgage could effectively be foreclosed.").[2]

[2] Appellants argue that M.G.L. c.244, § 14 has supplanted the common law rule regarding the inability of "naked mortgagees" to foreclose. If the Court believes it is necessary to address the statutory language of M.G.L. c.244, § 14, it should hold that the term "mortgagee" in that section to refers to the holder of the mortgage and the note, not to a naked mortgagee lacking the affiliated note, or as at least ambiguous.

The statutory language of section 14 refers to the term "mortgagee," but it is not clear on its face if this is meant to refer to merely to the holder of the mortgage, without regard to the note, or if this is meant in the more usual colloquial sense of the holder of the note and the mortgage. A survey of other sections of Chapter 244 of the General Laws indicates that the term mortgagee is being used to refer to the holder of both the mortgage and note. See, e.g., M.G.L. c.244, §§ 17B (using the terms "mortgagee" and "holder of a mortgage note" interchangeably), 19 (referring to payment "to the mortgagee"), 20 (creating a setoff right against a

B. Naked Mortgagees Lack an Economic Interest in the Note

There are numerous reasons why a mortgage and note might be intentionally (or accidentally) separated. In any case, the mortgagee is a "naked mortgage" that lacks any economic interest in the

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"mortgagee," which would require the mortgagee to be owed a debt by the mortgagor), 23 ([t]he court may determine . . . whether any and what amount due on the mortgage is not in dispute, and may by an interlocutory decree order it paid to the mortgagee…") (emphasis added), 36 ("If a mortgagee or person claiming or holding under him receives from rents and profits of the land, or upon a tender made to him, or in any other manner, more than is due on the mortgage…."), 39 (redemption of mortgage from the Commonwealth as mortgagee requires payment to the state treasurer, implying that the Commonwealth as mortgagee must also be the noteholder).

note.[3] Today, perhaps the most notable example of the separation of the mortgage and the note is through the use of the Mortgage Electronic Registration Systems (MERS), a private mortgage recordation system.[4] MERS does not engage in any sort of lending itself, but mortgages will frequently be assigned to MERS (or made out to MERS originally) in order to avoid county recordation taxes upon transfers of mortgage as well as the delays in local land record title searches. Christopher L. Peterson, Foreclosure, Subprime Mortgage Lending, and the Mortgage Electronic Registration System, 78 U. CINCINNATI L. REV. 1359, 1368-73 (2010). MERS will thus be listed in local land records as the mortgagee of record, but MERS never possesses the affiliated notes, and MERS claims no interest in the notes whatsoever. The result is a

[3] In some unusual situations, the mortgagee might have a beneficial interest in the note, but that is not the case before the Court.

[4] This Court need not delve into the problematic status of the Mortgage Electronic Registration System (MERS) to resolve this case. While there are serious questions about the validity of MERS assignments, they are not properly at issue in this case.

separation of the mortgage and note, with MERS holding the mortgage and another party holding the note.

Several states' appellate courts or Supreme Courts have recently held that MERS has no right to foreclose in its own name as it lacks any economic interest in the mortgage, which is but an incident to the note.[5] See, e.g., Bank of N.Y. v. Silverberg, 2011 NY Slip Op. 5002 (N.Y. App. Div. 2d Dep't 2011); Residential Funding Co., LLC v. Saurman, 2011 Mich. App. LEXIS 719 (Mich. Ct. App. Apr. 21, 2011); Mortgage Elec. Registration Sys. v. Saunders, 2010 Me. 79 (Me. 2010).

While these decisions have been based in part on the theory that the "mortgage follows the note," a proposition rejected by this Court in Ibanez, supra 458 Mass. at 652, it is not necessary for the Court to adopt the "mortgage follows the note" principle to concur with the fundamental logic of these cases: the mortgagee is not owed any money by the debtor and has

[5] If MERS were acting as agent for the noteholder, the analysis would proceed differently, but MERS would be required to prove that it was acting within the scope of its agency. Bank of N.Y. v. Silverberg, 2011 NY Slip Op 5002, 4-5 (N.Y. App. Div. 2011).

no interest in the note and is therefore not allowed to avail itself of the remedy of foreclosure.

Put differently, the holder of a "naked mortgage" – a mortgage without a note – lacks any economic interest that entitles it to foreclose. Were it otherwise, the homeowner could settle the debt with the noteholder and still lose his house to the mortgagee. Similarly, if the note were itself defective, the mortgagee would still be able to foreclose on the property. The mortgage may be separable from the note, but it is "but an incident to the" note and unenforceable without the note.[6] Perry v. Oliver, 317 Mass. 538, 541 (1945). Simply put, the mortgage has little meaning or value without the note.

C. Foreclosure by Naked Mortgagees Discourages Settlement

There are good policy bases for not permitting the holder of a naked mortgage to foreclose. First and foremost is the impact on settlement. It is the well-established policy of the Commonwealth to

[6] The note could, of course, be enforced without the mortgage, as an unsecured debt.

encourage settlements between parties. M.G.L. c. 244 § 35A(b); Wolfberg v. Hunter, 385 Mass. 390, 398 (Mass. 1982). While there are generic judicial economy arguments that favor encouragement of settlement, the policy impetus particularly pronounced in the case of mortgage foreclosure given the severity of the remedy—depriving of family of their home—and the collateral damage that foreclosures impose of families and communities. See, e.g., Adam J. Levitin & Tara Twomey, Mortgage Servicing, 28 YALE J. ON REG. 1, 5-6 (2011).

Permitting the mortgagee to foreclose without possession of the note would discourage settlements. Unless unification of the note and mortgage were a prerequisite to foreclosure, the homeowner would have to negotiate simultaneously with both the noteholder and the mortgagee. The homeowner might not be able to find the noteholder, much less coordinate a negotiation the noteholder with the mortgagee's foreclosure litigation schedule. Simply having to coordinate a negotiation with two parties is much harder than having to negotiate with one and could frustrate settlements.

Moreover, reaching a deal with the noteholder would not keep the property from foreclosure, while reaching a deal with the mortgagee would not relieve the homeowner of the debt. Thus, the homeowner would have to strike deals with both the noteholder and the mortgagee. This would raise the net settlement price for the homeowner, which may further frustrate settlement.

Indeed, it would also frustrate the Massachusetts redemption statute, as to avoid a foreclosure, the homeowner might have to pay more than the unpaid balance on the note to retain the property – a payment for the unpaid balance to the noteholder and then a payment to the mortgagee to halt the foreclosure. Such a result is patently absurd.

D. Foreclosure by a Naked Mortgagee Would Create the Possibility of a Double Recovery

The double-recovery scenario exists is not limited to the settlement context. While M.G.L. and principles of equity govern mortgage foreclosures, the enforcement of the note is governed by Article 3 of the Uniform Commercial Code, codified in Chapter 106

of the Massachusetts General Laws.[7] If a naked mortgagee could foreclose, the foreclosure would not discharge the note. M.G.L. c.106 § 3-602(a) provides that a negotiable note is discharged only when payment is made "to a person entitled to enforce the instrument." M.G.L. c.106 § 3-301 defines "person entitled to enforce" as:

> (i) the holder of the instrument, (ii) a nonholder in possession of the instrument who has the rights of a holder, or (iii) a person not in possession of the instrument who is entitled to

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[7] The Uniform Commercial Code does not govern the enforcement of security instruments in real property. The applicability of Article 3 to the enforcement of the note assumes that the note is a negotiable instrument. There is some question as to whether the most mortgage notes in fact qualify as negotiable instruments under Article 3 of the Uniform Commercial Code. See Ronald J. Mann, Searching for Negotiability in Payment and Credit Systems, 44 UCLA L. REV. 951, 968-973 (1997). They are, however, generally treated as negotiable, and the parties have not raised this issue before the Court.

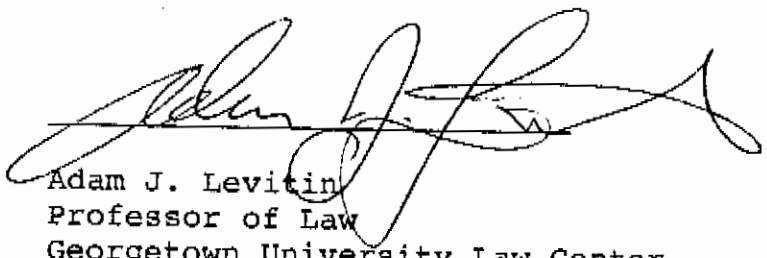
enforce the instrument pursuant to section 3-309 or subsection (d) of section 3-418.

A naked mortgagee does not generally qualify under any of these categories. It is not a holder or a nonholder in possession since it does not physically hold the note, and it is not claiming enforcement rights subject to the lost note provision of M.G.L. c.106, § 3-309 or the mistaken payment provision of M.G.L. c.106, § 3-418. In other words, a payment made to the mortgagee – in the form of the property – would not discharge the note, so the homeowner could face a double recovery situation. The simplest protection against such an inequitable result is to require unification of the mortgage and note in the hands of the party prosecuting the foreclosure.

IV. Conclusion

For the reasons set forth above, the judgment of the Superior Court, granting Ms. Eaton's motion for a preliminary injunction against the Federal National Mortgage Association ("Fannie Mae") and Green Tree Servicing, LLC, dated June 17, 2011, should be affirmed.

Respectfully submitted,



Adam J. Levitin
Professor of Law
Georgetown University Law Center
600 New Jersey Ave., NW
Washington, DC 20001
(202) 662-9234
adam.levitin@law.georgetown.edu

Dated September 22, 2011