



“Robo-Signing” and Other Alleged Documentation Problems in Judicial and Nonjudicial Foreclosure Processes

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Summary

During the summer of 2010, several employees and individuals with power-of-attorney signing authority for major servicers, including GMAC Mortgage, J.P. Morgan Chase, and Wells Fargo, were deposed as part of foreclosure contests. These depositions raised concerns about what has been characterized as "robo-signing"—the practice of having a small number of individuals sign a large number of affidavits and other legal documents submitted to courts and other public authorities by mortgage companies to execute foreclosures. As a result of these depositions, many have questioned whether individuals who claimed in sworn affidavits to have personal knowledge of facts necessary to legally foreclose on a property actually had that knowledge; whether assignments and sales of interests in mortgages were properly executed; whether legal documents were properly notarized in accordance with state law; and, as a result, whether mortgage companies had met the necessary requisites to legally foreclose on certain properties. In response, several major mortgage servicers temporarily halted foreclosure sales to review their internal foreclosure procedures.

These procedural defects have the potential to undermine the legitimacy of the foreclosure process and could result in judicial sanctions, civil penalties, and even criminal prosecutions. The servicers in question do not believe they have wrongfully foreclosed upon or evicted anyone, but that some of the paperwork that must be filed to complete a foreclosure in certain states may not have been properly reviewed or notarized by their employees. Whether or not homes have been wrongfully foreclosed upon is unknown at this time. It also is unclear whether or not the procedural problems masked substantive problems, such as a failure to properly transfer interests in a mortgage, thus calling into question true ownership of mortgages, in certain instances. Even if substantive problems do exist, it may be possible to rectify deficiencies in many, if not the vast majority, of cases to allow for the completion of a foreclosure. Correcting these problems would come at a cost by potentially causing significant delays in the completion of the foreclosure process.

This report seeks to shed light on some of these issues by explaining the mortgage market process and some of the legal agreements entered into between market participants; explaining the legal procedures of typical judicial and nonjudicial foreclosure statutes; explaining some of the procedural problems that have surfaced during the implementation of foreclosure proceedings that drove some mortgage servicers to briefly halt foreclosure sales and evictions; analyzing how the increasing complexity of the secondary mortgage market over the last 10 to 15 years may have led to or exacerbated these procedural problems; and addressing some of the potential substantive errors that could have been hidden by the procedural problems and the legal effect these problems could have on homeowners, lenders, and other mortgage market participants.

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Introduction

On September 20, 2010, GMAC Mortgage, a mortgage servicer affiliate of Ally Bank (formerly GMAC Bank) formally announced “a potential issue that was raised in a number of existing foreclosures challenging the internal procedure we used for executing one or more judicially required forms.”¹ As a result, “[t]he company temporarily suspended evictions and post-foreclosure closing in the 23 states while [Ally Bank] conduct[s] a review” of the procedure.² The “internal procedure” problems that GMAC Mortgage referenced have become popularly characterized as “robo-signing”—the practice of having a small number of individuals sign a large number of affidavits and other legal documents submitted to courts and other public authorities by mortgage companies to execute foreclosures. Several employees and individuals with power-of-attorney signing authority for major servicers, including GMAC Mortgage, J.P. Morgan Chase, and Wells Fargo, have been deposed as part of foreclosure contests.³ Some of these depositions raised concerns as to whether individuals who claimed in sworn affidavits to have personal knowledge of facts necessary to legally foreclose on a property actually had that knowledge; assignments and sales of interests in mortgages were properly executed; legal documents were properly notarized in accordance with state law; and, as a result, mortgage companies had met the necessary requisites to foreclose on certain properties.

Following GMAC Mortgage’s lead, three other major mortgage servicers owned by J.P. Morgan Chase & Co., Bank of America Corp., and PNC Financial Services Group Inc. temporarily halted foreclosure sales of their own in the same 23 states.⁴ The states affected by these voluntary stays on foreclosure sales and evictions are referred to as “judicial foreclosure states” because their laws either require the use of the courts to complete a foreclosure, or if not absolutely required, a significant portion of foreclosures in the states utilize the court systems in practice.⁵ Just a few days later, on October 8, 2010, Bank of America Home Loans announced an expansion of the temporary foreclosure sale freeze to all 50 states, including the so-called nonjudicial foreclosure states which have state laws that allow for foreclosures to be completed without the use of the courts. The Bank of America freeze is to last until its “assessment [of foreclosure documents] has been satisfactorily completed.”⁶ Additionally, Fannie Mae and Freddie Mac have directed all

¹ *GMAC Mortgage Statement on Speculation Related to Foreclosure Moratorium*, Ally Bank Press Release, Sept. 20, 2010, available at <http://media.ally.com/index.php?s=43&item=416>.

² *GMAC Mortgage Provides Update on Mortgage Servicing Process*, Ally Bank Press Release, Sept. 24, 2010, available at <http://media.ally.com/index.php?s=43&item=417>. The press release explicitly states that “GMAC Mortgage is not suspending foreclosures in any state.”

³ Links to a number of these depositions are available at <http://www.icelegal.com/Resources/Depositions/>. Some of these individuals also had signing authority for the Mortgage Electronic Registration System, Inc. (MERS), a company that is discussed in “The Mortgage Market, Players, & Process” section of this report.

⁴ Alan Zibel, *Bank of America stops US foreclosures for review*, Associated Press, Oct. 8, 2010, available at http://news.yahoo.com/s/ap/20101008/ap_on_bi_ge/us_foreclosure_mess.

⁵ The states in question are Connecticut, Florida, Hawaii, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Nebraska, New Jersey, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, Pennsylvania, South Carolina, South Dakota, Vermont, and Wisconsin. Although most of these states do not allow for nonjudicial foreclosures under any circumstances, some do (e.g., North Carolina), but a significant portion of the foreclosures in those states are conducted judicially or require the submission of sworn statements to some public institution, nevertheless. Delaware apparently was not affected by GMAC Mortgage’s temporary halt on foreclosure sales and evictions, even though foreclosures are typically judicial actions in that state. Amherst Mortgage Insight, *The Affidavit Fiasco—Implications for Investors in Private Label Securities*, Amherst Securities Group LP, Oct. 12, 2010. See also Del. Code Ann. tit. 10, § 5061.

⁶ *Statement from Bank of America Home Loans*, Bank of America Press Release, Oct. 8, 2010, available at (continued...)

servicers of mortgages held or guaranteed by the government sponsored enterprises (GSEs) to review their procedures for handling mortgage defaults, but the GSEs did not require servicers to halt foreclosure sales or evictions.⁷

On October 18, 2010, Bank of America announced that it would be resuming all foreclosures in the 23 judicial foreclosure states, and "will continue to delay foreclosure sales in the remaining 27 states until our review is complete on a state by state basis."⁸ A GMAC Mortgage spokeswoman announced that it would resume foreclosures as files are reviewed and remediated on an individual basis.⁹

The regulatory response to these alleged problems has begun, and likely will continue for some time. The Ohio Attorney General filed suit against GMAC Mortgage, Ally Financial, Inc., and one of its employees, alleging violations of the state Consumer Sales Practices Act and common law fraud.¹⁰ The Attorney General of Florida is conducting investigations of several law firms allegedly involved in submitting inaccurate or incomplete documentation to Florida courts in foreclosure cases.¹¹ The Attorneys General of all 50 states are conducting investigations into the matter, and the Obama Administration's Financial Fraud Enforcement Task Force¹² also is investigating whether federal laws were violated.¹³ At least two states' courts, Florida and New York, have augmented their evidentiary standards for residential foreclosure actions in response to deficiencies in foreclosure proceedings.¹⁴

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<http://mediaroom.bankofamerica.com/phoenix.zhtml?c=234503&p=irol-newsArticle&ID=1480657&highlight=>

⁷ Fannie Mae Lender Letter LL-2010-11, *Servicer Review of Procedures Relating to the Execution of Affidavits, Verifications, and Other Legal Documents*, Oct. 1, 2010, available at <https://www.efanniemae.com/sf/guides/ssg/annlrs/pdf/2010/111011.pdf>; Freddie Mac Industry Letter, *Foreclosure Proceedings*, Oct. 1, 2010, available at <http://www.freddiemac.com/sell/guide/bulletins/pdf/iltr100110.pdf>.

⁸ *Statement from Bank of America Home Loans*, Bank of America Press Release, Oct. 18, 2010, available at <http://mediaroom.bankofamerica.com/phoenix.zhtml?c=234503&p=irol-newsArticle&ID=1483909&highlight=>.

⁹ Nelson D. Schwartz and Andrew Martin, *Largest Bank Will Resume Foreclosure Push in 23 States*, New York Times, Oct. 18, 2010, available at <http://www.nytimes.com/2010/10/19/business/19mortgage.html>.

¹⁰ *Ohio v. GMAC Mortgage, LLC*, Case No. CI0201Q06984, *Complaint for Declaratory Relief, Preliminary Injunction, Damages, Civil Penalties and Punitive Damages*, filed Oct. 6, 2010, available at <http://www.ohioattorneygeneral.gov/GMAClawsuit>.

¹¹ See, e.g., Civil Investigation of the Law Office of David H. Stern, P.A., Case No. L10-3-145, available at http://myfloridalegal.com/_85256309005085AB.nsf/0/AD0F010A43782D9685257770067B68D?Open&Highlight=0,david,stern; *Attorney General Releases Additional Sworn Statement in the Investigations Involving David Stern and Marshall Watson*, Office of the Attorney General of Florida Press Release, Oct. 18, 2010, available at <http://www.myfloridalegal.com/newsrel.nsf/newsreleases/8736F08B4E588F61852577C0005F668B>; and Civil Investigation of Florida Default Law Group, PL and Michael Echevarria, Case No. L10-3-1095, available at http://myfloridalegal.com/_85256309005085AB.nsf/0/A4F1B85DCC5D5ACD852577130045B63F?Open&Highlight=0,florida,default,law.

¹² For background on this task force, see *President Obama Establishes Interagency Financial Fraud Enforcement Task Force*, U.S. Dept. of Justice Press Release, Nov. 17, 2009, available at <http://www.justice.gov/opa/pr/2009/November/09-opa-1243.html>.

¹³ Zachary A. Goldfarb, *Task force probing whether banks broke federal laws during home seizures*, Washington Post, Oct. 19, 2010, available at <http://www.washingtonpost.com/wp-dyn/content/article/2010/10/19/AR2010101904845.html?hpid=topnews>.

¹⁴ Fla. Sup. Ct., *In re Amendments to the Florida Rules of Civil Procedure*, No. SC09-1460 and *In re: Amendments to the Florida Rules of Civil Procedure—Form 1.996 (Final Judgment of Foreclosure)*, Feb. 11, 2010, available at <http://www.floridasupremecourt.org/decisions/2010/sc09-1460.pdf> (amending Fla. R. Civ. Proc. 1.110, General Rules of Pleading, to state: "When filing an action for foreclosure of a mortgage on residential real property the complaint (continued...)").

Each of the servicers that voluntarily stayed foreclosure sales and evictions seem to stress that any problems that have come to their attention have been problems of process, not of substance. In other words, they do not believe anyone has been wrongfully foreclosed upon or evicted, but that some of the paperwork that must be filed to complete a foreclosure in certain states may not have been properly reviewed or notarized by their employees. In actuality, these procedural defects have the potential to undermine the legitimacy of the foreclosure process in both judicial and nonjudicial states and create a cloud over the legal title of homes and, depending on the facts and circumstances of each case, could result in judicial sanctions, civil penalties, and even criminal prosecutions. It is unclear whether or not the procedural problems masked substantive problems, such as a failure to transfer interests in a mortgage properly, thus calling into question true ownership of mortgages, in certain instances. Even if substantive problems do exist, it may be possible to rectify deficiencies in many, if not the vast majority, of cases to allow for the completion of a foreclosure. Correcting these problems would come at a cost by potentially causing significant delays in the completion of the foreclosure process, even for properties in which foreclosure is inevitable.

There is a great deal of uncertainty in exactly what transpired in the run-up to the housing market crash and what continues to occur as financial institutions and homeowners deal with the crash's aftermath. What is clear is that there will be legal disputes arising in virtually every corner of the market, and it likely will take many years for these disputes to be settled by the parties and the courts. This report seeks to shed light on some of these uncertainties by explaining the mortgage market process and some of the legal agreements entered into between market participants; explaining the legal procedures of typical judicial and nonjudicial foreclosure statutes; explaining some of the procedural problems that have surfaced during the implementation of foreclosure proceedings that drove some mortgage servicers to pause foreclosure sales and evictions; analyzing how the increasing complexity of the secondary mortgage market over the last 10 to 15 years may have led to or exacerbated these procedural problems; and addressing some of the potential substantive errors that could have been hidden by the procedural problems and the legal effect these problems could have on homeowners, lenders, and other mortgage market participants.¹⁵

This report primarily focuses on sections of the mortgage market that directly affect homeowners. Of course, there are many agreements and legal relationships that are linked to mortgages that do not directly involve homeowners. Many of the same documentation and proper transfer of ownership problems that may affect homeowners directly through the foreclosure process have the potential to cause even more significant legal and economic problems for the financial institutions involved. These problems include violations of securities laws for failing to

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shall be verified. When verification of a document is required, the document filed shall include an oath, affirmation, or the following statement: 'Under penalty of perjury, I declare that I have read the foregoing, and the facts alleged therein are true and correct to the best of my knowledge and belief.'"); Residential Foreclosure Attorney Affirmation, NY Sup. Ct., Chief Judge, available at <http://www.courts.state.ny.us/attorneys/foreclosures/Affirmation-Foreclosure.pdf> (attorney affirmation subject to "penalties of perjury").

¹⁵ This report does not address the policy implications of these or related foreclosure issues, such as the effectiveness of loss mitigation and mortgage modification relief efforts like the Obama Administration's Making Home Affordable Program. For more information on this topic, see CRS Report R40210, *Preserving Homeownership: Foreclosure Prevention Initiatives*, by (name redacted). Nor does it address the effect that a temporary foreclosure moratorium could have on the housing market as a whole. For more information on this topic, see CRS Report RL34653, *Economic Analysis of a Mortgage Foreclosure Moratorium*, by (name redacted).

accurately describe the mortgages underlying mortgage-backed securities (MBS) and violations of representations and warranties (e.g., regarding the quality of underwriting standards and other mortgage characteristics) provided for in the contracts that executed the sale of mortgage interests in the secondary market. These problems have the potential to cost financial institutions billions of dollars in legal claims while also increasing market uncertainty, which comes with its own costs.¹⁶

Another interesting wrinkle is that the federal government is an active participant in multiple, and sometimes conflicting aspects, of the mortgage market. For instance, the Department of the Treasury (Treasury) has used Troubled Asset Relief Program (TARP) funds to acquire stock and warrants to purchase stock in banks with significant mortgage-related assets (e.g., CitiGroup) and to implement the Making Home Affordable Program; the Treasury also has used funds from the Housing and Economic Recovery Act (HERA, P.L. 110-343) to purchase millions of dollars' worth of mortgage-backed securities from Fannie Mae and Freddie Mac; the Federal Housing Finance Agency (FHFA) is acting as conservator of Fannie Mae and Freddie Mac; and the Federal Deposit Insurance Corporation (FDIC) holds interests in mortgage assets as conservator and receiver over failed commercial banks and thrifts. As a result, the government will be directly impacted by, and at times, will be actively involved in, mortgage-related legal disputes. Many of these problems are outside of the scope of this particular report, but at times they are alluded to here.

The Mortgage Market, Players, and Process

When individuals purchase residential real property with borrowed funds, they usually enter a contractual agreement, typically called a promissory note, to, among other things, make principal and interest payments to the originating lender for a period of time. Lenders obtain a security interest¹⁷ in the underlying property as security against borrower default. In other words, what is commonly referred to as a "mortgage" consists of both a promissory note evidencing the debt to be paid by borrower and the security interest in the underlying property, which generally is provided for in a deed of trust or a mortgage. *(To avoid confusion, this report refers to a note as the evidence of a borrower's obligation, a deed of trust as evidence of a security interest in the real property, and a mortgage as the interest in the note and the deed combined.)*

Every state has a land recordation and title system with laws governing how security interests in real property (i.e., land) should be recorded to establish the priority of secured lien holders in the same property. These land recordation systems put subsequent purchasers on notice of existing interests in the property and can protect subsequent purchasers from mortgagees (and their successors or assigns) that fail to properly record their interest in the property.¹⁸ These systems

¹⁶ Ed Reardon, Abhishek Mistry, John Sim, and Asif Sheikh, *Putbacks and foreclosures: fact vs. fiction*, J.P. Morgan Securitized Products Weekly; Laurie Goodman, Amherst Securities Group LP, Grais and Ellworth LLP hosted conference, *Robosigners and Other Servicing Failures: Protecting the Rights of RMBS Investors*, Oct. 27, 2010, slide 10, available at <http://video.remotecounsel.com/mediasite/Viewer/?peid=12e6411377a744b9a9f2eefd1093871c1d>.

¹⁷ A "security interest" is "[a] property interest created by agreement or by operation of law to secure performance of an obligation (esp. repayment of a debt)." *Black's Law Dictionary*, 7th ed.

¹⁸ There are three primary types of record statutes. Notice statutes protect subsequent purchasers who do not have actual or constructive notice of existing interests. Pure race statutes give priority to the first to properly record, regardless of whether or not a subsequent purchaser had actual knowledge of an unrecorded interest. Race-notice statutes provide protections to subsequent purchasers who did not have actual or constructive notice at the time of the (continued...)

date back to colonial times. They generally require that each time a company acquires a security interest in a piece of real property—either through the assignment¹⁹ or sale of an existing interest or the creation of a new one, such as through a home equity line of credit—it physically records the existence of that interest with the register of the deeds office in the county in which the property is located, while also paying recordation fees.²⁰ Failure to record an interest in property properly does not invalidate the homeowner's obligations under the mortgage.²¹

Sometimes the originating lender retains its interest in the mortgage for the life of the loan. In recent years, however, it has become far more common for the originating lender to sell or assign its interest in both the note and the deed to another financial institution. Sometimes the sale or assignment of the mortgage was merely to a larger bank with a more diversified portfolio, but more often the sale or assignment was for the purpose of securitizing the mortgage. Ownership of the mortgage could change hands multiple times throughout the life of the loan. Eventually, more than half of all mortgages either are sold to one of the GSEs or assigned to special purpose vehicles (SPVs)—companies formed for the sole purpose of owning mortgages. These SPVs usually are formed as passive real estate investment trusts, such as Real Estate Mortgage Investment Conduits (REMICs), which receive favorable tax treatment. The trusts, thus, become the holder of both the note and the security interest. The mortgage payments for the mortgages held in trust are distributed to investors as mortgage-backed securities (MBS) based on a pre-arranged formula. The trust hires a trustee to administer the trust on behalf of the investors (i.e., certificate holders or bondholders) in the MBS.

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conveyance and who are the first to properly record. *Powell on Real Property* § 82.02.

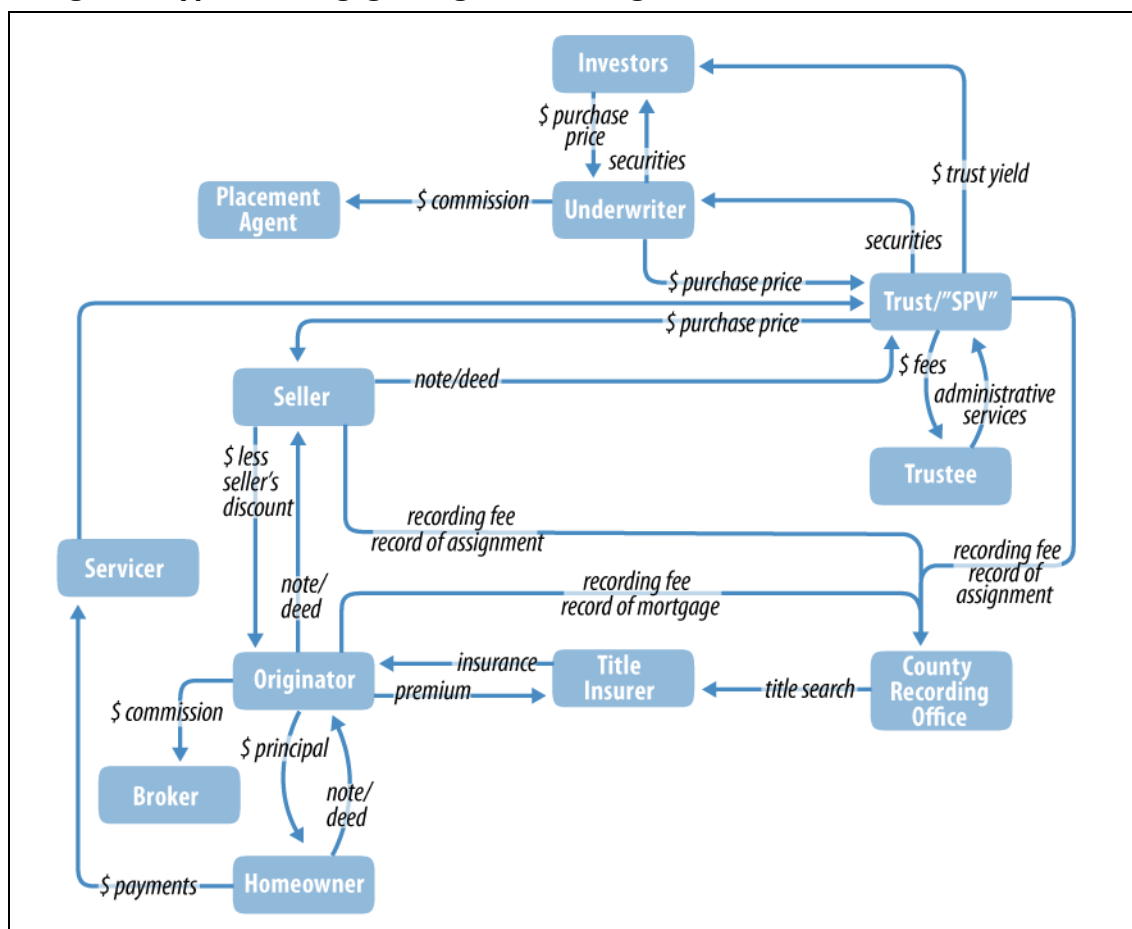
¹⁹ An assignment of a mortgage can take several forms, but most commonly it is either the transfer of all rights in the mortgage from the assignor to the assignee or the transfer of rights in the mortgage as collateral for another loan. See, *Black's Law Dictionary*, 7th ed., "assignment," "absolute assignment," and "collateral assignment."

²⁰ *Powell on Real Property* § 82.01. The process by which real property interests are recorded varies from state to state. Many states require rigid compliance to recording statutes in order for a mortgage to be recorded. See, e.g., *Bank of America, N.A. v. Corzin*, 2010 LEXIS 8755 (Oh. E.D. 2010) (holding that a mortgage was not properly executed, and therefore cannot be recorded under state law and cannot provide constructive notice to subsequent purchasers, because the acknowledgment was not signed by the homeowner even though the homeowner's initials were placed at the bottom of the acknowledgment page, the homeowner's full signature was placed on the page before the acknowledgment page, and the subsequent purchaser had actual knowledge of the lien); *Agin v. Mortg. Elec. Registration Sys., Inc.*, 2010 LEXIS 3641, 17 (Bankr. E.D. Mass. 2010) ("Mortgage acknowledgments must be strictly executed in the manner proscribed by Massachusetts law or they are invalid."). See also *Nolan v. Wells Fargo Bank N.A.*, 395 B.R. 33, 46, fn. 4 (Bankr. W.D. Ohio 2008) ("Cases under Ohio law abound invalidating mortgages for technical deficiencies in the perfection of such mortgages.") See e.g., *Menninger v. Mortgage Electronic Registration Systems (In re Bowling)*, 314 B.R. 127 (Bankr. S.D. Ohio 2004) (defective notary acknowledgment subjects a mortgage to a Chapter 7 trustee's avoidance power under Code § 544(a)(3)); *Simon v. Chase Manhattan Bank (In re Zaptocky)*, 250 F.3d 1020 (6th Cir. 2001) (Chapter 7 trustee was entitled to avoid a mortgage not executed in the presence of two witnesses as required under Ohio law); *Logan v. Universal 1 Credit Union, Inc. (In re Bozman)*, 365 B.R. 824 (Bankr. S.D. Ohio 2007) (Under Ohio law, notary's signature and seal, without additional language, was insufficient to constitute acknowledgment for execution of mortgage, and thus Chapter 7 trustee was entitled to avoid mortgage as subsequent bona fide purchaser, even though notary wrote his name and included his commission information in area of mortgage designated for acknowledgment).

²¹ *Powell on Real Property* § 82.01. See, e.g., *Nolan v. Wells Fargo Bank N.A.*, 395 B.R. 33, 43 (Bankr. W.D. Ohio 2008) ("[Ohio Revised Code] § 5301.25 does not invalidate an assignment that has not been recorded. The recording statute deems such an assignment for the encumbrance of land as fraudulent 'so far as it related to a subsequent bona fide purchaser' who, at the time of purchase, has no knowledge of the existence of an encumbrance on the land.... The recording statute is meant to protect innocent subsequent bona fide purchasers of land who have no knowledge of any encumbrances. The statute does not release the mortgage obligation of the original mortgagor's estate or heirs.") (internal citations omitted).

Whether a mortgage is securitized or not, a mortgage holder hires a mortgage servicer to interact with the homeowners. In some instances, originating lenders retain servicing rights over loans even when they sell their security interest in the mortgages to unaffiliated parties. In other cases, originating lenders assign the servicing rights to their mortgage servicer affiliates or subsidiaries. **Figure 1** illustrates how mortgages typically are originated, assigned, securitized, and recorded along with the various interests that are exchanged at each step of the process.

Figure 1. Typical Mortgage Origination, Assignment, and Securitization Process



Source: Christopher L. Peterson, *Foreclosure, Subprime Mortgage Lending, and the Mortgage Electronic Registration System*, 78 U. Cin. L. Rev. 1359, 1367, Summer 2010.

During the housing boom, the sale of millions of mortgages to other banks, GSEs, and securitizers made it costly and time-consuming for financial institutions to comply with local land recordation laws. One way the industry attempted to alleviate these difficulties was by creating a mortgage servicing system, the Mortgage Electronic Registration Systems, Inc. (MERS). To help alleviate the costs and procedural burdens of recording each change in ownership with the local register of the deeds office, some mortgage market participants work with MERS—a corporation created in the late 1990s by other mortgage companies and industry groups to chronicle the assignment of mortgages electronically.²² Mortgage holders name MERS as “mortgagee of record

²² MERS, About MERS, available at <http://www.mersinc.org/about/index.aspx>.

in nominee capacity” or as nominee assignee so that MERS is recorded as the nominee (i.e., agent) of a security interest in the local register of deeds office, even though MERS does not actually hold a beneficial interest in the deed, nor does it claim any interest in the note. Instead, MERS, acting as an agent of the actual mortgagee and/or its successors and assigns, acquires possession of the physical deed of trust, files its name once with the local register of deeds office, and then tracks (and actively engages in the execution of) every subsequent change of ownership or assignment of the mortgage to a MERS participant during the life of the loan in its electronic database instead of at the local register of deeds office. As nominee, MERS must be actively involved in the execution of mortgage documents.²³ As described in detail below, the question of who is the actual holder of the mortgage is very important to the foreclosure process. With millions of mortgages in the MERS electronic system, the effectiveness of MERS’ documentation and processes plays a critical role in the determination of mortgage ownership in the country. The use of MERS raises a number of legal questions, such as whether MERS has the legal standing to initiate foreclosures in its own name and to what extent recording MERS as mortgagee or assignee provides sufficient notice to subsequent purchasers under state recording statutes, which are currently being litigated in many jurisdictions.²⁴

Neither trustees nor servicers hold a beneficial interest in the mortgage. Rather, they perform their duties as agents for the actual mortgage holders. Although servicers of securitized mortgages are supposed to act as agents on behalf of the MBS investors, one of the servicer’s affiliates may have an interest in the underlying mortgages, which some have argued creates a conflict of interest.²⁵ For example, it is relatively common for affiliates of the four largest servicers (Bank of America, Wells Fargo, JPMorgan Chase, and Citigroup) to own second liens on primary-lien mortgages held in trusts they service.²⁶

The rights of investors and the duties of trustees and servicers are spelled out in a contract called a pooling and servicing agreement (PSA). Trustees serve primarily clerical duties on behalf of the investors by, for example, verifying that the documentation for each mortgage acquired by the trust is in order and divvying the proceeds of homeowner payments to the investors of the various

²³ MERS, About MERS, available at <http://www.mersinc.org/about/index.aspx>. See also Christopher L. Peterson, *Foreclosure, Subprime Mortgage Lending, and the Mortgage Electronic Registration System*, 78 U. Cin. L. Rev. 1359, 1361-62, Summer 2010; John R. Hooge and Laurie Williams, *Mortgage Electronic Registration Systems, Inc.: A Survey of Cases Discussing MERS’ Authority to Act*, Norton Bankruptcy Law Adviser, Issue No. 8, Aug. 10, 2010.

²⁴ Christopher L. Peterson, *Foreclosure, Subprime Mortgage Lending, and the Mortgage Electronic Registration System*, 78 U. Cin. L. Rev. 1359, 1361-62, Summer 2010; John R. Hooge and Laurie Williams, *Mortgage Electronic Registration Systems, Inc.: A Survey of Cases Discussing MERS’ Authority to Act*, Norton Bankruptcy Law Adviser, Issue No. 8, Aug. 10, 2010.

²⁵ Laurie Goodman, Amherst Securities Group LP, Grais and Ellworth LLP hosted conference, *Robosigners and Other Servicing Failures: Protecting the Rights of RMBS Investors*, Oct. 27, 2010, oral presentation accompanying slides 3-11, available at <http://video.remotecounsel.com/mediasite/Viewer/?peid=12e6411377a744b9a9f2eefd1093871c1d>. See also Diane E. Thompson, *Why Servicers Foreclose When They Should Modify and Other Puzzles of Servicer Behavior: Servicer Compensation and its Consequences*, National Consumer Law Center, at fn. 220, available at <http://www.macdc.org/research/Servicer-Report1009.pdf> (“Affiliated servicers holding junior liens may be particularly reluctant to agree to a short sale, since the junior lien must usually be wiped out by a short sale. The junior lien could be erased in a foreclosure, as well, but in that circumstance the servicer would have at least the possibility of a deficiency judgment against the borrower. Additionally, if the foreclosure is delayed, an optimistic servicer may believe that the housing market will recover sufficiently to cover both the first lien and some of the second lien.”).

²⁶ Laurie Goodman, Amherst Securities Group LP, Grais and Ellworth LLP hosted conference, *Robosigners and Other Servicing Failures: Protecting the Rights of RMBS Investors*, Oct. 27, 2010, slide 3, available at <http://video.remotecounsel.com/mediasite/Viewer/?peid=12e6411377a744b9a9f2eefd1093871c1d>.

tranches or classes of securities based on the pre-arranged formula established by the PSA.²⁷ Servicers mainly are charged with interacting with individual homeowners, which most frequently consists of acquiring borrower payments. Mortgage servicers' primary source of revenue is through a fixed percentage of the mortgage principal amount.²⁸ When borrowers become delinquent or default on their monthly payments, servicers (of both securitized and non-securitized mortgages) may engage in loss mitigation and/or initiate foreclosure proceedings on behalf of mortgage holders (e.g., the trusts). PSAs govern under what circumstances and in what ways servicers may engage in loss mitigation efforts. In fact, loss mitigation actions and foreclosure proceedings often are performed simultaneously. Foreclosure proceedings are more streamlined than loss mitigation efforts, which are more tailored to the individual characteristics of borrowers and their underlying homes. Servicers also tend to be able to recoup a greater amount of fees and expenses through a foreclosure. As a result, engaging in loss mitigation efforts usually is more expensive and time consuming for servicers than initiating foreclosure.²⁹

State Foreclosure Procedures

The process that mortgage holders must follow in order to foreclose upon a residential property is governed by state law. The details of these procedures vary considerably from state to state. However, there are some guiding principles that generally apply across the board. In about half of the states, courts usually, if not always are part of a foreclosure process. The laws of the remaining states allow for the use of a nonjudicial foreclosure process under certain circumstances.³⁰ In most of these states, a judicial foreclosure process is allowed under the law, but the nonjudicial process is used more often. As will be explained below, it is possible for homeowners to get courts involved in a foreclosure that is initiated pursuant to a nonjudicial

²⁷ Trustees may act as a fiduciary of the trust in certain circumstances, such as if the servicer's actions constitute an "event of default," as defined by the PSA or if there are potential violations of the representations/warranties regarding the mortgage characteristics acquired by the trust. See, e.g., Bank of America Mortgage Securities, Inc., Mortgage Pass-Through Certificates, Series 2002-H, Pooling and Servicing Agreement, p. 60, available at <http://www.sec.gov/Archives/edgar/data/1014956/000095016802001980/d424b5.txt>.

²⁸ Larry Cordell, *The Incentives of Mortgage Servicing: Myths and Realities*, Finance and Economics Discussion Series, Federal Reserve Board, Sept. 8, 2008, available at <http://www.federalreserve.gov/PUBS/FEDS/2008/200846/200846pap.pdf>.

²⁹ *Id.* In absence of a structured loss mitigation or loan modification program, such as the Making Home Affordable Program, that offers incentive payments for participation, servicers often do not receive any up-front compensation for the time and energy they spend engaging in loss mitigation. On top of these costs, servicers, under some circumstances, are contractually obligated to advance principal and interest payments to secondary market participants when the borrower is delinquent. Servicers only begin receiving payment when delinquent borrowers resume monthly payments and cure defaults, and because servicers usually get paid a set percentage, their compensation decreases when borrowers' monthly payments are reduced. On the other hand, servicers are able to recoup these advanced payments and certain fees assessed from the proceeds of a foreclosure sale. See, *id.* and Written Testimony of Adam J. Levitin, Associate Professor of Law, Georgetown Law Center, *Helping Families Save their Homes: the Role of Bankruptcy Law*, U.S. Senate, Committee on the Judiciary, Nov. 19, 2008, available at http://judiciary.senate.gov/hearings/testimony.cfm?id=3598&wit_id=7542 (internal citations omitted). Thus, servicers often receive more in compensation through a foreclosure than they do through loss mitigation or loan modification. This is especially true where a servicer goes through the time and effort of offering a borrower a modification only to have the borrower redefault in the near future. Roberto G. Quercia, *et. al*, *Loan Modifications and Redefault Risk: An Examination of Short-term Impact*, Center for Community Capital, University of North Carolina at Chapel Hill, Working Paper, Mar. 2009, available at http://www.ccc.unc.edu/documents/LM_March3_%202009_final.pdf.

³⁰ John Rao and Odette Williamson, *Foreclosure: Defenses, Workouts, and Mortgage Servicing*, §§ 4.2.2-4.2.3, 1st ed. (2005). There are at least two other less common types of foreclosure: strict foreclosure and entry and possession. *Id.* at § 4.2.4.

process; however, there are some procedural hurdles homeowners must pass to do so. An analysis of the typical judicial and nonjudicial processes follows.

The Judicial Foreclosure Process

In order to foreclose on a residential property utilizing a judicial foreclosure process, a foreclosing party must file an action with a court (usually a local court in the county in which the property is located) and receive judicial approval of the foreclosure. The plaintiff (i.e., the foreclosing party) seeking approval from the court for the foreclosure generally must prove

1. that there is a valid mortgage between the borrower/homeowner and the mortgage holder; and
2. that the borrower/homeowner is in default or has otherwise breached the mortgage contract.

To prove that there is a valid mortgage, a foreclosing entity can submit to the court the original promissory note and the deed of trust. Some state laws allow foreclosing entities to submit other evidence that there is a valid mortgage in lieu of producing the original note.³¹ For instance, most states allow for the submission of affidavits,³² that is, sworn statements attesting to the fact that the entity holds the note, but that the original note is lost, destroyed, or otherwise cannot be produced for the court. In other instances, mortgage holders may produce copies of the original note and deed of trust accompanied by a sworn affidavit attesting to the fact that the holder has physical possession of the originals.³³ These affidavits often require a testament that the signer has personal knowledge of the facts to which she is swearing or that she has personally examined the attested facts.³⁴ Affidavits usually must be signed in the presence of a notary and/or other witnesses. Similarly, mortgage holders often are able to show the amount of the borrower’s outstanding obligation and that the borrower is in default of his obligation through sworn affidavits. Courts rely upon the accuracy and authenticity of statements made under oath in affidavits.

Where the foreclosing entity is able to meet its burden of proof on the two criteria (i.e., there is a valid mortgage between the borrower and mortgage holder; and the borrower is in default or breach of contract) and the borrower fails to or is unable to raise any valid defenses, then the foreclosure is confirmed by the court and a sale date is set. The mortgage holder must meet the state’s notice of sale requirements, if applicable. Then the home will be put up for sale, usually at a public auction conducted by a public entity, such as a representative from the local sheriff’s office. Mortgage holders often establish a minimum bid. If no one makes a bid that exceeds the minimum, then the property reverts to “real estate owned” property held by the mortgage holder.

³¹ See, e.g., *Mitchell Bank v. Schanke*, 676 N.W.2d 849, 862-63 (Wis. S.Ct. 2004).

³² An “affidavit” is [a] voluntary declaration of facts written down and sworn to by the declarant before an officer authorized to administer oaths.” *Black’s Law Dictionary*, 7th ed.

³³ See, e.g., *Ohio v. GMAC Mortgage LLC*, Case No. CIQ1Q06984, Complaint for Declaratory Relief, Preliminary and Permanent Injunction, Damages, Civil Penalties, and Punitive Damages, Appx. A, filed Oct. 6, 2010, available at <http://www.ohioattorneygeneral.gov/GMACLawsuit>.

³⁴ *Id.* (e.g., “‘Affiant,’ being duly sworn according to law, deposes and says on the basis of personal knowledge....”)

Contesting a Judicial Foreclosure

Although most judicial foreclosures are uncontested, a homeowner has the right to contest a judicial foreclosure by raising defenses. Among other things,³⁵ the homeowner may produce evidence to show that the mortgage holder has not proved that it meets the general requirements for a foreclosure. For instance, a homeowner could produce evidence that the plaintiff lacks legal standing to raise a foreclosure action because the plaintiff is not the mortgage holder or because the assignment of the mortgage interest was improperly executed.³⁶

Legal standing³⁷ is a requirement for seeking any claim, not just a foreclosure action, but whether the plaintiff in a foreclosure action has legal standing to raise the claim has become a common challenge in contested foreclosures in recent years because of the frequency by which interests in mortgages have been sold and assigned in the secondary market. The more times that an interest is sold or assigned, the more opportunities there are for mistakes to occur in the execution. State laws vary on who has standing to bring a foreclosure action, but in all cases the legal holder of the mortgage (and generally its legal representatives, acting in the name of the mortgage holder) has the right to foreclose on the property.³⁸ Many challenges over standing in a foreclosure action center on whether the plaintiff is the actual mortgage holder. This may come into question where the paperwork documenting a sale or assignment of interest in a mortgage is missing or deficient in some way, such as if it is not properly endorsed by the parties or the assignment occurred after the foreclosure complaint was filed.³⁹

If a homeowner is able to show deficiencies in the chain of title⁴⁰ that puts ownership of the mortgage subject to a foreclosure action in doubt, then a court either may dismiss the action

³⁵ There are many different potential defenses to a foreclosure that could be raised by a homeowner. For example, the Truth in Lending Act, 15 U.S.C. § 1635, allows for a limited right of rescission of certain mortgage transactions if certain disclosures are not made properly. John Rao and Odette Williamson, *Foreclosure: Defenses, Workouts, and Mortgage Servicing*, §§ 4.3, 1st ed. (2005). This report is not intended to provide an exhaustive list of potential defenses.

³⁶ See, e.g., *Village Bank v. Wild Oaks Holding, Inc.*, 196 N.Y.S.2d 812, 812 (N.Y. App. Div. 1993); *First Knox Nat'l Bank v. Peterson*, 2009 Ohio App. LEXIS 4342, 8 (Ohio Ct. App. 2009); *Wells Fargo Bank, N.A. v. Jordan*, 2009 Ohio App. LEXIS 881 (Ohio Ct. App. 2009); *Verizzo v. Bank of New York*, 28 So. 3d 976 (Fla. Dist. Ct. App. 2010).

³⁷ “Standing” refers to “[a] party’s right to make a legal claim or seek judicial enforcement of a duty or right.” *Black’s Law Dictionary*, 7th ed.

³⁸ See, e.g., *Wash. Mut. Bank, F.A. v. Green*, 156 Ohio App. 3d 461, 464 (Ohio Ct. App. 2004) (“It is well-established that the real party in interest in such a case is the current note holder/mortgage holder, which, due to the possibility of assignment, could be different than the original holder.”); *Everhome Mortg. Co. v. Rowland*, 2008 Ohio App. LEXIS 1103, 6-7 (Ohio Ct. App. 2008); *Greystone Bank v. Peralta*, 2010 U.S. Dist. LEXIS 88753, 11-12 (NY Dist. Ct. E.D. 2010) (“... there never seems to have been any doubt that the 100 percent beneficial interest holder always enjoyed the right to enforce his borrower’s obligations.”). See also John Rao and Odette Williamson, *Foreclosure: Defenses, Workouts, and Mortgage Servicing*, §§ 4.3.4, 1st ed. (2005).

³⁹ See, e.g., *Wells Fargo Bank, N.A. v. Jordan*, 2009 Ohio App. LEXIS 881, 12 (Ohio Ct. App. 2009) (“Attached to the Notice were a Final Judicial Report and an Assignment of Mortgage, indicating the Mortgage had been assigned to WFB on August 22, 2007, nearly three weeks after it filed its complaint. In short, WFB was not the real party in interest on the date it filed its complaint seeking foreclosure against Jordan. Thus, WFB lacked standing to bring a foreclosure action against Jordan.”); *Kluge v. Fugazy*, 145 A.D. 2d 537, 537-38 (NY Sup. Ct. 1988) (“The plaintiff’s first and second causes of action for foreclosure and a deficiency judgment, respectively, must fail since foreclosure of a mortgage may not be brought by one who has no title to it and absent transfer of the debt, the assignment of the mortgage is a nullity...” (internal citations omitted)); *U.S. Bank, N.A. v. Emmanuel*, 2010 NY Slip Op. 50819U (NY Sup. Ct. 2010) (dismissal of foreclosure action with prejudice because plaintiff lacks standing because of an ineffective assignment of the promissory note and mortgage).

⁴⁰ “Title” refers to “[t]he union of all elements (as ownership, possession, and custody) constituting the legal right to (continued...) ”

outright or give the plaintiff a period of time to submit evidence to show the plaintiff's standing. In some instances, a plaintiff would be able to simply submit new evidence into the record and continue the process where it ended.⁴¹ When a case is dismissed, a plaintiff may need to start the judicial process from the beginning. Starting again can result in significant delays, especially in states where there is a backlog of foreclosure cases in the court system.⁴²

A homeowner also could produce evidence showing that the foreclosing plaintiff has failed to meet all notice and other procedural requirements imposed under state laws. Generally, state laws require notice that the borrower is in default and/or a notice of the pending foreclosure sale. The method of service in which the notice must be delivered (e.g., by certified mail; by publication in a local newspaper), the timing in which it must be served (e.g., within three months of default; within 15 days of the foreclosure sale date), and the information that must be provided in the notice (e.g., discussion of a right to cure;⁴³ outstanding balance on the debt) vary considerably state-to-state.⁴⁴ A homeowner also may contest the mortgage holder's calculation of the outstanding balance by arguing that the holder's tally includes a late fee that is not permissible under state or federal law.⁴⁵

These types of defenses are not likely to prevent a foreclosure altogether, but may result in a reduction in a homeowner's outstanding balance or a delay of the foreclosure sale until the mortgage holder can correct the deficiency in the notice process—potentially providing more time for a homeowner to produce the means to redeem the obligation, to cure a default, to seek some form of loss mitigation, or to find new housing. It also may reduce a homeowner's obligations under a deficiency judgment, if such a judgment is allowed under state law and is pursued by the mortgage holder.⁴⁶

(...continued)

control and dispose of property; the legal link between a person who owns property and the property itself.... [or l]egal evidence of a person's ownership rights in property; an instrument (such as a deed) that constitutes such evidence." *Black's Law Dictionary*, 7th ed.

⁴¹ See, e.g., *In re Foreclosure Cases*, Case Nos. 3:07CV043, 07CV049, 07CV085, 07CV138, 07CV237, 07CV240, 07CV246, 07CV248, 07CV257, 07CV286, 07CV304, 07CV312, 07CV317, 07CV343, 07CV353, 07CV360, 07CV386, 07CV389, 07CV390, 07CV433, 521 F. Supp. 2d 650, 654 (Ohio Dist. Ct. W.D. 2007) ("Therefore, plaintiffs are given until not later than thirty days following entry of this order to submit evidence showing that they had standing in the above-captioned cases when the complaint was filed....").

⁴² See, e.g., *U.S. Bank, N.A. v. Emmanuel*, 2010 NY Slip Op. 50819U (NY Sup. Ct. 2010) (dismissal of foreclosure action with prejudice because plaintiff lacks standing because of an ineffective assignment of the promissory note and mortgage). See **Figure 2** below for an understanding of foreclosure lag times.

⁴³ Some state laws allow homeowners to stop a foreclosure process by "curing" their default, that is, paying all arrearages and permissible fees and penalties to bring the debt current. See, e.g., Cal. Civ. Code § 2924c. State laws may place limitations on the right to cure, for instance, by only allowing homeowners to cure a certain number of times over a certain period of time. See, e.g., D.C. Code § 42-815.01.

⁴⁴ Compare, e.g., the various notice requirements under the laws of Iowa (Iowa Code §§ 654.2B, 654.2D, 654.4A, 654.4B, 654.15A, and 654.15B) with those of Hawaii (Haw. Rev. Code §§ 667-5.5, 667-6, and 667-7).

⁴⁵ Katherine Porter, *Misbehavior and Mistake in Bankruptcy Mortgage Claims*, 87 Tex. L. Rev. 122 (2008), available at <http://www.utexas.edu/law/journals/tlr/assets/archive/v87/issue1/porter.pdf>.

⁴⁶ Most states allow mortgage holders to seek a deficiency judgment against a homeowner whose property has been foreclosed upon where the foreclosure sale does not cover the outstanding balance of the homeowner's obligation or the fair market value of the property at the time of the foreclosure sale. The circumstances under which a holder can pursue a deficiency judgment and the way in which the deficiency judgment is calculated varies tremendously by state law. For instance, some states do not allow mortgage holders to seek a deficiency judgment if they utilized a nonjudicial foreclosure rather than the judicial process. See, e.g., Cal. Civ. Proc. Code § 580d.

The Nonjudicial, “Power of Sale,” Foreclosure Process

To foreclose on a property utilizing a nonjudicial process, such a process must be permissible under state law.⁴⁷ Notice of a mortgage holder’s ability to utilize a nonjudicial foreclosure process typically is provided for in a “power of sale” clause within the deed of trust. For this reason, nonjudicial foreclosures are referred to as power of sale foreclosures. Mortgage holders must meet the same two criteria as are required in a judicial foreclosure process. The major difference between the two processes is that, because the mortgage holders do not need the court’s involvement, a homeowner must affirmatively raise actions with a court to contest the foreclosure.⁴⁸ In many states, this requires affirmatively seeking a court injunction⁴⁹ to at least temporarily stop the foreclosure sale. State laws often require the posting of a bond for an injunction to be granted, although the law may give courts some leeway to waive the bond under certain circumstances.⁵⁰ Courts also require individuals seeking an injunction to provide sufficient evidence to show that irreparable harm likely will occur in absence of the injunction and that the movant likely will win on the merits of his claim.⁵¹

In sum, a mortgage servicer (or any other entity) that initiates a foreclosure pursuant to a power of sale still must meet the two foreclosure criteria—that there is a valid mortgage and that the borrower is in default—and must adhere to all of the procedural and notice requirements established by state law. However, a homeowner faces substantial procedural obstacles to contest that these criteria have been met.

Because courts usually are not involved in the process, power of sale foreclosures tend to be less expensive and completed faster than judicial foreclosures.⁵² Historically, the vast majority of power of sale foreclosures are uncontested. **Figure 2** compares the average amount of time it takes to complete the liquidation process in judicial and power of sale foreclosure states from February 2006 to October 2010.

⁴⁷ See, e.g., Cal. Civ. Code § 2924a; Nev. Rev. Stat. § 107.080; N.H. Rev. Stat. Ann. § 479.25.

⁴⁸ John Rao and Odette Williamson, *Foreclosure: Defenses, Workouts, and Mortgage Servicing*, §§ 4.2.3, 1st ed. (2005). At least one state requires a pre-sale hearing before a power of sale foreclosure. North Carolina law requires a pre-sale hearing be conducted before a clerk of court (not a judge). The law limits the issues that may be raised by the debtor during the hearing. N.C. Gen. Stat. § 45-21.16.

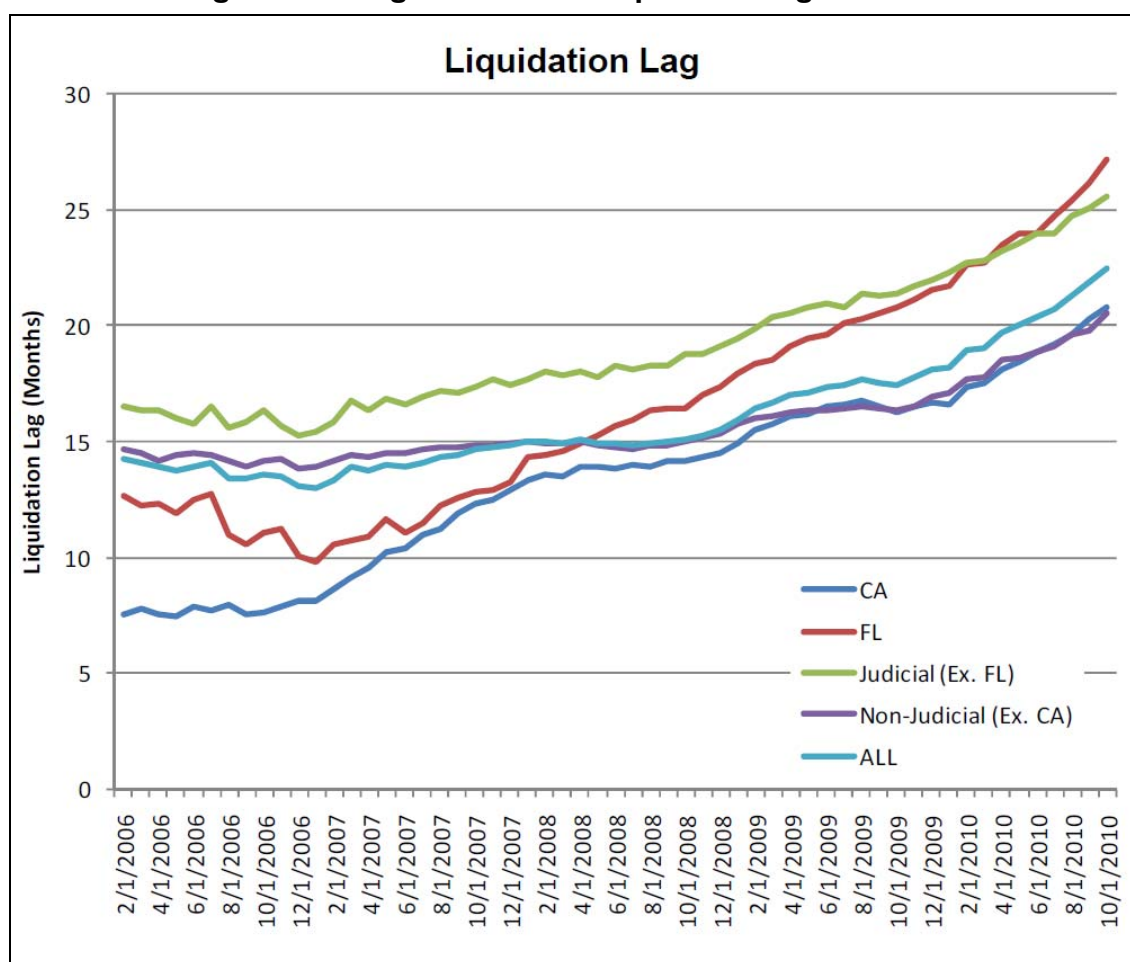
⁴⁹ An “injunction” is “[a] court order commanding or preventing an action. To get an injunction, the complainant must show that there is no plain, adequate, and complete remedy at law and that an irreparable injury will result unless the relief is granted.” *Black’s Law Dictionary*, 7th ed.

⁵⁰ See, e.g., N.H. Rev. Stat. Ann. § 479.25 (“Notice of the sale as served on or mailed to the mortgagor shall include the following language: ‘You are hereby notified that you have a right to petition the superior court for the county in which the mortgaged premises are situated, with service upon the mortgagee, and upon such bond as the court may require, to enjoin the scheduled foreclosure sale.’”).

⁵¹ *Winter v. Natural Res. Def. Council, Inc.*, 129 S. Ct. 365, 374, (2008) (“A plaintiff seeking a preliminary injunction must establish that he is likely to succeed on the merits, that he is likely to suffer irreparable harm in the absence of preliminary relief, that the balance of equities tips in his favor, and that an injunction is in the public interest.”), vacated by 130 S. Ct. 2371, 176 L. Ed. 2d 764 (2010), reinstated in relevant part by 607 F.3d 355 (4th Cir. June 8, 2010). See also *Amoco Prod. Co. v. Vill. of Gamdell*, 480 U.S. 531, 542 (1987); *Moore’s Answer Guide: Federal Civil Motion Practice* § 5.06, Matthew Bender & Co., Inc. (2010).

⁵² Amherst Mortgage Insight, *The Affidavit Fiasco—Implications for Investors in Private Label Securities*, p. 4, Oct. 12, 2010.

Figure 2. Average Foreclosure Liquidation Lag Over Time



Source: Laurie Goodman, *Outlook and Opportunities in the RMBS Market*, Amherst Securities Group LP, Nov. 2010.

"Robo-Signers," Improper Affidavits, and Other Documentation Problems and Some of the Legal Battles That Likely Will Result

As previously mentioned, the foreclosure process in judicial foreclosure states often requires the submission of sworn affidavits to a court as evidentiary support for the foreclosure. These affidavits are signed by an employee of a mortgage servicer who usually attests to have personal knowledge of the facts underlying the foreclosure, such as the existence of a valid mortgage between the holder and the borrower and that the borrower is in default. As an added layer of accountability, many state and local court rules require affidavits to be notarized, that is, certified by a notary public.⁵³ Notary publics generally do not certify to the accuracy of the underlying

⁵³ See, e.g., *Ohio v. GMAC Mortgage, LLC*, Case No. CI0201Q06984, *Complaint for Declaratory Relief, Preliminary Injunction, Damages, Civil Penalties and Punitive Damages*, filed Oct. 6, 2010, available at (continued...)

facts of an affidavit, but merely certify that the person signing the affidavit is who she says she is and signed at the time she said she did. Most state laws require affidavits to be signed in the presence of the notary in order for the notary to legally notarize the document.⁵⁴ The courts rely on the accuracy of these sworn affidavits because courts do not have the capacity to investigate the books of mortgage servicers to ensure the accuracy of each statement made in an affidavit.⁵⁵ It also is rare for inaccuracies to be evident on the face of affidavits.⁵⁶

Depositions of employees and attorneys for several major mortgage servicers have called into question the authenticity of some of affidavits submitted to courts as evidence to support foreclosure actions.⁵⁷ For example, Jeffrey Stephan, a "limited signing officer" and leader of the document execution team in GMAC Mortgage, Inc.'s foreclosure department, stated under oath during a deposition that thousands (6,000-8,000) of foreclosure files would go through his team per month.⁵⁸ Stephan stated that he signed affidavits for many of those files and, in some cases, he relied upon outside attorneys who prepared the documents to verify the accuracy of parts of the affidavits.⁵⁹ Stephan stated that the process he followed for the signing of affidavits adhered to GMAC Mortgage's policies and procedures.⁶⁰ Stephan also indicated that some affidavits were notarized by notary publics who had not witnessed his signature on the affidavits.⁶¹

Similar statements were made by Beth Cottrell,⁶² operation supervisor for Chase Home Finance, a subsidiary of JP Morgan Chase & Co.⁶³ Cottrell stated that she and seven other managers signed,

(...continued)

<http://www.ohioattorneygeneral.gov/GMACLawsuit>; Fla. Sup. Ct., *In re Amendments to the Florida Rules of Civil Procedure*, No. SC09-1460 and *In re: Amendments to the Florida Rules of Civil Procedure—Form 1.996 (Final Judgment of Foreclosure)*, Feb. 11, 2010, available at <http://www.floridasupremecourt.org/decisions/2010/sc09-1460.pdf>.

⁵⁴ See, Notary Public Code of Professional Responsibility, Guiding Principle III, Nat'l Notary Ass'n (July 2009), available at http://www.nationalnotary.org/UserImages/Notary_Code.pdf.

⁵⁵ Fed. Nat'l Mortg. Ass'n v. Bradbury, *Order on Four Pending Motions*, Docket No. BRI-RE-09-65, Sept. 24, 2010 (Me. Bridgton Dist. Ct. 2010), available at <http://graphics8.nytimes.com/packages/pdf/business/FourMotionsOrder.pdf> ("These documents are submitted to a court with the intent that the court find a homeowner liable to the Plaintiff for thousands of dollars and subject to a foreclosure on the debtor's residence. Filing such a document without significant regard for its accuracy, which the court in ordinary circumstances may never be able to investigate or otherwise verify, is a serious and troubling matter.").

⁵⁶ But see, *In re Foreclosure Cases*, Case Nos. 07-cv-166, 07-cv-190, 07-cv-226, 07-cv-279, 07-cv-423, 07-cv-534, 07-cv-536, 07-cv-642, 07-cv-670, 07-cv-706, 07-cv-714, 07-cv-727, 07-cv-731, 07-cv-963, 07-cv-999, 07-cv-1047, 07-cv-1091, 07-cv-1119, 07-cv-1150, 2007 U.S. Dist. LEXIS 90812 (Ohio Dist. Ct. 2007) (Ordering plaintiff counsel to submit an order of law explaining why the court should not dismiss the 20 foreclosure cases in which the only evidence to support the notion that plaintiffs are the beneficial holders of the mortgages were affidavits and assignments dated after the complaints for the foreclosure actions were filed; "Aside from their affidavits, however, Plaintiffs have not presented any evidence of any assignment, legal or equitable, that was executed before the Complaints were filed. Without such evidence, Plaintiffs' affidavits do not carry their burden to plead standing.").

⁵⁷ Links to a number of these depositions are available at <http://www.icelegal.com/Resources/Depositions/>.

⁵⁸ Fed. Nat'l Mortg. Ass'n v. Bradbury, Docket No. BRI-RE-09-65, Oral Deposition of Jeffrey D. Stephan, p. 46 (June 7, 2010), available at <http://www.molleurlaw.com/themed/molleurlaw/files/uploads/2010%20Stephan%20Deposition.pdf>.

⁵⁹ *Id.* at 57-62.

⁶⁰ *Id.* at 64.

⁶¹ *Id.* at 56.

⁶² Chase Home Finance, LLC v. _____, Case No. 50-2008-CA-016857, Oral Deposition of Beth Ann Cottrell, May 17, 2010 (Fla. Cir. Ct. 2010).

⁶³ See, JPMorgan Chase & Co., SEC Form 10-K, Ex. 21.1 for fiscal year ending Dec. 31, 2009, filed Feb. 21, 2010, (continued...)

on average, 18,000 documents per month. These documents include "affidavits, deeds, assignments ... [a]llonges,⁶⁴ lost note affidavits, [and] lost mortgage affidavits."⁶⁵ Cottrell stated that she relied on outside attorneys to draft the affidavits and her staff to fill in the numbers (i.e., outstanding balance, amount in escrow, etc.) on the affidavits and to raise any questions or concerns regarding those numbers to her. If a member of her staff raised issues with a particular file, Cottrell would review the firm's electronic systems herself to ensure the accuracy of the information on the affidavits. When no issues were raised by staff, Cottrell would spend less time reviewing the accuracy of the information provided in the affidavits of the files.⁶⁶ Cottrell also stated in the deposition that notaries were in the room with her when she signed affidavits.⁶⁷

These and several other depositions call into question whether employees and attorneys for major mortgage servicers who signed affidavits attesting to have personally researched or to have personal knowledge of the underlying facts set out in the affidavits actually had done so. At least one of these depositions also raised questions about whether the affidavits were properly notarized, and thus whether they met the technical evidentiary standards to be properly filed with the court. If these procedural issues existed in a few large mortgage servicers, concern is raised that other large mortgage servicers with comparable foreclosure workloads may suffer from similar procedural deficiencies.

There is little doubt that state laws requiring individuals who sign affidavits to have personal knowledge of the information to which they are attesting, notaries witness the signatures of documents they notarize, and similar evidentiary standards serve important functions, such as fraud prevention. There also is little doubt that mortgage servicers should follow proper legal procedures when foreclosing on a borrower's home. If affidavits with improper signatures or notarizations were submitted to courts, the signers could face perjury⁶⁸ charges, among others, and courts could force the signer, his employer, or the attorneys representing them to pay sanctions.⁶⁹ Parties could face a number of other civil or administrative penalties, as well,

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available at <http://www.sec.gov/Archives/edgar/data/19617/000095012310016029/e82150exv21w1.htm>.

⁶⁴ An "allonge" is "[a] slip of paper sometimes attached to a negotiable instrument for the purpose of receiving further indorsements when the original paper is filled with indorsements." *Black's Law Dictionary*, 7th ed.

⁶⁵ *Id.* at 5-6.

⁶⁶ *Id.* at 6-9.

⁶⁷ *Id.* at 9.

⁶⁸ "Perjury" is "[t]he act or an instance of a person's deliberately making material false or misleading statements while under oath." *Black's Law Dictionary*, 7th ed. Fla. Sup. Ct., *In re Amendments to the Florida Rules of Civil Procedure*, No. SC09-1460 and *In re: Amendments to the Florida Rules of Civil Procedure—Form 1.996 (Final Judgment of Foreclosure)*, Feb. 11, 2010, available at <http://www.floridasupremecourt.org/decisions/2010/sc09-1460.pdf> (amending Fla. R. Civ. Proc. 1.110, General Rules of Pleading, to state: "When filing an action for foreclosure of a mortgage on residential real property the complaint shall be verified. When verification of a document is required, the document filed shall include an oath, affirmation, or the following statement: 'Under penalty of perjury, I declare that I have read the foregoing, and the facts alleged therein are true and correct to the best of my knowledge and belief.'"); Residential Foreclosure Attorney Affirmation, NY Sup. Ct., Chief Judge, available at <http://www.courts.state.ny.us/attorneys/foreclosures/Affirmation-Foreclosure.pdf> (attorney affirmation subject to "penalties of perjury").

⁶⁹ Fed. Rule Civ. Proc. 11. Many states have similar rules of civil procedure. See, e.g., Fed. Nat'l Mortg. Ass'n v. Bradbury, *Order on Four Pending Motions*, Docket No. BRI-RE-09-65, Sept. 24, 2010 (Me. Bridgton Dist. Ct. 2010), available at <http://graphics8.nytimes.com/packages/pdf/business/FourMotionsOrder.pdf> (imposing sanctions against GMAC Mortgage, LLC for attorney's fees associated with defendant-counsel's deposition of Limited Signing Officer, Stephan, who signed affidavits in "bad faith" under Me. Civ. Proc. Rule 56(g)). See also N.C. Gen. Stat. § 1A-1 Rule 11 ("If a pleading, motion, or other paper is signed in violation of this rule, the court, upon motion or upon its own initiative, shall impose upon the person who signed it, a represented party, or both, an appropriate sanction, which may (continued...)")

depending on the facts and circumstances of each case. For example, notary publics who fail to follow state notary laws could have their licenses revoked and be forced to pay fines, and attorneys who submitted faulty documents to a court could be reprimanded by their state bars' disciplinary entities.

While these issues are serious, even if they are proven true, they, in and of themselves, do not mean that the facts in the affidavit were untrue or that the foreclosing entity does not have the legal basis to foreclose on properties. In judicial foreclosure proceedings where affidavits that are improperly signed or notarized have been submitted as evidence, new affidavits can be submitted that are not defective.

Charges could be more serious if it were shown that the affidavits were purposefully forged or affiants knowingly lied for the purpose of covering up defects in the prerequisites to instituting a valid foreclosure. If evidence did surface of this type of behavior, then it would raise the possibility that individuals had committed civil or criminal fraud.⁷⁰ There are various types of criminal fraud established under state and federal law, including mail and wire fraud⁷¹ and financial institutions fraud.⁷² Each type of fraud requires proof of slightly different jurisdictional elements.⁷³ However, the basic elements of all criminal frauds are (1) a material misstatement (or omission or misrepresentation); (2) *with the intent* to defraud someone of something of value.⁷⁴ In other words, for an employee of a mortgage servicer to be found guilty of criminal fraud for the affidavit issues raised by the depositions cited above, the misstatements would have to be material, which may not be the case if all of the statements of fact contained in the affidavits are true (even if the signer did not have personal knowledge of those facts), and the signer would have to have had the requisite mental state, that is, an intent to defraud, which may not be the case if she believed the statements of fact were true, even if they turned out not to be.

What is unclear is the extent to which there are substantive problems that are not easily rectifiable. Substantive problems could include multiple entities claiming to be the mortgage holders; properties foreclosed upon where the homeowners actually own the title free and clear of encumbrances; and entities claiming to have had valid title to properties that were foreclosed upon and sold by a company that did not have legal title to the property. Anecdotal evidence of these types of substantive problems has been reported.⁷⁵

(...continued)

include an order to pay to the other party or parties the amount of the reasonable expenses incurred because of the filing of the pleading, motion, or other paper, including a reasonable attorney's fee.").

⁷⁰ Allegations of fraudulent behavior have already been raised. See, e.g., *Ohio v. GMAC Mortgage, LLC*, Case No. CI0201Q06984, *Complaint for Declaratory Relief, Preliminary Injunction, Damages, Civil Penalties and Punitive Damages*, filed Oct. 6, 2010, available at <http://www.ohioattorneygeneral.gov/GMACLawsuit> (alleging common law fraud).

⁷¹ 18 U.S.C. §§ 1341 and 1343.

⁷² 18 U.S.C. § 1344.

⁷³ *Neder v. United States*, 527 U.S. 1, 20 (1999).

⁷⁴ See *Neder v. United States*, 527 U.S. 1, 20-25 (1999); *United States v. Sloan*, 492 F.3d 884, 891 (7th Cir. 2007) ("To show an intent to defraud, we require a willful act by the defendant with the specific intent to deceive or cheat, usually for the purpose of getting financial gain for one's self or causing financial loss to another"). See also *United States v. McAuliffe*, 490 F.3d 526, 531 (6th Cir. 2007); *United States v. Mann*, 493 F.3d 484, 493 (5th Cir. 2007); *United States v. Ward*, 486 F.3d 1212, 1222 (11th Cir. 2007).

⁷⁵ See, e.g., Andrew Martin and Motoko Rich, *Homeowners Facing Foreclosure Demand Recourse*, NY Times, Oct. 27, 2010, available at http://www.nytimes.com/2010/10/28/business/28victims.html?_r=1&ref=foreclosures.

Substantive defects could have been hidden by defective documentation and internal protocols even for homes foreclosed upon through a nonjudicial process. If mortgage servicers are having paperwork problems in their foreclosure departments, it is not difficult to imagine paperwork problems in the departments that deal with mortgage assignments and sales, especially considering the number and speed with which securitized mortgages tend to be assigned and sold.⁷⁶ Problems in the execution of assignments, for example, could equally affect properties in judicial and nonjudicial foreclosure states. The use of the judicial system and the requirement that affidavits be submitted into evidence in judicial foreclosure states arguably made it easier for potential documentation and internal review to come to light. Another potential cause for concern is the extent to which substantive problems did not surface during uncontested foreclosure actions, in both judicial and nonjudicial foreclosure proceedings. This also has the potential to raise uncertainty about the legal chain of title, which could stifle the market for foreclosed properties.

Substantive defects, if they do exist in significant numbers, could have a much more long lasting impact on housing markets. If a foreclosing entity cannot establish clear title to the mortgage, then the foreclosure process may be significantly delayed until proper title can be shown. Demonstrating proper title may require the holder to redo the paperwork for each assignment or sale throughout the line of title until all gaps are filled. This may prove difficult where certain entities within the chain of title have gone out of business or were acquired by other companies. It may be even more difficult where multiple parties believe they are the rightful owners.

If widespread mortgage assignment/sale problems among commercial banks, investment banks, and other finance companies exist, then title problems could haunt even subsequent bona fide purchasers of foreclosed properties who thought they purchased the property free and clear of encumbrances on the property. Homeowners of properties may have difficulty selling their properties if they are unable to show that they hold valid mortgages, and potential buyers may fear that others have valid security interests in the properties. These fears could be allayed to some degree if buyers are able to secure title insurance on the property, but some title insurers seem to be concerned about the potential problems. For instance, one major title insurer at least temporarily stopped extending new policies on properties foreclosed upon by GMAC Mortgage, Ally Bank, or Ally Financial.⁷⁷

Inadequate mortgage documentation and internal controls also make financial institutions more vulnerable to Ponzi schemes and similar frauds committed against them.⁷⁸

In sum, alleged documentation and procedural problems will result in varying degrees of delay in the ability to complete the foreclosure process. In some cases, problems may be easily remedied. In other cases, delays may be more significant. All delays will come at an administrative cost to mortgage holders and servicers, and in some instances, these entities and their representatives could be subject to civil or criminal penalties. Some individual borrowers may benefit from these delays because in some instances they may be able to continue to reside in the property until the foreclosure process is complete. However, based on the information that has surfaced thus far, it

⁷⁶ Kottrell stated in her deposition that her department handled both foreclosure files and deed assignments.

⁷⁷ Stephanie Armour, *Old Republic to stop writing policies for some foreclosures*, Oct. 2, 2010, available at http://www.usatoday.com/money/economy/housing/2010-10-02-old-republic-foreclosures_N.htm.

⁷⁸ See, e.g., Elaine Silvestrini, *Ex-mortgage broker to plead guilty in Ponzi scheme*, The Tampa Tribune, available at <http://www2.tbo.com/content/2009/oct/26/ex-mortgage-broker-plead-guilty-ponzi-scheme/news-breaking/>.

appears that the majority of these individuals will eventually lose their homes. Documentation and procedural deficiencies also create a cloud of uncertainty over the title to properties, thus discouraging investment in foreclosed properties and potentially subjecting purchasers and title insurers to conflicting claims on the titles.

Loan servicers could be significantly affected if the documentation issue lengthens the time it takes to foreclose, on average. The potential cost to servicers of lengthening the time that it takes to finally resolve a delinquent mortgage has been estimated at over \$1,300 per month on a \$200,000 loan.⁷⁹ Recognizing the potential exposure of loan servicers to delayed foreclosure proceedings, Moody's recently put the bond ratings of six major servicers (Bank of America, Wells Fargo, IndyMac Mortgage Services, Bayview Loan Servicing, MetLife Home Loans, and Litton Loan Servicing) under review.⁸⁰ However, the Federal Deposit Insurance Corporation's (FDIC's) description of its loan modification programs suggests that if housing markets recover and prices begin rising again, then delayed loan resolutions will not have a net negative impact on banks.⁸¹

Conclusion

The country continues to deal with historically high foreclosure rates, which are placing a strain on the judicial system and the financial standing of many individuals and financial institutions. The uncertainty created by mortgage market participants' allegedly deficient documentation and internal protocols in their origination, assignment, securitization, and foreclosure processes likely will exacerbate these problems. The economic and legal repercussions of the alleged deficiencies likely will reverberate for years to come.

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⁷⁹ Amherst Mortgage Insight, *Servicing Advances: Expect a Further Decline*, p. 1, Amherst Securities Group LP, Nov. 9, 2010.

⁸⁰ Allison Bisbey Colter, *MBS Holders Could Clean Up From the Foreclosure Mess*, Am. Banker, Nov. 15, 2010, available at http://www.americanbanker.com/issues/175_219/mbs-holders-foreclosure-mess-1028637-1.html.

⁸¹ See FDIC Loan Modification Program, page 13, fn. 3, available at <http://www.fdic.gov/consumers/loans/loanmod/FDICLoanMod.pdf>.

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