COMMONWEALTH OF MASSACHUSETTS

Supreme Judicial Court

No. 11041

Henrietta Eaton,
Plaintiff-Appellee,

v.

Federal National Mortgage Association,
Defendant-Appellant

and

Green Tree Servicing, LLC
Defendant-Appellant

On Direct Appeal from Suffolk Superior Court

BRIEF OF AMICI CURIAE WILMERHALE LEGAL SERVICES CENTER, NATIONAL CONSUMER LAW CENTER AND PAUL COLLIER IN SUPPORT OF PLAINTIFF-APPELLEE AND ARGUING FOR AFFIRMANCE

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This brief is submitted in support of Appellee Henrietta Eaton pursuant to Mass. R. App. P. 17 and the Supreme Judicial Court's September 6, 2011 Announcement soliciting amicus briefs in this matter. The WilmerHale Legal Services Center, the National Consumer Law Center, and Paul Collier make this submission as amici curiae, on behalf of their respective eligible clients.

STATEMENT OF INTEREST

The National Consumer Law Center ("NCLC") has been referred to as the "leading non-profit low-income consumer advocacy organization in the country." Mazola, et al. v. May Department Stores Co., No. 97-CV-10872-NG, 1999 WL 1261312 at *4 (D. Mass. January 27, 1999). Through its advocacy and policy work, NCLC has developed expertise in the abuses visited on consumers by the contemporary process of mortgage securitization. In NCLC's experience, this process is one of the source causes of an extensive range of problematic lending and loan servicing practices.

The WilmerHale Legal Services Center, an independent neighborhood legal services office affiliated with the Harvard Law School clinical program, represents homeowners facing impending

foreclosure due to the predatory lending practices of subprime lenders and the structurally unfair terms of their mortgage loans; and homeowners whose subprime mortgages have already been foreclosed upon by the alleged assignees of their mortgage contract. In both instances, the purported foreclosing mortgagee is frequently unable to prove present ownership of the promissory note and debt secured by the mortgage. Many of the Center's clients stand in the shoes of Appellee Henrietta Eaton and they accordingly illustrate the importance of the lower court's decision.

SUMMARY OF ARGUMENT

When a homeowner receives a mortgage loan, only a mortgagee who is the holder of the promissory note - not a bare assignee of the mortgage contract, not a "nominee" - has the right to foreclose in the event of the homeowner's default. This long-settled doctrine has protected the integrity of title to real estate in the Commonwealth for more than a century and has ensured that only a person with the real interest in payment of the mortgage debt can dispossess a homeowner through foreclosure. (pp. 4-8)

This requirement is reinforced by the express terms of the Eaton mortgage, which is the source of

Greentree's purported authority to foreclose. (pp. 8-13) Under the terms of that mortgage, MERS as "nominee," and its assignee Greentree, simply lacked the authority to foreclose because they neither held the Note nor met the mortgage requirements for exercise of the Power of Sale. (pp. 13-20)

These rules are all the more important in light of the labyrinthine securitization of mortgage loans. Homeowners now confront a myriad of claimants to splintered rights in their mortgage contracts - servicers, sub-servicers, nominees and the like - who may seek to foreclose not to obtain the largest possible return for the actual owner of the promissory note, but because of narrow, self-serving profit incentives arising out of securitization. (pp. 20-28) This Court should not create a rule of law facilitating foreclosures by such entities but should affirm the lower court's decision and reaffirm the long-standing rule that only the holder of the promissory note may foreclose. (pp. 28-31)

I. ABSENT THE AUTHORITY OF THE NOTE HOLDER, THE LIMITED CAPACITY CONFERRED UPON A "NOMINEE" OR UPON A BARE MORTGAGE ASSIGNEE - BY LAW AND THE MORTGAGE CONTRACT'S OWN TERMS - IS INSUFFICIENT TO SUPPORT THE ACCELERATION OF THE DEBT AND FORECLOSURE SALE OF THE RESIDENCE.

Upon the sale of a residence, the title is unified in the fee simple deed. In traditional financing transactions, that unity is divided upon the mortgage of the property. This division creates an equitable or beneficial title in favor of the borrower-homeowner. It creates a debt, owned by the lender and note holder, and it vests "bare legal title" to the residence in a mortgagee or mortgage-assignee. When the mortgagee and note holder are two different entities, the mortgagee is owed nothing, and holds the mortgage in trust solely for the benefit of the lender and/or note holder. When such a division of the mortgage and note occurs, absent the authority of the holder of the note, a bare assignee of the mortgage lacks the legal interest and power to foreclose upon the borrower-homeowner's interest.

Here, Mortgage Electronic Registration Systems, Inc. ("MERS"), a purported "nominee" for the Eaton mortgage and predecessor-in-interest and assignor to Appellant Greentree, lacks even the limited authority conferred upon a bare assignee of a mortgage. In order to facilitate the securitization of mortgage loans, the rights created by a traditional financing transaction were splintered even further. MERS was

granted only a splintered part of a mortgagee's rights. The explicit terms of the mortgage contract continue to vest the broad rights to accelerate the debt and initiate foreclosure in the lender, and not in MERS or, indeed, in any subsequent assignee of MERS's splintered rights, i.e. Appellant Greentree.

A. Absent the Authority of the Holder of the Note, Legal Doctrine Leaves Only "Bare Legal Title" in the Mortgage Assignee, with all Beneficial Interests Residing in the Homeowner and the Note Holder.

In its recent decision concerning the authority to foreclose upon a residence, this Court began the discussion about the role of a mortgage in Massachusetts real property law in the following fashion:

> In a "title theory state" like Massachusetts, a mortgage is a transfer of **legal title** in a property to secure a debt. See Faneuil Investors Group, Ltd. Partnership v. Selectmen of Dennis, 458 Mass. 1, 6, 933 N.E.2d 918 (2010). Therefore, when a person borrows money to purchase a home and gives the lender a mortgage, the homeowner-mortgagor retains only equitable title in the home; the legal title is held by the mortgagee.

United States Bank Nat'l Ass'n v. Ibanez, 458 Mass. 637, 649 (Mass. 2011). Or, as the Appeals Court instructed:

> The mortgage splits the title in two parts: the legal title, which becomes the mortgagee's, and the equitable title, which the mortgagor retains. The purpose of vesting legal title in the mortgagee is to secure the debt owed by the mortgagor. Although a mortgage vests title, that title is defeasible and is an off-shoot of the underlying debt. "[T]he debt," as the venerable maxim puts it, "is the principal and the mortgage an incident . . . ." So it is that the mortgagor retains an equity of redemption ...

Maglione v. Bancboston Mortg. Corp., 29 Mass. App. Ct. 88, 90 (1990)(citations omitted). As to the mere "incident" represented by a mortgage, absent the "principal" of "the debt," this Court long ago described the truncated and restricted interest the severed mortgage instrument conveys:

> [The holder of a mortgage separated from the Note] would hold only a barren fee, without beneficial interest, and ... the law may well imply the intention of the parties that the mortgage is thenceforth to be held by the mortgagee in trust for the [note holder].

Young v. Miller, 72 Mass. 152, 154 (1856);[1] see also Wolcott v. Winchester, 81 Mass. 461, 465 (1860)("a

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[1] In fact, the "legal title" held by a mortgagee is so much less than "true title" that a mortgagee is held to have no right to notice of a tax taking:

> A review of our prior decisions, and especially an examination of the general statutory scheme for the assessment and collection of real property taxes, leads us to the conclusion that a mortgagee not in possession is not entitled, as a matter of right, to notice of a taking.

mere technical interest"); Morris v. Bacon, 123 Mass. 58, 59 (1877) ("naked legal title").

The consequences of this separation of note and mortgage instrument are also undisputable. Absent the note, the assignee of a mortgage has, itself, no interest in the performance of the note, or, indeed, its non-performance.[2] It likewise has no interest in the preservation of the mortgaged estate, its value, or the proceeds from its sale.[3] An ill-advised, or unwise foreclosure sale, or the denial of a borrower's right to cure a default or other reinstatement or

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Vee Jay Realty Trust Co. v. Di Croce, 360 Mass. 751, 753 (1972). If a mortgage, separated and standing unaided by the debt and the Note, represented an independent property right of significance, then its taking without notice could not be upheld.

[2] Or, in the words of the Supreme Court of Maine:

> Nothing in the trial court record demonstrates that [mortgagee] MERS suffered any injury when the [borrowers] failed to make payments on their mortgage.

Mortgage Elec. Registration Sys. v. Saunders, 2010 ME 79, 2 A.3d 289, 297(Me. 2010), cited with approval Bank of NY v. Bailey, 460 Mass 327, 333 (2011).

[3] Not only has the Court held the mortgagee without right to a notice of public taking (see n. 1, supra), but this Court has also held that the mortgage cannot be reached in a reach and apply action, as only the holder of the Note has the right to its payment. Cooperstein v. Bogas, 317 Mass. 341, 344 (1944)("It is for this reason that a creditor who is unable to reach the interest of his debtor in a note secured by a real

forbearance remedies contemplated by the unified mortgage and note are irrelevant to its "barren fee."

For these reasons, this Court, and others, have frequently repeated the predictable conclusion: a mortgagee, absent the authority of the holder of the note, may not foreclose upon the mortgaged real estate.[4] 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."); see also Crowley v. Adams, 226 Mass. 582, 585, (1917) ("possession of the note was essential to an enforceable mortgage, without which neither mortgage could be effectively foreclosed"); Landmark Nat'l Bank v. Kesler, 289 Kan. 528, 536-540, 216 P.3d 158 (Kan. 2009); Bellistri v. Ocwen Loan Servicing, LLC, 284 S.W.3d 619, 623 (Mo. App. 2009).[5]

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estate mortgage cannot reach and apply the interest of the debtor in the mortgage itself.")

[4] In a non-sequitir, Greentree argues that because this Court's *Ibanez* decision and G.L. c. 244, §14 do not permit the Note holder to foreclose absent the mortgage, then the court below erred in holding that the assignee of the mortgage could not foreclose absent the authority of the Note. Of course, there is nothing inconsistent in these results.

[5] Restatement (Third) of Property § 5.4 cmt. e (1997) is to the same effect:

In short, even the traditional, limited separation of note and mortgage precludes foreclosure by a bare mortgage assignee, in the absence of the authority of the holder of the note.[6]

B. The Mortgage Contract Further Restricts the Authority of a "Nominee" and Reserves the Authority to Foreclose to the Lender, Rather Than to a "Nominee."

The common law and statutory incapacity of a bare mortgage assignee to foreclose absent the authority of the note becomes inevitable in light of the mortgage contract's express language - language which is to be construed strictly against the Lender as drafter of the document.[7] Benalcazar v. Goldsmith, 400 Mass. 111, 112 (1987):

> [I]n general a mortgage is unenforceable if it is held by one who has no right to enforce the secured obligation.

[6] There is absolutely no evidence in the record that Greentree acted under the authority of the note holder in conducting this foreclosure. Indeed, the record is surprisingly devoid of evidence of the identity of the note holder, and of evidence that the note holder was even aware or notified of the assignee's foreclosure action.

[7] In one of the more unrealistic arguments made by the proponent of an adhesion contract, Greentree argues both that the borrowers were free to negotiate and alter the mortgage terms, and that the document reflects the intent of those borrowers. Of course, the law in the Commonwealth as to such contracts is contrary:

> [an] adhesion contract to be construed strictly against Lechmere in whose behalf it

In deciding the meaning, if the language is clear and leaves no doubt or ambiguity, then only the language should be considered. But if there are portions or phrases of these documents where meanings are ambiguous, or conflicting, or uncertain, then the rule in Massachusetts is that ..."the ambiguity would be construed against the drafter." That principle is particularly applicable where an attorney drafts a ... contract which he knows will be signed by a person without legal training.

Any fair examination of the terms of the relevant mortgage contract demonstrates that the foreclosure sale challenged here did not meet the terms of that contract.[8] Specifically, the Eaton mortgage contract contains the following provisions governing the legal relationship between the various parties and the foreclosure process:

(C) "MERS" is Mortgage Electronic Registrations Systems, Inc. **MERS is a separate corporation that is acting solely**

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had been drafted ... all doubts as to its interpretation and as to the meaning of the [contract] itself are to be resolved in favor of the [consumer].

Lechmere Tire & Sales Co. v. Burwick, 360 Mass. 718, 720-721 (1972).

[8] The requirement that foreclosures be conducted in strict compliance with the terms and powers of the mortgage arises *not only* from common law and contractual doctrine, but also from the express terms of the statutes authorizing the Commonwealth's "self-help' foreclosures only if the foreclosing entity has "first compl[ied] with the terms of the mortgage and with the statutes relating to the foreclosure of mortgages by the exercise of a power of sale." G.L. c. 183, § 21.

as a nominee for Lender and Lender's successors and assigns. MERS is organized and existing under the Laws of Delaware, and has an address and telephone number of P.O. Box 2026, Flint, MI 48501-2026, tel. (888) 679-MERS.

(D) "Lender" is BankUnited, FSB ...

(E) "Note" means the promissory note signed by borrower ...

(G) "Loan" means the debt evidenced by the Note ...

TRANSFER OF RIGHTS IN THE PROPERTY

This Security Instrument secures to **Lender**: (i) the repayment of the Loan, and all renewals, extensions and modifications of the Note; and (ii) the performance of Borrower's covenants and agreements under this Security Instrument and the Note. For this purpose, Borrower does hereby mortgage, grant and convey to MERS (solely as nominee for Lender and Lender's successors and assigns) and to the successors and assigns of MERS, with power of sale, the following described property ...
Borrower understand and agree that MERS holds only legal title to the rights granted by Borrowers in this Security Instrument, but, ***if necessary to comply with law or custom, MERS (as nominee for Lender and Lender's successors and assigns) has the right: (A) to exercise any or all of those rights, including, but not limited to, the right to foreclose and sell the Property;*** and (B)to take any action required of Lender including, but not limited to, releasing and canceling this Security Instrument.
¶22 **Acceleration; remedies. Lender shall give notice to the Borrower prior to acceleration following Borrower's breach of any covenant or agreement in this Security instrument ... This notice shall specify (a) the default; (b) the action required to**

cure the default; (c) a date, not less than thirty days from the date the notice is given to the Borrower, by which the default must be cured; and (d) that failure to cure the default on or before the date specified in the notice may result in the acceleration of the sums secured by this Security Instrument and sale of the property ... If the default is not cured on or before the date specified in the notice, Lender at its option may require immediate payment in full of all sums secured by this Security Instrument without further demand and may invoke the STATUTORY POWER OF SALE and any other remedies permitted by Applicable Law.

Construed strictly against the Greentree, these provisions preclude the foreclosure sale conducted by Greentree - both by the plain meaning of the text of the contract, and by the meaning that the highest courts of multiple states have given to identical contractual terms.

1. Neither Local Law nor Custom made it Necessary for MERS as "nominee," or its Assignee Greentree to Conduct the Eaton Foreclosure.

On contractual grounds, the issue is simple. As an entity foreclosing upon a *mortgage* in the Commonwealth, a non-judicial foreclosure state, Greentree must:

> adhere to the familiar rule that "one who sells under a power [of sale] must follow strictly its terms. If he fails to do so there is no valid execution of the power, and the sale is wholly void."

United States Bank Nat'l Ass'n v. Ibanez, 458 Mass. 637, 646-647 (Mass. 2011)(citations omitted). Greentree does not even pretend to have proven that it was "***necessary to comply with law or custom***" for Greentree, as MERS's assignee, to conduct the foreclosure sale. To the contrary, the assignment of the mortgage to the holder of the note - unifying the lender's title - was both reasonable and necessary. Greentree simply has not met its burden of proving that it was the ***necessary*** foreclosing entity.

2. MERS as "Nominee" Lacked the Legal Capacity to Foreclose, Absent the Authority of the Note.

Doctrinally, the answer is the same, as the Supreme Judicial Court of Maine, and the Supreme Courts of Kansas and Nebraska, have reasoned from such language. These courts have faced, over the past six years, the issue of the meaning of the term "MERS, acting solely as nominee." All have concluded that this term permits MERS (and Greentree, whose capacity to foreclose arises an assignment from MERS of MERS's contractual powers) to act only under the authority of the holder of the note - a circumstance neither claimed nor proven here.

The first of these determinations was that of the Supreme Court of Nebraska, in 2005. Construing the identical mortgage language at issue here, and MERS's own corporate documents, the Nebraska Court reached the exact result arrived at by the trial court - MERS (and its assignees) may only foreclose with and upon the authority of the holder of the beneficial interest represented by the note:

> MERS shall serve as mortgagee of record with respect to all such mortgage loans solely as a nominee, in an administrative capacity, for the beneficial owner or owners thereof from time to time ... [and] "MERS shall at all times comply with the instructions of the beneficial owner of mortgage loans as shown on the MERS tm System."

Mortg. Elec. Registration Sys. v. Neb. Dep't of Banking & Fin., 704 N.W.2d 784, 786-787, 704 N.W.2d 784 (Neb. 2005)(citations omitted).

The Kansas Supreme Court reached the very same result in 2009, in holding that the "beneficial" note holder was entitled to notice of a tax taking, but that MERS's "solely-as-nominee" status merited no such result. Again, after quoting the virtually identical contractual language appearing in the Eaton mortgage, after a lengthy discussion, the Kansas Court concluded that "straw man" MERS acquired neither rights nor

powers separate from the Note holders under this language:

> The mortgage instrument states that MERS functions "solely as nominee" for the lender and lender's successors and assigns. The word "nominee" is defined nowhere in the mortgage document, and the functional relationship between MERS and the lender is likewise not defined. In the absence of a contractual definition, the parties leave the definition to judicial interpretation.
>
> ...
>
> Black's Law Dictionary defines a nominee as "[a] person designated to act in place of another, usu. in a very limited way" and as "[a] party who holds bare legal title for the benefit of others or who receives and distributes funds for the benefit of others." Black's Law Dictionary 1076 (8th ed. 2004). This definition suggests that a nominee possesses few or no legally enforceable rights beyond those of a principal whom the nominee serves ...
>
> The relationship that MERS has to (Lender's assignee) is more akin to that of a straw man than to a party possessing all the rights given a buyer ... The law generally understands that a mortgagee is not distinct from a lender: a mortgagee is "[o]ne to whom property is mortgaged: the mortgage creditor, or lender." Black's Law Dictionary 1034 (8th ed. 2004) ...
>
> Although MERS asserts that, under some situations, the mortgage document purports to give it the same rights as the lender, the document consistently refers only to rights of the lender, including rights to receive notice of litigation, to collect payments, and to enforce the debt obligation. The document consistently limits

> MERS to acting "solely" as the nominee of the lender.

Landmark Nat'l Bank v. Kesler, 289 Kan. 528, 536-540, 216 P.3d 158 (Kan. 2009). And, quoting the Missouri appeals court, the Kansas Supreme Court further noted:

> "The practical effect of splitting the deed of trust from the promissory note is to make it impossible for the holder of the note to foreclose, unless the holder of the deed of trust is the agent of the holder of the note. [Citation omitted.] *Without the agency* relationship, the person holding only the note lacks the power to foreclose in the event of default. The person holding only the deed of trust will never experience default because only the holder of the note is entitled to payment of the underlying obligation. [Citation omitted.] The mortgage loan becomes ineffectual when the note holder did not also hold the deed of trust."

Id. (quoting Bellistri v. Ocwen Loan Servicing, LLC, *284 S.W.3d 619, 623 (Mo. App. 2009)).*

Although the Commonwealth is a mortgage-title state, rather than a deed of trust state, the doctrinal construction of "acting solely as nominee" is equally applicable.

Finally, the Supreme Judicial Court of Maine faced the same judicial construction issue last year, in addressing the capacity of a Maine assignee to foreclose upon a residential property. As Maine's Supreme Judicial Court held, the "MERS acting solely

as nominee" language in the mortgage contract simply does not grant MERS, or its assignees, the power to foreclose, absent the authority of the note holder:

> In Maine, we follow the title theory of mortgages; a mortgage is a conditional conveyance vesting legal title to the property in the mortgagee, with the mortgagor retaining the equitable right of redemption and the right to possession. To determine whether MERS has standing in the present case, we must first examine what rights MERS had in the [Borrower's] debt and the mortgage securing that debt.
>
> In the note that [Borrower] executed in favor of [Lender], there is no mention of MERS, and the [Lender], admitted in its statement of material facts that MERS never had an interest in the note. MERS is, however, included in the [Borrower's] mortgage document.[9]
>
> The only rights conveyed to MERS in either the [Borrower's] mortgage or the corresponding promissory note are bare legal title to the property for the sole purpose of recording the mortgage and the corresponding right to record the mortgage with the Registry of Deeds. This comports with the limited role of a nominee. A nominee is a "person designated to act in place of another, [usually] in a very limited way," or a "party who holds bare legal title for the benefit of others or who receives and distributes funds for the benefit of others." Black's Law Dictionary 1149 (9th ed. 2009). The remaining, beneficial rights in the mortgage and note are vested solely in the lender… and its successors and assigns. The mortgage clearly

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[9] Again, the Supreme Judicial Court of Maine recited the virtually identical language in the Borrowers' mortgage.

> provides that, by signing the instrument, the (Borrowers)were "giving [the] Lender those rights that are stated in this Security Instrument and also those rights that Applicable Law gives to Lenders who hold mortgages on real property." Not one of the mortgage covenants in the document, including the [Borrower's] obligations to make timely payments on the note, pay property taxes, obtain property insurance, and maintain and protect the property, is made to MERS or in favor of MERS. Each promise and covenant gives rights to the lender and its successors and assigns, whereas MERS's rights are limited solely to acting as a nominee. The Bank argues that MERS's status as a "nominee" for the lender and as the "mortgagee of record" within the document qualifies it as a "mortgagee" within 14 M.R.S. § 6321. We disagree.

Mortgage Elec. Registration Sys. v. Saunders, 2 A.3d 289, 294-295, 2 A.3d 289 (Me. 2010).

While the law of each of these states differs in some respects, as to the central issue - the legal authority granted to MERS by the contractual language in the Eaton mortgage - the differences are of no import. And, just as these courts have concluded, MERS, and MERS's assignees - here, Greentree - are authorized by this contractual language to take action solely under the authority of the "beneficial owner" and note holder.[10] Because MERS's assignee Greentree

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[10] In its formation, MERS itself represented that the MERS mortgages were unenforceable absent the authority of the note holder:

has failed to prove that its foreclosure of the Eaton's home was "executed in strict compliance" with the terms of the mortgage, and under the authority of the note holder, this Court should affirm the trial court's injunction issuance.

II. PERMITTING THE "NOMINEE" OR BARE ASSIGNEE/ SERVICER TO FORECLOSE UPON HOMES IN THE ABSENCE OF THE AUTHORITY OF THE NOTE PRESENTS REAL AND UNACCEPTABLE RISKS TO THE HOLDERS OF THE BENEFICIAL INTERESTS AFFECTED BY THE FORECLOSURE.

Appellants propose to give the power of sale to the mere assignee of a mortgage contract - an entity that lacks ownership of the promissory note and debt secured by the mortgage, and that accordingly has

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> Currently, notes sold into the secondary market are bearer instruments, possession of which under Article III of the Uniform Commercial Code generally determines ownership. Notes and other key documents are held on behalf of investors by third-party document custodians… by mortgage servicers…, or by the secondary market investors themselves ...
> **As for mortgages, it is a legal maxim that the mortgage depends on the note for enforceability.**

Phyllis K. Slesinger & Daniel Mclaughlin, Mortgage Electronic Registration System, 31 Idaho L. Rev. 805, 808 (1995); see also Fannie Mae Single Family 2011 Servicing Guide, available at https://www.efanniemae.com/sf/guides/ssg/svcgpdf.jsp, at p. 102-36 (requiring servicer to have "possession of the mortgage note whenever the servicer, acting in its own name, represents the interests of Fannie Mae in foreclosure actions.)

little or no incentive to maximize the value of that debt. Such a rule would result in perverse foreclosures that harm *both* the actual owner and beneficiary of the note *and* the foreclosed-upon homeowner, but enrich the legion of mortgage servicers and collection agents that now populate the mortgage industry.

Mortgage servicers - hired companies that handle the day-to-day management of individual mortgage loans, including collection activity - do not, as a rule, own the mortgage debt that they manage. But servicers do seek to conduct foreclosures in their own names, and obtain bare mortgage assignments in order to accomplish that task. Problematically, the financial incentives of a mortgage servicer diverge from and conflict with the interests of both the actual beneficiaries of the note and the borrowers themselves.[11] Servicers do not profit by maximizing the value of the mortgage debts they service, but instead are entitled to assess and retain

[11] See Diane Thompson, National Consumer Law Center, Why Servicers Foreclose When They Should Modify and Other Puzzles of Servicer Behavior: Servicer Compensation and its Consequences (Oct. 2009), at http://www.consumerlaw.org/ issues/ mortgage_servicing/content/Servicer_Report1009.pdf, at 4 (describing the structure of servicer compensation and concluding that "[s]ervicers' incentives thus are neither those of the investors - the beneficial owners of the mortgage - nor the borrowers.").

late penalties and other fees arising from borrower defaults, as well as income from their more automated servicing functions. The resulting compensation scheme is "skewed toward foreclosure."[12] Mortgage servicers "are sometimes incentivized either to foreclose when a loan restructuring would be optimal or engage in a suboptimal restructuring that will be likely to result in a redefault."[13] Appellant's proposed rule would empower servicers, when they are merely mortgage assignees, to conduct foreclosures solely to maximize their own compensation - even when both the homeowner and the actual owner of his or her mortgage debt would derive greater benefit from a loan modification. This Court should decline to adopt such a rule, and reaffirm that only the owner of the note and debt may foreclose.

Banks once made mortgage loans that they intended to hold in their own portfolios. Portfolio lenders loaned out their own capital to their borrowers, who pledged their homes as collateral for the loan. In the event of a borrower default, the same portfolio lender that made the mortgage loan would have the right to foreclose on the mortgagor's home.

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[12]Adam Levitin and Tara Twomey, Mortgage Servicing, 28 Yale J. on Reg. 1 (2011).

As the subprime mortgage crisis has revealed, the business of mortgage finance is now far more byzantine than this simple model. A single mortgage loan to a single borrower now involves a so-called "originating" mortgage lender, an aggregator of mortgage loans on the secondary market, an underwriter of mortgage-backed securities, a trust that issues those securities, a trustee for the trust, investors in the securities, and servicers and sub-servicers to handle the everyday management of the loan.[14]

The process of bundling mortgage loans into pools deposited in special purpose entities, which then issue securities - the so-called "securitization" of mortgage loans - creates practical and legal challenges for struggling mortgagors facing foreclosure. Mortgagors are frequently unable even to determine the owners of their mortgage debt.[15]

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[13] *Id.* at 5.

[14] See, e.g., Christopher L. Peterson, Predatory Structured Finance, 28 Cardozo L. Rev. 2185, 2208 (2007) (graphical depiction of the structure of a privately securitized mortgage).

[15] *See, e.g.*, Gretchen Morgenson, If Lenders Say 'The Dog Ate Your Mortgage', N.Y. Times, Oct. 25, 2009 at BU1 ("[S]ome of the nuts and bolts of the mortgage game – notes, for example – were never adequately tracked or recorded during the boom. In some cases, that means nobody truly knows who owns what.").

As a result of the securitization process, the various lending functions that were once unified in a single portfolio lender - loaning bank funds to a mortgagor, collecting and applying monthly principal and interest payments, deciding whether to foreclose or modify a loan in the event of a borrower's default - are now separately performed by different entities. The mortgage industry is composed of numerous specialists, companies that focus on one element or function of lending activity. These specialists obtain (or fail to obtain) their profit through different mechanisms, causing their financial incentives to diverge.

The private securitization process drove subprime lending during the housing bubble.[16] Various entities - Wall Street investment banks, hedge funds, large national lenders - purchased mortgage loans in bulk from various originating lenders.[17] These securitizers,

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[16] See Elizabeth Renuart & Kathleen E. Keest, The Cost of Credit: Regulation, Preemption and Industry Abuses 682 (4th ed. 2009) ("At the beginning of the 1990s, less than half of all mortgage loans were securitized. By 2005, nearly 70% of all residential mortgage loans were securitized.").

[17] The lender that actually makes a mortgage loan is now known as an "originating" lender, so-called in recognition of the fact that lenders sell the majority of mortgage loans to other entities on the secondary

sometimes called "underwriters" or "wholesale lenders" or "sellers," grouped their mortgages into large pools containing hundreds of millions of dollars in mortgage loans. Through a variety of corporate subsidiaries, the typical securitizer transferred a mortgage pool to a "special purpose vehicle (SPV)," which usually took the legal form of a trust. Pursuant to a complex contract, usually entitled a "pooling and servicing agreement (PSA)," the "SPV" issued mortgage-backed securities or "certificates," entitling the owner to a small share of the monthly principal and interest payments of borrowers whose mortgages are contained in the pool. The securities themselves were organized into "tranches" of senior securities, whose holders are entitled to be paid first out of borrowers' monthly payment, and tranches of intermediate and junior securities, whose holders only receive any payment if all senior securities holders are paid first.[18] The

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mortgage market. See John Rao et al., Foreclosures: Defenses, Workouts and Mortgage Servicing 9-10 (3d ed. 2010) ("Today, most mortgages are sold or otherwise transferred to another entity shortly after origination.").

[18] See generally Peterson, supra note 14, at 2206-13; Rao et al., supra note 17, at 13-16; see also Katherine Porter, Misbehavior and Mistake in Bankruptcy Mortgage Claims, 87 Tex. L. Rev. 121, 126 (2008) ("Put simply, securitization is the process of

supposed safety of senior mortgage-backed securities allowed investment banks and other underwriters to demand an enhanced premium for these purportedly sound investments. In reality, even the holders of senior mortgage-backed securities have suffered severe losses in the foreclosure *crisis*.[19]

The securitization process splinters the ownership of an individual mortgage loan. Each mortgage loan is an asset in the SPV's trust fund. The SPV, like any other trust, is not a legal person and cannot act on its own behalf.[20] Instead, the owner of legal title of the assets *in* the trust fund is a trustee, typically the trust department of a large commercial bank.[21] While the trustee is the legal owner of the trust fund,

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creating debt instruments (usually bonds) by pooling mortgage loans, transferring those obligations to a trust, and then selling to investors fractional interests in the trust's pool of mortgages.")

[19] See, e.g., Scott Paterson, Prime Time? Investors Bet Against AAA, Wall St. J., Dec. 9, 2008 at C1 ("Since October, Markit Group's ABX index that tracks triple-A-rated subprime bonds has been almost sliced in half.").

[20] Kurt Eggert, Limiting Abuse and Opportunism by Mortgage Servicers, 15 Housing Pol'y Debate 753, 754 (2004) ("The SPV is a passive entity, designed merely to hold the mortgages while other entities do the actual work of collecting payments and distributing them to investors.").

[21] See generally Talcott J. Franklin & Thomas F. Nealon, Mortgage and Asset Backed Securities Litigation Handbook, § 1:10 (2010).

the beneficiaries of the trust fund are the owners of the mortgage-backed securities issued by the SPV. The trustee's primary responsibility is to distribute principal and interest payments from the mortgage loans in the pool to the owners of the securities.

However, neither the trustee, nor the securities owners handle day-to-day management of the mortgage loans in the pool. Instead, a mortgage servicing company performs that role. This servicer mails mortgage bills, collects borrowers' monthly payments and forwards them to the trustee, responds to borrowers' inquiries, assesses late penalties and other fees.[22] For loans that do not default, servicers receive compensation in the form of a fee calculated as a fixed percentage of the outstanding principal balance of the mortgage loans in the pool - as little as 0.25% for pools of prime mortgages and as high as 0.5% for subprime mortgages - and derive investment income from the collection account before forwarding borrowers'

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[22] See Eggert, supra note 20, at 754 ("Much of the real work of mortgage collection is left to third parties, called servicers, that contract with the trustee to collect mortgage payments and to employ various loss mitigation techniques, such as foreclosure or forebearance, should the borrower default.").

monthly payments to the trustee.[23] However, servicers earn additional income when borrowers default on their mortgage loans, including compensation for conducting foreclosure proceedings.[24] This additional compensation is not calculated as a flat fee, but instead on a "cost-plus percentage of cost" basis.[25] There is, moreover, no cap or limit on the amount of compensation a servicer may derive from loans in default.[26] On the other hand, servicers are not compensated or reimbursed for costs expended for making loan modifications rather than foreclosing.[27] Servicers deduct the entirety of their compensation from their collection accounts before forwarding principal and interest payments to the trustee for distribution to securities-owners.[28]

Because of the structure of their compensation, servicers are incentivized to inflate their default costs and foreclose, even when securities-owners and homeowners alike would profit more from loan modification. Appellants now seek to empower servicers to engage in such behavior acting in their own name as

[23] See *Thompson*, supra note 11, at 19, 16-17.
[24] See id. at 16-17.
[25] See Levitin and Twomey, supra note 12 at 70.
[26] Id.
[27] Id. at 71.
[28] Id. at 37.

mere assignees of the mortgage and without a beneficial interest in the underlying debt. While such a mortgage assignee ordinarily holds the mortgage in trust for the owner of the note, neither the trustee, nor the securities-owners will likely be able to prevent their servicer's unjustified self-enrichment. The trustee will likely have neither the resources, nor the inclination to monitor the performance of each mortgage loan. The primary responsibility of a trustee - and, indeed, the primary function of a trust department at a commercial bank - is to distribute funds forwarded by the servicer to the certificate holders. The trustee, accordingly, has few resources with which to monitor mortgage activity and, in any event, is not accustomed to monitoring the administration of individual mortgage loans.[29] The ultimate beneficiaries of the trust assets - the securities-owners - are no more likely to ensure that the servicer acts in a fashion that best furthers their interests. The securities-owners have

[29] See, e.g., Franklin & Nealon, supra note 21, at § 2:5 ("The saying, 'we make no money and take no risk' is an apt description of a typical PSA trustee perspective. Therefore, corporate trustees of securitization trusts … have traditionally limited their liability by contractually limiting their obligations in litigation and by requiring

no authority to control the servicer and can only direct the trustee if a majority of the certificate holders agree to do so.[30] Moreover, the securities-owners will likely lack information regarding the status of a particular mortgage loan.[31]

While trustees and securities-owners may lack the ability to control the self-dealing of their servicers, homeowners and mortgagors face an even harsher reality as a result of the securitization of their mortgage loans. Throughout the Commonwealth, there are many struggling homeowners who can better serve the financial interests of their mortgage creditors through a loan modification than by foreclosure. Many homeowners can now afford their promissory note interest rate on the actual, post-bubble value of their

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indemnification of the trustee by another PSA party and by the trust fund itself.").

[30] See Thompson, supra note 11, at 8 ("Investors can usually only take action against a servicer through the trustee and then only if a majority of the investors agree … Thus, although servicers are nominally accountable to investors, investors have, in most cases, little control over the servicer's decisions ...")

[31] See Franklin & Nealon, supra note 21, at § 1:13 ("[G]iven the nature of structured finance and its investors, certificateholders in the issuing trust that holds these mortgage assets may be unfamiliar with the servicer who acts on their behalf. The certificateholders are almost certainly not directly familiar with the trust's underlying borrowers.")

homes. Their mortgagees can expect to recover no more - and likely much less - than the market value of the home in a foreclosure sale, while a sustainable loan modification will ensure substantial interest income in an era of historically-low interest rates. Yet it is the experience of the undersigned amici that servicers stubbornly refuse to make rational loan modifications that maximize the value of mortgage debt.

This Court should not adopt a new rule of law permitting servicers to enrich themselves while needlessly inflicting the social devastation of foreclosure throughout the Commonwealth. Reaffirmation of the common law rule that only the owner of a promissory note may foreclose protects the interests of both the actual owners of mortgage loans and Massachusetts homeowners.

CONCLUSION

The decision of the lower court should be affirmed.

Respectfully submitted,

For Amicus Curiae
WilmerHale Legal Services Center
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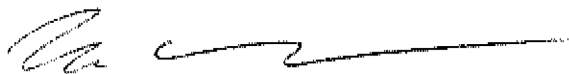

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