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Proposal for a National Mortgage Registry: MERS Done Right, A

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A Proposal for a National Mortgage Registry: MERS Done Right

Dale A. Whitman *

Abstract: In this Article, Professor Whitman analyzes the existing legal regime for transfers of notes and mortgages on the secondary market, and concludes that it is highly inconvenient and dysfunctional, with the result that large numbers of market participants simply did not observe its rules during the huge market run-up of the early and mid-2000s. He also considers Mortgage Electronic Registration System (MERS), which was designed to alleviate the inconveniences of repeatedly recording mortgage assignments, but concludes that it was conceptually flawed and has proven to be an inadequate response to the problem. For these reasons the legal system was ill-prepared for the avalanche of foreclosures that followed the collapse of the mortgage market in 2007, and continues to be beset by litigation and uncertainty. This Article then provides a conceptual outline for an alternative National Mortgage Registry, which would supplant the present legal system and would provide convenience, transparency, and efficiency for all market participants. He concludes with a draft of a statute that could be enacted by Congress to create such a registry.

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The law of the United States governing transfers of mortgages on the secondary market and foreclosures by secondary market investors is in a dismal state. In this Article I propose to explore those deficiencies and to present a proposal for an alternate legal regime that I believe would be far more functional and efficient.

The need for such a system – a nationwide registry of mortgage ownership – has already been recognized. In its recent white paper, “The U.S. Housing Market: Current Conditions and Policy Considerations,” the Federal Reserve Board commented:

A final potential area for improvement in mortgage servicing would involve creating an online registry of liens. Among other problems, the current system for lien registration in many jurisdictions is antiquated, largely manual, and not reliably available in cross-jurisdictional form. Jurisdictions do not record liens in a consistent manner, and moreover, not all lien holders are required to register their liens. This lack of organization has made it difficult for regulators and policymakers to assess and address the issues raised by junior lien holders when a senior mortgage is being considered for modification. Requiring all holders of loans backed by residential real estate to register with a national lien registry would mitigate this information gap and would allow regulators, policymakers, and market participants to construct a more comprehensive picture of housing debt.¹

Section I of this Article will discuss the traditional methods by which mortgages were traded on the secondary market in the United States prior to the mid-1990s and will attempt to illuminate why participants in the market found these methods lacking and generally discontinued using them. Section II will explain why and how MERS was set up in the mid-1990s and why it

1. BD. OF GOVERNORS OF THE FED. RESERVE SYS., THE U.S. HOUSING MARKET: CURRENT CONDITIONS AND POLICY CONSIDERATIONS 24-25 (2012). The Board further commented,

The national lien registry could also record the name of the servicer. Currently, parties with a legitimate interest in contacting the servicer have little to go on from the land records because, among other reasons, many liens have been recorded only in the name of the trustee or of Mortgage Electronic Registration Systems (MERS). Registering the servicer, and updating the information when servicing is transferred, could help local governments and nonprofits, for example, who might be working to resolve the status of vacant or abandoned properties.

Id. at 25. Other commentators recommending creation of such a system include FED. HOUSING FIN. AGENCY, A STRATEGIC PLAN FOR ENTERPRISE CONSERVATORSHIPS: THE NEXT CHAPTER IN A STORY THAT NEEDS AN ENDING 13 (2012) (“A sound, efficient system for document custody and electronic registration of mortgages, notes, titles, and liens that respects local property laws but also enhances the liquidity of mortgages so that borrowers may benefit from a liquid secondary market for buying and selling mortgages.”); Tanya Marsh, *Foreclosures and the Failure of the American Land Title Recording System*, 111 COLUM. L. REV. SIDEBAR 19, 25 (2011), available at <http://www.columbia-lawreview.org/articles/foreclosures-and-the-failure-of-the-american-land-title-recording-system> (recommending the creation of such a system).

has largely failed to achieve the purposes which many envisioned for it. Section III will present an alternative to MERS – one that would not suffer from its deficiencies, and would achieve the results MERS could not accomplish. It will analyze the policy and legal questions that must be answered in creating such a new system. Finally, an appendix to this article will provide a draft of a statute that would create such a new system.

I. THE TRADITIONAL MORTGAGE TRANSFER PROCESS

Mortgage borrowers in the United States are nearly always asked to sign two documents, one of them an evidence of the obligation to repay the debt, and the other a security agreement encumbering the real estate. In former times, a bond was sometimes used as the debt instrument, but today a promissory note is virtually always employed.² The security instrument may be a mortgage, a deed of trust, or (in Georgia) a security deed. While these different names for security instruments may portend differences in foreclosure procedure, for most purposes of mortgage law they are treated as identical.

A. Separation of Note and Mortgage

Borrowers probably wonder why two documents are used instead of one. Why are the note and the mortgage not combined into a single document, as is usually done with consumer credit contracts? The reason is partly tradition, and perhaps partly that the drafter wished to make the note negotiable in order to take advantage of the Holder in Due Course doctrine (which permits the holder of the note to take free of many defenses that the maker might raise), and could not accomplish this negotiability if the terms of the mortgage were incorporated into the note.³ Therefore, modern practice is to

2. The distinction between bonds and notes is largely formalistic: bonds are traditionally issued in a series (rather than as a single document), are executed with a seal, and are nonnegotiable. FREDRICK A. CLEVELAND, FUNDS AND THEIR USES 182 (Henry B. Hall ed., revised ed. 1922). In modern practice, bonds are almost never employed to evidence loans to individuals.

3. All references to Article 3 of the U.C.C. are to the 1990 version (the most recent broad-scale revision) unless otherwise noted. Under U.C.C. § 3-104(a)(3), a note is negotiable only if it “does not state any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money.” There are exceptions – that is, certain other promises that may be included, but the incorporation of the full terms of the typical mortgage into the note would almost certainly destroy its negotiability. See Dale A. Whitman, *How Negotiability Has Fouled Up the Secondary Mortgage Market, and What to Do About It*, 37 PEPP. L. REV. 737, 747-48 (2010) [hereinafter Whitman, *How Negotiability Has Fouled Up the Secondary Mortgage Market*]. The historical development of the concept of negotiability and the rationale for keeping the note and mortgage separate are nicely summarized in Mark B. Greenlee & Thomas J. Fitzpatrick IV, *Reconsidering the Application of the Holder in Due Course Rule to Home Mortgage Notes* (Fed. Reserve Bank

have two separate documents,⁴ though on rare occasions in the past the two were incorporated together.⁵

However, the use of two documents raises a troublesome prospect: that they could be transferred to two different parties. As we will see, the courts labor diligently to prevent this result from occurring unless it is very clearly the intention of the transferor, and for good reason. If a legal separation of the note and mortgage occurs, the Comment in the Mortgages Restatement explains the results as follows:

[S]eparating the obligation from the mortgage results in a practical loss of efficacy of the mortgage When the right of enforcement of the note and the mortgage are split, the note becomes, as a practical matter, unsecured. This result is economically wasteful and confers an unwarranted windfall on the mortgagor.

It is conceivable that on rare occasions a mortgagee will wish to disassociate the obligation and the mortgage, but that result should follow only upon evidence that the parties to the transfer so agreed. The far more common intent is to keep the two rights combined. Ideally a transferring mortgagee will make that intent plain by executing to the transferee both an assignment of the mortgage and an assignment, indorsement, or other appropriate transfer of the obligation. But experience suggests that, with fair frequency, mortgagees fail to document their transfers so carefully. This section's purpose is generally to achieve the same result even if one of the two aspects of the transfer is omitted.⁶

of Cleveland, Working Paper No. 08-08, 2008), *available at* <http://www.clevelandfed.org/research/workpaper/2008/wp0808.pdf>.

4. Keeping the note and mortgage separate has, at least theoretically, some additional advantages. A single mortgage can secure more than one note, and if several notes are employed, they can subsequently be sold to different investors or "participants," while continuing to be secured in the aggregate by a single lien on the real estate. But again, this is not a common modern practice. *See* GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW § 5.35 (5th ed. 2007) (discussing mortgage loan participations).

5. *See* CLEVELAND, *supra* note 2, at 165 (indicating that the practice of combining the two documents was not common in 1921).

6. RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES § 5.4 cmt. a (1997). The Comment suggests only one situation in which a mortgagee might wish to separate ownership of the note from the mortgage: a case in which the mortgagee wishes to bifurcate the obligation (or in which it is already bifurcated by virtue of being represented by two or more notes), and the mortgagee wishes to transfer part of the obligation while at the same time making it unsecured, while keeping the entire security for himself. *See id.* This is, of course, a very rare sort of transaction, and has nothing in common with ordinary residential mortgage finance. *Id.* It is also conceivable that in

Not only does the note become unsecured if the note and mortgage are separated, but “[t]he mortgage becomes useless in the hands of one who does not also hold the obligation because only the holder of the obligation can foreclose.”⁷ This outcome follows from the universally-agreed principle that “a mortgage may be enforced only by, or in behalf of, a person who is entitled to enforce the obligation the mortgage secures.”⁸ It is apparent that any situation that results in the holding of the note and mortgage by two independent parties is likely to prove bitterly frustrating to both of them – one because his or her obligation has become unsecured, and the other because she or he holds a mortgage that can never be foreclosed.

To accomplish what is nearly always the intended purpose of the parties, the Restatement thus provides that “[a] transfer of an obligation secured by a mortgage also transfers the mortgage unless the parties to the transfer agree otherwise.”⁹ The common way of expressing this principle is to say, “the mortgage follows the note.”¹⁰ Hence, a transfer of the note will transfer the mortgage with it automatically in the absence of a contrary agreement. On this point the Restatement is supported by a host of authority,¹¹ much of it

rare cases in which the land has become undesirable as security, as when it is contaminated with hazardous waste, the holder of the note and mortgage will intentionally release the mortgage but retain and enforce the note.

7. *Id.* § 5.4 reporters’ note, intro. cmt. a (citing *In re Atlantic Mortg. Corp.*, 69 B.R. 321 (Bankr. E.D. Mich. 1987); *Swinton v. Cuffman*, 213 S.W. 409 (Ark. 1919); *Stribling v. Splint Coal Co.*, 5 S.E. 321 (W. Va. 1888)). The sort of separation discussed here is a *legal*, not a physical separation. Physical separation is common; for example, the note may be held by a custodian for a secondary market investor, while the mortgage and assignments of the mortgage may be held in the investor’s files. No particular legal consequences arise from such a physical separation, and there is no requirement that the note and mortgage be kept physically together.

8. *Id.* § 5.4(c); see also *Multicircuits, Inc. v. Grunsted*, 809 N.W.2d 900 (Wis. Ct. App. 2012) (per curiam) (finding that when a mortgage was assigned without transfer of note, that mortgage became unenforceable).

9. RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES § 5.4(a).

10. See, e.g., *CPT Asset Backed Certificates, Series 2004-EC1 v. Cin Kham*, 278 P.3d 586, 589 (Okla. 2012).

11. *Horvath v. Bank of N.Y.*, 641 F.3d 617, 623 (4th Cir. 2011) (“a transfer of a secured debt carries with it the security without formal assignment or delivery”); *Bryant v. HSBC Mortg. Servs., Inc. (In re Bryant)*, 452 B.R. 876, 880 (Bankr. S.D. Ga. 2011) (under South Carolina law “the assignment of a note secured by a mortgage carries with it an assignment of the mortgage” (citing *Midfirst Bank, SSB v. C.W. Haynes & Co., Inc.*, 893 F. Supp. 1304, 1318 (D.S.C. 1994))); *Unsecured Creditors’ Comm. v. Shawmut Worcester Cnty. Bank (In re Ivy Properties, Inc.)*, 109 B.R. 10, 14 (Bankr. D. Mass. 1989); *In re Union Packing Co.*, 62 B.R. 96, 100 (Bankr. D. Neb. 1986); *First Nat’l Bank v. Larson (In re Kennedy Mortg. Co.)*, 17 B.R. 957, 965 (Bankr. D.N.J. 1982); *Rodney v. Ariz. Bank*, 836 P.2d 434, 436 (Ariz. Ct. App. 1992); *Campbell v. Warren*, 726 P.2d 623, 625 (Ariz. Ct. App. 1986) (holding an assignment of a portion of the payments from a promissory note automatically transfers a pro tanto interest in the mortgage that secures the note); *Domarad v. Fisher &*

taking an even stronger position: that it is legally impossible to separate the mortgage from the note, even by means of a contrary agreement.¹²

Suppose a mortgagee creates a situation in which holding of the note and mortgage seem to be bifurcated, by transferring the note to another but carelessly or malevolently retaining the mortgage or transferring it to a separate and independent party. What could the holder of the note do about it? If the holder of the mortgage refused to assign the mortgage to the noteholder voluntarily, the noteholder could bring an action in equity to compel such an

Burke, Inc., 76 Cal. Rptr. 529, 535-36 (Cal. Ct. App. 1969); Margiewicz v. Terco Props., 441 So. 2d 1124, 1125 (Fla. Dist. Ct. App. 1983); Moore v. Lewis, 366 N.E.2d 594, 599 (Ill. App. Ct. 1977); Jones v. Titus, 175 N.W. 257, 259 (Mich. 1919); Goetz v. Selsor, 628 S.W.2d 404, 405 (Mo. App. S.D. 1982); Deutsche Bank Trust Co. Ams. v. Codio, 943 N.Y.S.2d 545, 546 (N.Y. App. Div. 2012) (“[A] written assignment of the underlying note . . . is sufficient to transfer the obligation, and the mortgage passes with the debt as an inseparable incident” (quoting Bank of N.Y. v. Silverberg, 926 N.Y.S.2d 532, 538 (N.Y. App. Div. 2011))); Deutsche Bank Nat’l Trust Co. v. Pietranico, 928 N.Y.S.2d 818, 829 (N.Y. Sup. Ct. 2011) (“[A]s the note changes hands, the mortgage remains connected to it legally even though it is not physically attached.”); Edgar v. Haines, 141 N.E. 837, 838 (Ohio 1923) (“[T]he mortgage security is an incident of the debt which it is given to secure, and, in the absence of a specific agreement to the contrary, passes to the assignee or transferee of such debt.”); BAC Home Loans Servicing, L.P. v. White, 256 P.3d 1014, 1017 (Okla. Civ. App. 2010) (“[I]n Oklahoma it is not possible to bifurcate the security interest from the note. An assignment of the mortgage to one other than the holder of the note is of no effect.”); Commonwealth Prop. Advocates, LLC v. Mortg. Elec. Registration Sys., Inc., 263 P.3d 397, 403 (Utah Ct. App. 2011); Bartlett Estate Co. v. Fairhaven Land Co., 94 P. 900, 902 (Wash. 1908). Several states have statutes expressing the same position. See ALA. CODE §8-5-24 (West, Westlaw through 2012 Reg. Sess.) (“The transfer of a . . . note given for the purchase money of lands . . . passes to the transferee the lien of the vendor of the lands.”); ARIZ. REV. STAT. ANN. § 33-817 (West, Westlaw through 2012) (“The transfer of any contract or contracts secured by a trust deed shall operate as a transfer of the security for such contract or contracts.”); CAL. CIVIL CODE § 2936 (West, Westlaw through 2012 Reg. Sess.) (“The assignment of a debt secured by [a] mortgage carries with it the security.”); CONN. GEN. STAT. § 49-17 (West, Westlaw through 2012 Spec. Sess.), construed in Chase Home Fin., LLC v. Fequiere, 989 A.2d 606, 610-11 (Conn. App. Ct. 2010) (“The statute codifies the common-law principle of long standing that ‘the mortgage follows the note’”); UTAH CODE ANN. § 57-1-35 (West, Westlaw through 2012 Spec. Sess.) (“The transfer of any debt secured by a trust deed shall operate as a transfer of the security therefor.”).

12. See, e.g., Carpenter v. Longan, 83 U.S. 271, 274 (1872) (“The note and mortgage are inseparable An assignment of the note carries the mortgage with it, while an assignment of the latter alone is a nullity.”); Hill v. Favour, 84 P.2d 575, 578 (Ariz. 1938) (“The mortgage, being a mere incident of the debt, cannot be assigned separately from it, so as to give any beneficial interest”). This position seems unnecessarily restrictive because there may be rare occasions in which the holder of the note and mortgage will, for legitimate reasons, wish to separate their ownership. See *supra* note 6.

assignment,¹³ or simply apply to the equity court for a decree that the mortgage was deemed to be held for the benefit of the noteholder.¹⁴ The noteholder could then foreclose the mortgage as readily as if he or she held a paper assignment of it.¹⁵

B. *The Uses of Recorded Mortgage Assignments*

If a person to whom a note, secured by a mortgage, is transferred without an accompanying assignment of the mortgage itself, can then foreclose the mortgage, what is the purpose of mortgage assignments? A quite plausible argument can be made that they are simply unnecessary, except perhaps as a quick and simple way to prove to a court that the note is indeed secured. But as it turns out, mortgage assignments, particularly if they are recorded in the public land records, have their purposes. There are, I suggest below, four grounds on which a secondary mortgage market investor might decide that it is worthwhile to obtain and record a mortgage assignments. Before considering them, however, we need to take a closer look at the recording process itself.

13. See *Morris v. Bacon*, 123 Mass. 58 (Mass. 1877).

14. *Pettus v. Gault*, 71 A. 509 (Conn. 1908) (holding assignee of note permitted to foreclose mortgage, although it was never assigned or delivered to him); *Rembert v. Ellis*, 17 S.E.2d 165 (Ga. 1941) (holding noteholder permitted to foreclose as an equitable mortgage despite absence of assignment); *Morris Canal & Banking Co. v. Fisher*, 9 N.J. Eq. 667 (N.J. 1855) (holding assignment of bond acts as an assignment of mortgage). An alternative judicial explanation is that the mortgage interest is held in trust for the benefit of the noteholder. See *Barrett v. Hinkley*, 14 N.E. 863, 868 (Ill. 1888) (“Such [mortgagee’s] title exists for the benefit of the holder of the mortgage indebtedness, and it can only be enforced by an action in furtherance of his interests”); *Averill v. Cone*, 149 A. 297, 299 (Me. 1930) (“The result in equity is that the legal title passed to the assignee but in naked trust for the owner of the mortgage debt”); *U.S. Bank Nat’l Ass’n v. Ibanez*, 941 N.E.2d 40, 54 (Mass. 2011) (“[T]he holder of the mortgage holds the mortgage in trust for the purchaser of the note, who has an equitable right to obtain an assignment of the mortgage, which may be accomplished by filing an action in court and obtaining an equitable order of assignment.”); *Jackson v. Mortg. Elec. Registration Sys., Inc.*, 770 N.W.2d 487, 497 (Minn. 2009) (“[A]n assignment of the promissory note operates as an equitable assignment of the underlying security instrument.” (emphasis omitted)); *Kinna v. Smith*, 3 N.J. Eq. 14 (N.J. Ch. 1834) (heir who receives mortgage from decedent holds it in trust for personal representative to whom secured note passes); *U.S. Bank Nat’l Ass’n v. Marcino*, 908 N.E.2d 1032, 1038 (Ohio Ct. App. 2009) (“[T]he negotiation of a note operates as an equitable assignment of the mortgage, even though the mortgage is not assigned or delivered.”); see also 2 GARRARD GLENN, MORTGAGES § 314 (1943); GEORGE OSBORNE, MORTGAGES § 224 (1951).

15. This conclusion follows from common law principles, and has been modified by statute in some jurisdictions. See *infra* notes 55-69 and accompanying text.

1. The Recording System and Mortgage Assignments

Recording in America is a unique institution, and is quite different than the system of title registration employed in most other developed countries. Recording a document that conveys or creates an interest in land places it in the public domain, where anyone who wishes (and who knows how to locate it) can find and read it. Hence, in general, recorded documents are deemed to give constructive notice of their contents to anyone who acquires a subsequent interest in the same land. Thus, a conveyee who records his or her conveyance can be sure that the conveyor cannot later “pull the rug out from under” the conveyee by making a competing conveyance to someone else. On the other hand, if a conveyance is not recorded, the conveyor can do exactly that – provided that the subsequent and competing conveyee qualifies under the particular recording by being a bona fide purchaser, recording his or her own document first, or both.

Because conveyees have a strong incentive to record, most conveyances are in fact recorded. This makes it possible, in most cases, for a person who is about to acquire an interest in land to perform a “title search” in the public records, finding the chain of title (which in theory will extend back to some sovereign owner) and ensuring that no holder in that chain of title made an “adverse” conveyance to someone *outside* the chain before creating the next link *in* the chain.

But one must not place too much confidence in recording or in searching titles. There is no assurance whatever that, merely because a document is recorded, it is valid. It might be a forgery, or for any number of other reasons be ineffective. In addition, there are numerous types of rights or interests in land – title by adverse possession is one example – that can arise without being documented, and hence without being recorded. Finally, there is no requirement that anyone record a conveyance of land that she or he receives, and conveyances are perfectly valid as between their parties without recording – although they are at risk of being made void by a later competing conveyance from the same conveyor, as explained above. For all of these reasons, the popular notion that one can always find out who owns interests in land by performing a title search in the public records is fraught with serious fallacies.¹⁶

So how do these general principles affect mortgage assignments? It is perhaps best to begin by identifying what a recorded mortgage assignment does *not* do – in addition to its being unnecessary to the noteholder’s right to foreclose. As we have already seen, the assignment, recorded or not, is not essential to a completed transfer of the note and mortgage between the mort-

16. All of these principles are well documented and thoroughly discussed elsewhere. See, e.g., WILLIAM B. STOEBUCK & DALE A. WHITMAN, *THE LAW OF PROPERTY* §§ 11.9-11.11 (3d ed. 2000) [hereinafter *STOEBUCK & WHITMAN, PROPERTY*].

gagee and a transferee, or between successive transferees.¹⁷ Likewise, a recorded assignment provides no notice to the mortgagor that his or her obligation has been transferred, and that it is now necessary to begin paying a new party.¹⁸ This situation follows for the simple reason that to suppose otherwise would require us to assume that mortgagors will examine the public records before making each payment on their loans – an absurd burden that no sensible court would inflict on borrowers.

Similarly, the recording of mortgage assignments is likely to have little significance in a case in which the same mortgagee executes and delivers two or more competing assignments of the same mortgage. The recording acts may determine which of assignees is regarded as holding the legal interest in the real estate security, but under the principles already discussed, whoever wins that battle can expect to have the holder of the note successfully demand the mortgage as well. Under U.C.C. Article 9, a purchaser¹⁹ of an instrument (that is, a promissory note, whether negotiable or not²⁰) can acquire ownership by complying with the following rules, as recently summarized by the Permanent Editorial Board of the U.C.C.:²¹

17. See *supra* notes 9-15 and accompanying text; see also *MetLife Home Loans v. Hansen*, 286 P.3d 1150 (Kan. Ct. App. 2012) (“MetLife did not need that assignment in order to vest it with a beneficial interest in the [m]ortgage. As a valid holder of the [n]ote, it already had such an interest sufficient to give it standing to initiate a foreclosure action.”); *Bank of Am., N.A. v. Kabba*, 276 P.3d 1006, 1008-09 (Okla. 2012) (“An assignment of the mortgage, however, is of no consequence because under Oklahoma law, ‘[p]roof of ownership of the note carried with it ownership of the mortgage security.’” (quoting *Engle v. Fed. Nat’l Mortg. Ass’n*, 300 P.2d 997, 999 (Okla. 1956))).

18. The relevant cases are collected in NELSON & WHITMAN, *supra* note 4, § 5.33 nn.18-27; see also ALASKA STAT. ANN. § 34.20.010 (West, Westlaw through 2012 Spec. Sess.) (stating the principle by statute). Kansas is a notable exception; its courts have held that mortgagors are bound by constructive notice from a recorded assignment. See *Walmer v. Redinger*, 227 P. 329 (Kan. 1924); Verle R. Seed, *Mortgage “Payment” Statutes in Kansas and New Mexico*, 3 U. KAN. L. REV. 87, 95-96 (1954).

19. Somewhat confusingly, Article 9 employs the terminology of security or collateral assignments to outright sales of notes as well; thus the transferor is termed the “debtor,” the transferee is the “secured party,” and the rights transferred constitute a “security interest” even when an outright sale occurs. See U.C.C. § 9-102(a)(28)(B) (2012) (defining “debtor”); § 9-102(a)(72)(D) (defining “secured party”). In the text above, I have “translated” the terminology to that ordinarily used in describing outright sales of notes.

20. U.C.C. § 9-102(a)(47) defines an “instrument” as “a negotiable instrument or any other writing that evidences a right to the payment of a monetary obligation . . . and is of a type that in ordinary course of business is transferred by delivery with any necessary endorsement or assignment.” Nonnegotiable instruments are plainly covered by this language.

21. PERMANENT EDITORIAL BD. FOR THE UNIF. COMMERCIAL CODE, AM. LAW INST., APPLICATION OF THE UNIFORM COMMERCIAL CODE TO SELECTED ISSUES RELATING TO MORTGAGE NOTES 9-10 nn.33-40 (2011) [hereinafter PEB REPORT].

Section 9-203(b) of the Uniform Commercial Code provides that three criteria must be fulfilled The first two criteria are straightforward – “value” must be given²² and the debtor/seller must have rights in the note or the power to transfer rights in the note to a third party. . . .²³ The third criterion may be fulfilled in either one of two ways. Either the debtor/seller must “authenticate”²⁴ a “security agreement”²⁵ that describes the note²⁶ or the secured party must take possession²⁷ of the note pursuant to the debtor’s security agreement.²⁸

Thus, either a delivery of possession of the note or the execution of a written document of assignment of the note will serve to transfer its ownership. And under U.C.C section 9-203(g), the transfer of “a right to payment or performance secured by a security interest or other lien on personal or real property is also attachment of a security interest”²⁹ in the security interest,

Footnotes attached to the quoted text below are those of the original PEB report. Note that the discussion in the text refers to “ownership” of the note, which is indeed the subject of U.C.C. Article 9. Under the U.C.C., however, ownership may be separated from the right to enforce the note; the right to enforce is the subject of U.C.C. Article 3 if the note is negotiable. See *infra* notes 85-95 and accompanying text.

22. See PEB REPORT, *supra* note 21, at 9, 9 n.33 (“U.C.C. § 9-203(b)(1). U.C.C. § 1-204 provides that giving ‘value’ for rights includes not only acquiring them for consideration but also acquiring them in return for a binding commitment to extend credit, as security for or in complete or partial satisfaction of a preexisting claim, or by accepting delivery of them under a preexisting contract for their purchase.”).

23. *Id.* at 9, 9 n.34 (“U.C.C. § 9-203(b)(2). Limited rights that are short of full ownership are sufficient for this purpose. See Official Comment 6 to U.C.C. § 9-203.”).

24. *Id.* at 9, 9 n.35 (“This term is defined to include signing and its electronic equivalent. See U.C.C. § 9-102(a)(7).”).

25. *Id.* at 9, 9 n.36 (“A ‘security agreement’ is an agreement that creates or provides for a security interest (including the rights of a buyer arising upon the outright sale of a payment right). See U.C.C. § 9-102(a)(73).”).

26. *Id.* at 9, 9 n.37 (“Article 9’s criteria for descriptions of property in a security agreement are quite flexible. Generally speaking, any description suffices, whether or not specific, if it reasonably identifies the property. See U.C.C. § 9-108(a)-(b). A ‘supergeneric’ description consisting solely of words such as ‘all of the debtor’s assets’ or ‘all of the debtor’s personal property’ is not sufficient, however. U.C.C. § 9-108(c). A narrower description, limiting the property to a particular category or type, such as ‘all notes,’ is sufficient. For example, a description that refers to ‘all of the debtor’s notes’ is sufficient.”).

27. *Id.* at 9, 9 n.38 (“See U.C.C. § 9-313.”) (remainder of footnote omitted).

28. *Id.* at 9-10, 10 n.39 (“U.C.C. § 9-203(b)(3)(A)-(B).”).

29. Because of Article 9’s use of the phrase “security interest” to encompass outright sales, as explained *supra* note 19, this line can more readily understood in the context of sales of mortgage notes by rewriting it to say, “the transfer of a promissory note secured by a mortgage on real property is also a transfer of the mortgage.”

mortgage, or other lien.” This provision is, of course, reminiscent of the common law principle that the mortgage follows the note.³⁰ Hence, which of the competing holders of mortgage assignments will prevail under the recording act is likely to be irrelevant in practical terms; the transferee of ownership of the note, as determined by Article 9, will have the benefit of the mortgage as well.³¹

If the foregoing are not persuasive reasons to record mortgage assignments, what incentives exist for market participants to record their ownership on a current, timely basis? The next four subsections will discuss plausible reasons to record.

2. Prevention of Fraud by the Transferor

This reason for recording a mortgage assignment is based on the notice-giving effect of recording mentioned above. If an original mortgagee transfers the note, but there is no recorded mortgage assignment, it appears on the public records as if the mortgagee still holds the mortgage. This appearance opens an opportunity for the mortgagee to engage in a variety of fraudulent but potentially successful tricks, in cahoots with the mortgagor.

For example, the mortgagee may issue and record a satisfaction of the mortgage, allowing the mortgagor to sell the property free and clear of the encumbrance to a bona fide purchaser or to remortgage it for a new loan.³²

30. But it is not quite the same. The common law principle is that the mortgage will follow the right to enforce the note. In cases in which ownership of a note (Article 9’s bailiwick) and the right to enforce it (Article 3’s bailiwick) are separated, it is the right to enforce that carries with it the mortgage, because foreclosure of the mortgage is simply a means of enforcing the note. *See infra* notes 90-92 and accompanying text on the issue of separation. There is no reason to regard U.C.C. § 9-203(g) as supplanting the common law or exhausting the topic. For example, if the owner of the note delivers it to its servicer for the purpose of enforcing it, thus transferring the entitlement to enforce under Article 3, there is every reason to think the servicer will, under common law principles, be entitled to foreclose the mortgage as well, with or without a formal mortgage assignment. Nothing about § 9-203(g) bars this result.

31. This was the conclusion reached by the court under an earlier version of the U.C.C. in *American Bank of the South v. Rothenberg*, 598 So. 2d 289 (Fla. Dist. Ct. App. 1992). The statement in the text assumes that the owner and the person “entitled to enforce the note” are the same, as is usually the case. *See RMS Residential Props., LLC v. Miller*, 32 A.3d 307, 314 (Conn. 2011) (“[A] holder of a note is presumed to be the owner of the debt, and unless the presumption is rebutted, may foreclose the mortgage”). If the owner and the person entitled to enforce are different, only the latter or the agent of the latter will be able to foreclose the mortgage under common law principles. *See Edelstein v. Bank of New York Mellon*, 286 P.3d 249 (Nev. 2012) (making it clear that it is the right to enforce, and not ownership of the note, that confers the power to foreclose the mortgage).

32. *See, e.g., Ameribanc Sav. Banks v. Resolution Trust Corp.*, 858 F. Supp. 576, 582 (E.D. Va. 1994); *Tomsic v. Beaulac (In re Beaulac)*, 298 B.R. 31 (Bankr. D.

He or she may subordinate the mortgage to a subsequent lien obtained in good faith, thereby greatly reducing the value of the mortgage as security, or may even foreclose the mortgage, obtain title, and sell the land to a bona fide purchaser.³³ In each of these cases (and several other variations on them), the courts have held that a bona fide purchaser or secured creditor of the real estate, relying on the apparent state of the title, will prevail over the holder of the mortgage debt. The facts that the note may be negotiable and that the noteholder may be a Holder in Due Course are irrelevant. In all of these cases, the recording of a mortgage assignment would have prevented the mortgagee from perpetrating the fraud, because it would have made it obvious on the face of the public records that the original mortgagee no longer had any authority to deal with the land.

Is this risk (assuming secondary market mortgage investors and their counsel are aware of it) enough to convince them to record mortgage assignments? Practically speaking, probably not. Essentially, the jeopardy here is that the mortgage originator will become a criminal and turn to fraud. While such cases have occurred and will doubtless occur in the future,³⁴ they are probably quite rare. Most lawyers would, of course, warn their clients to record assignments in order to mitigate this risk, but many clients would likely conclude that doing so was not worth the trouble and expense.³⁵

3. Assurance of Receiving Notice of Legal Proceedings

The notice-giving effect of recording, discussed above, applies not only to provide notice to persons who acquire subsequent interests in the land but those who file suits or other legal proceedings against it as well. Suppose a secondary market investor buys a mortgage loan, but records no assignment.

Mass. 2003) (trustee in bankruptcy as BFP under strong-arm powers); Kan. City Mortg. Co. v. Crowell, 239 So. 2d 130, 131 (Fla. Dist. Ct. App. 1970); Fed. Nat'l Mortg. Ass'n v. Kuipers, 732 N.E.2d 723 (Ill. App. Ct. 2000); Brenner v. Neu, 170 N.E.2d 897 (Ill. App. Ct. 1960); Henniges v. Johnson, 84 N.W. 350 (N.D. 1900); Kalen v. Gelderman, 278 N.W. 165 (S.D. 1938); Fannin Inv. & Dev. Co. v. Neuhaus, 427 S.W.2d 82 (Tex. Civ. App. 1968); Marling v. Milwaukee Realty Co., 106 N.W. 844, 845 (Wis. 1906).

33. See, e.g., Huitink v. Thompson, 104 N.W. 237 (Minn. 1905); Bremen Bank & Trust Co. v. Muskopf, 817 S.W.2d 602 (Mo. App. E.D. 1991); Willamette Collection & Credit Serv. v. Gray, 70 P.2d 39 (Or. 1937).

34. See, e.g., Impac Warehouse Lending Grp. v. Credit Suisse First Boston LLC, 270 Fed. App'x 570 (9th Cir. 2008) (originating lender gave fraudulent loan documents to creditor providing line of credit, while selling original loan documents on the secondary mortgage market).

35. Moreover, recording an assignment does not inoculate the mortgage payoff process against other types of fraud. See *America's Wholesale Lender*, FRAUD INSIGHTS, Feb. 2012, <http://fraudinsights.fnf.com/vol07iss02/fullarticle.htm#article01a> (describing a case in which a crook impersonated the holder of the loan and purported to approve a payoff of the loan to a false bank account).

Then a suit is filed that could jeopardize the validity or priority of the mortgage. One obvious example is a foreclosure of a mortgage senior to the one in question. The plaintiff in that foreclosure action performs a title examination, discovers the identity of the original mortgagee or previous holder of the mortgage, and makes service of process on that party. The actual (but unrecorded) holder of the mortgage gets no direct service (because there is no obvious way for the plaintiff to identify the holder), and may or may not learn of the suit from the party who was actually served.

This is precisely what occurred in *Fifth Third Bank v. NCS Mortgage Lending Co.*³⁶ In *Fifth Third Bank* an Ohio court found the judgment binding on the secondary market investor, which had never learned of or entered an appearance in the litigation, despite its claim that it had instructed its predecessor to record an assignment of the mortgage – an act that was “inexplicably” never done.³⁷ Because most secondary market investors use independent servicers to manage their mortgage portfolios, an investor may prefer to have a recorded assignment run to its servicer rather than itself. In this way, any notice issued will find its way directly to the entity that is responsible for the loan, rather than having to take the circuitous route of going first to the investor, who will then need to notify the servicer. But in *Fifth Third Bank*, no assignment at all was recorded, and hence no notice was directed either to the investor or its servicer.³⁸

Alternatively, the investor may prefer to have an assignment recorded to MERS, the Mortgage Electronic Registration Systems, about which we will have much more to say later. MERS is merely a nominee for the investor, but it operates a “mail room” function, keeping a record of all investors and servicers, and redirecting to the relevant servicer any notice that it receives with respect to a particular mortgage. Unfortunately, this notion is not foolproof, for it depends on the courts taking the same view of MERS that MERS itself takes. In *Landmark National Bank v. Kesler*,³⁹ the original mortgagee named in the junior mortgage was MERS, as nominee for the actual lender. The senior mortgagee filed a foreclosure action, but never served either MERS or the junior lender, and a default judgment was entered against both

36. 860 N.E.2d 785 (Ohio Ct. App. 2006).

37. *Id.* at 786.

38. *Id.*

39. 216 P.3d 158 (Kan. 2009); *see also* Lang v. Butler, 483 P.2d 994 (Colo. App. 1971) (finding that a foreclosing senior deed of trust holder had no obligation to give notice to the holder of an unrecorded junior deed of trust); Citimortgage, Inc. v. Barabas, 950 N.E.2d 12 (Ind. Ct. App. 2011) (same), *vacated*, 975 N.E.2d 805 (Ind. 2012); Mortg. Elec. Registration Sys., Inc. v. Sw. Homes of Ark., 301 S.W.3d 1 (Ark. 2009) (reaching a similar conclusion where MERS was the nominee of the senior deed of trust holder, and was held to have no right to notice of the foreclosure of the junior deed of trust, the holder of which apparently falsely alleged that it was senior; notice was given to the original holder of the senior deed of trust, but it no longer held the loan, although no assignment from it had been recorded).

of them, wiping out the second mortgage.⁴⁰ The Kansas Supreme Court found no error in the trial judge's refusal to set aside the default judgment – against the junior mortgagee because there was no assignment to it in the public records,⁴¹ and against MERS because it was merely a nominee, had advanced no funds under the mortgage loan, and was therefore not a real party in interest.⁴² This result may seem like the ultimate “Catch-22,” but it illustrates starkly how failing to record an assignment to the right party can leave a mortgage investor exposed to the drastic losses that may flow from failure to get notice of pending litigation.

Foreclosures of prior mortgages are not the only examples of this risk. Other possibilities include an eminent domain action, a government forfeiture proceeding,⁴³ a quiet title action, or an action to enforce a zoning, housing code, or building code infraction. It is obviously in the interest of a mortgage holder and its servicer to get immediate notice of such suits because they can have a powerful effect on the value of the real estate collateral. However, suits of all these kinds are relatively rare. Protection against them, like protection against foreclosures of prior liens, may well be an insufficient incentive to convince secondary market investors to record mortgage assignments.

4. Recordation of Assignments as a Practical Necessity for Future Title Examiners

Another reason to record mortgage assignments might be to serve the title industry and the system of records on which it depends. When a mortgage is foreclosed future title examiners may want to be able to locate a complete and recorded chain of title establishing that the party foreclosing the mortgage is the person with the right to do so. Otherwise, title examiners may say, they will be faced with cases in which A mortgages land to B, and some time later C forecloses and a foreclosure deed is delivered to D. The problem is that it is not apparent on the face of the land records why C had the right to foreclose.

40. *Landmark Nat'l Bank*, 216 P.3d at 162.

41. *See id.* at 167.

42. *Id.*

43. The federal government may maintain a “criminal forfeiture” action pursuant to 18 U.S.C. § 982 (2006) and 21 U.S.C. § 881 against property used in the commission in certain crimes. The title to real estate so forfeited “relates back” to the date of the first commission of illegal activity. *See* 21 U.S.C. § 881(h). Hence the effective date of vesting of title in the government could be earlier than the creation of a mortgage on the land. There is an exception for owners of secured mortgages unconnected to the illegal activity. *See* 21 U.S.C. § 853(n). However, such “innocent owners” must file a petition within 30 days of receipt of notice of the forfeiture, which they only will receive if their interest is properly recorded. *Id.*; *see also* *United States v. Schecter*, 251 F.3d 490, 497 (4th Cir. 2001).

While this argument seems plausible, in reality it is highly dubious, and assignments based on it are almost certainly unnecessary. To show why this is so, we need to consider each of the three types of foreclosure processes that are common in the United States.

First, consider a judicial foreclosure. Here, the court's foreclosure order implies that the judge has verified under oath that the party seeking foreclosure has demonstrated the right to enforce the note. As we have already seen,⁴⁴ under traditional mortgage law, having the right to foreclose depends on holding the obligation represented by the note, not on having an assignment of the mortgage, recorded or not. Leaving aside for a moment the question of exactly what evidence the judge will demand before ordering a foreclosure,⁴⁵ if the judge concludes that the right person – namely, the person with the right to enforce the note – is foreclosing, that conclusion can be the end of the inquiry. Assuming that the time for any possible appeal of the court's order has run, it is *res judicata* and can be relied upon by any future title examiner.⁴⁶ Hence, the existence of a chain of assignments is irrelevant.

Second, suppose the security instrument is a deed of trust, foreclosed by trustee's sale. In this setting the trustee (or a substitute trustee, if there is a recorded substitution) is literally the titleholder, and if the trustee forecloses, it can be presumed (and there is often a statutory presumption)⁴⁷ that the trus-

44. See *supra* notes 9-15 and accompanying text.

45. Of course, the judge, in turn, might demand a recorded chain of mortgage assignments. See, e.g., *In re Foreclosure Cases*, Nos. 1:07CV2282, 07CV2532, 07CV2560, 07CV2602, 07CV2631, 07CV2638, 07CV2681, 07CV2695, 07CV2920, 07CV2930, 07CV2949, 07CV2950, 07CV3000, 07CV3029, 2007 WL 3232430, at *1-2 (N.D. Ohio Oct. 31, 2007) (requiring foreclosing parties to produce assignments). However, there appears to be no such requirement in Ohio law, and to this extent the judge's demand seems unwarranted. The critical issue for the court to determine is the right of the foreclosing party to enforce the note.

46. This is not to say that a collateral attack on a foreclosure judgment is impossible, particularly if the judgment was obtained despite the defendant's failure to appear. See, e.g., *Ramagli Realty Co. v. Craver*, 121 So. 2d 648, 654 (Fla. 1960) ("As between the parties any judgment or order procured from any court by the practice of fraud or deception may in appropriate proceedings be set aside at any time. A void judgment is a nullity, a brutum fulmen and is subject to collateral attack and may be stricken at any time."). But the presence or absence of a chain of assignments is likely to have very little relationship to the grounds – "fraud or deception" – for setting aside a judgment.

47. These presumptions vary in weight; some of them apply only to the notice given and the mechanics of the sale itself, and hence would have little value in establishing that the foreclosing party had the right to foreclose. See ALASKA STAT. § 34.20.090 (West, Westlaw through 2012 Spec. Sess.); CAL. CIV. CODE § 2924 (West, Westlaw through 2012 Reg. Sess.); GA. CODE ANN. § 44-14-162.4 (West, Westlaw through 2012 Reg. Sess.); N.C. GEN. STAT. ANN. § 45-21.17A (West, Westlaw through 2012 Reg. Sess.); W. VA. CODE ANN. § 38-1-4 (West, Westlaw through 2012 Sess.). Others are stronger, apparently covering all aspects of the foreclosure. See

tee is acting on the instruction of the proper beneficiary. This presumption is valid whether the beneficiary is the original noteholder or a subsequent transferee from the original noteholder.⁴⁸ If the trustee can be relied upon to make this determination – much like the judge in a judicial foreclosure – then as with judicial foreclosure, the existence of a recorded assignment or chain of assignments should be unnecessary to future title examiners.⁴⁹ Such reliance is a fundamental premise of foreclosure by trustee’s sale.

ARIZ. REV. STAT. ANN. § 33-811 (West, Westlaw through 2012 Reg. Sess.), *construed in U.S. Bank Nat’l Ass’n v. Myers*, No. 1 CA–CV 10–0780, 2011 WL 6747428, at *2 (Ariz. Ct. App. Dec. 22, 2011); ARK. CODE ANN. § 18-50-111 (West, Westlaw through 2012 Fiscal Sess.); HAW. REV. STAT. § 667-33 to -32 (West, Westlaw through 2012 Reg. Sess.); IDAHO CODE ANN. § 45-1510 (West, Westlaw through 2012 Reg. Sess.); MINN. STAT. ANN. § 580.19 (West, Westlaw through 2012 Spec. Sess.); MONT. CODE ANN. § 71-1-318 (West, Westlaw through 2011 laws); NEB. REV. STAT. ANN. § 76-1010 (West, Westlaw through 2012 Reg. Sess.); NEV. REV. STAT. ANN. § 107.030 (West, Westlaw through 2011 Reg. Sess.); N.M. STAT. ANN. § 48-10-14 (West, Westlaw through 2012 Reg. Sess.); OKLA. STAT. ANN. tit. 46, § 47 (West, Westlaw through 2012 Reg. Sess.); OR. REV. STAT. ANN. § 86.780 (West, Westlaw through 2012 Reg. Sess.); UTAH CODE ANN. § 57-1-28 (West, Westlaw through 2012 Spec. Sess.); WASH. REV. CODE ANN. § 61.24.040 (West, Westlaw through 2012 Legis. Measures). All of them are available only in favor of a bona fide purchaser. *See generally* Grant S. Nelson & Dale A. Whitman, *Reforming Foreclosure: The Uniform Non-judicial Foreclosure Act*, 53 DUKE L.J. 1399, 1503-06 (2004) [hereinafter Nelson & Whitman, *Reforming Foreclosure*].

48. The non-judicial foreclosure statutes are frequently obscure in indicating who is authorized to instruct the trustee of a deed of trust to foreclose. Indeed, perhaps because most of them were enacted when the secondary mortgage market was largely undeveloped, they often seem to have been drafted with no recognition that such a market exists. *See, e.g.*, VA. CODE ANN. § 55-59(7) (West, Westlaw through 2012 Spec. Sess.) (trustee may foreclose “at the request of any beneficiary[.]” but inferentially the trustee is expected to demand to see the note, because § 55-59.1(B) begins, “[i]f a note or other evidence of indebtedness secured by a deed of trust is lost or for any reason cannot be produced . . .”). Arizona is likewise ambiguous in describing the nature of the proof of authority the trustee must show. *See Hogan v. Washington Mut. Bank*, 277 P.3d 781, 783 (Ariz. 2012) (“The only proof of authority the trustee’s sales statutes require is a statement indicating the basis for the trustee’s authority. *See* A.R.S. § 33-808(C)(5) (requiring the notice to set forth ‘the basis for the trustee’s qualification pursuant to § 33-803, subsection A’)”).

49. The California presumption statute covers only “the mailing of copies of notices or the publication of a copy of the notice of default or the personal delivery of the copy of the notice of default or the posting of copies of the notice of sale or the publication of a copy thereof[.]” *See* CAL. CIV. CODE § 2924(c). Despite this relative weakness, the California courts have sometimes seemed to impose a much stronger presumption of compliance with the foreclosure process:

If the trustee’s deed recites that all statutory notice requirements and procedures required by law for the conduct of the foreclosure have been satisfied, a rebuttable presumption arises

A third possible foreclosure mode is non-judicial foreclosure of a mortgage. In nine states, mortgagees and their successors may exercise a direct power of sale.⁵⁰ No deed of trust is involved, and there is no trustee to exercise independent judgment. In this setting, if the mortgage is sold on the secondary market and then foreclosed, and if there is no recorded assignment, it is literally a case of A (the mortgagor) to B (the mortgagee) and C (the secondary market holder) to D (the foreclosure purchaser), with nothing in the public records to connect B to C.⁵¹ Some members of the title industry seem to argue that a recorded assignment is essential in this setting,⁵² but this argument is unconvincing. Proof of the existence of a recorded assignment or chain of assignments proves nothing about whether the foreclosing party held the promissory note at the time of the foreclosure, and it is the holding of the

that the sale has been conducted regularly and properly; this presumption is conclusive as to a bona fide purchaser Thus, as a general rule, a trustor has no right to set aside a trustee's deed as against a bona fide purchaser for value by attacking the validity of the sale.

Moeller v. Lien, 30 Cal. Rptr. 2d 777, 783 (Cal. Ct. App. 1994).

50. See ALA. CODE §§ 35-10-1 to 35-10-10 (West, Westlaw through 2012 Spec. Sess.); GA. CODE ANN. §§ 23-2-114, 44-14-162 to 44-14-162.4 (West, Westlaw through 2012 Reg. Sess.); ME. REV. STAT. tit. 14 §§ 6203-A, 6203-B (2011) (applicable only to nonresidential property); MASS. GEN. LAWS ANN. ch. 183, § 21 (West, Westlaw through 2012 2d. Ann. Sess.); MINN. STAT. ANN. §§ 580.01 to 580.20 (West, Westlaw through 2012 Spec. Sess.); MISS. CODE ANN. §§ 89-1-53 to 89-1-57 (West, Westlaw through 2012 Reg. Sess.); N.H. REV. STAT. ANN. §§ 479:25 to 479:27-a (West, Westlaw through 2012 Reg. Sess.); R.I. GEN. LAWS ANN. § 34-11-22 (West, Westlaw through 2012 Reg. Sess.); WYO. STAT. ANN. §§ 34-4-101 to 34-4-113 (West, Westlaw through 2012 Budget Sess.).

51. The title insurance industry's trade association has argued that the mortgage assignment is the critical and sole document needed to complete the chain of title in this setting. See *ALTA Files Brief in Massachusetts Foreclosure Case*, TITLE NEWS, Mar. 2012, at 7, 8, http://www.alta.org/publications/titlenews/12/Volume91_Issue03.pdf.

52. The Minnesota Supreme Court was convinced that benefitting future title examiners was the purpose of the Minnesota statutory requirement for recording mortgage assignments. See *Jackson v. Mortg. Elec. Registration Sys., Inc.*, 770 N.W.2d 487, 498 (Minn. 2009) (“[T]he record, without the aid of extraneous evidence, ‘put[s] the title of the assignee of a mortgage beyond doubt.’” (quoting *Soufal v. Griffith*, 198 N.W. 807, 809 (Minn. 1924))). Arguably the need for a chain of assignments is lessened if the foreclosure is confirmed by a judicial decree, as is true in some circumstances in a few non-judicial foreclosure states. See GA. CODE ANN. § 44-14-161 (requiring judicial confirmation of sale if secured party seeks a deficiency judgment; court is to consider “the legality of the notice, advertisement, and regularity of the sale”); N.C. GEN. STAT. ANN. § 45-21.27 (West, Westlaw through 2012 Reg. Sess.) (requiring confirmation by clerk of court if an upset bid is filed following foreclosure sale).

note that gives one the right to foreclose. If any recorded evidence is needed, it is evidence as to who holds the note, but no American jurisdiction seems to require recording of evidence of transfer of the note as a condition of the right to foreclose.⁵³

In sum, the comfort provided to title examiners by chains of assignments in mortgage foreclosures is illusory. If the note is negotiable, the important question is whether the foreclosure was done by the person entitled to enforce the note – a status which, as I will discuss in detail below, usually depends on physical possession of the note.⁵⁴ Finding a mortgage assignment is no proof at all that the note was not previously assigned to someone else. Thus, a recorded chain of assignments may make a subsequent title examiner feel good, but it is weak evidence on which to rely. Its supposed benefits to title examiners are likely insufficient to induce mortgage investors to record.

5. Recordation of Assignments as a Statutory Prerequisite to Foreclosure

By statute, eleven states require the existence or recordation of a chain of assignments from the originating mortgagee to the foreclosing party as a prerequisite to foreclosure.⁵⁵ They include California,⁵⁶ Georgia,⁵⁷ Idaho,⁵⁸

53. Virginia makes provision for the optional recording of a “Certificate of Transfer” which memorializes the transfer of the indebtedness. *See* VA. CODE ANN. § 55-66.01 (West, Westlaw through 2012 Spec. Sess.). However, there is no requirement that such a certificate or chain of certificates be recorded as a prerequisite to foreclosure. *See* Horvath v. Bank of New York, 641 F.3d 617, 626 (4th Cir. 2011) (Virginia law) (“[P]arties may elect to record the transfer in the land records, but their failure to do so does not undermine the transaction in any way.”).

54. *See infra* notes 88-95 and accompanying text.

55. In addition to the states listed, Mississippi’s statute seems to require recordation of assignments, but apparently the only sanction for failure to record is that a payment made by the mortgagor to the original mortgagee is binding despite the assignment, unless the mortgagor has actual notice of the assignment. *See* MISS. CODE ANN. § 89-5-17. Hence, recording of assignments does not appear to be a condition to foreclosure, although there is no case law construing the point. Similarly, an Indiana statute seems to require recordation of assignments; *see* IND. CODE ANN. § 32-29-1-8(c) (West, Westlaw through 2013) (“an assignment of mortgage must be recorded on a separate written instrument from the mortgage”). However, the provision has been construed as only for the protection of subsequent purchasers from the mortgagee, and not as a requirement for foreclosure. Indiana follows the common law doctrine that the mortgage follows the note without a written assignment. *See* Perry v. Fisher, 65 N.E. 935 (Ind. Ct. App. 1903).

A few states require a chain of recorded assignments as a matter of court-made law for judicial foreclosure. *See, e.g., In re* Foreclosure Cases, Nos. 1:07CV2282, 07CV2532, 07CV2560, 07CV2602, 07CV2631, 07CV2638, 07CV2681, 07CV2695, 07CV2920, 07CV2930, 07CV2949, 07CV2950, 07CV3000, 07CV3029, 2007 WL 3232430, at *1-2 (N.D. Ohio Oct. 31, 2007); *Gee v. U.S. Bank*

Maine,⁵⁹ Massachusetts,⁶⁰ Michigan,⁶¹ Minnesota,⁶² Nevada,⁶³ Oregon,⁶⁴ South Dakota,⁶⁵ and Wyoming.⁶⁶ In all cases except Maine, these statutes

Nat'l Ass'n, 72 So. 3d 211, 213 (Fla. Dist. Ct. App. 2011). Such decisions appear to disregard the common-law principle that the mortgage follows the note automatically. Florida law on this point is in doubt. *See* Musselman v. Deutsche Trust Co. Ams. (*In re* Balderrama) 451 B.R. 185, 190 (Bankr. M.D. Fla. 2011) (“[P]roof of ownership of the debt underlying a mortgage is sufficient under Florida law to equitably convey the mortgage to the debt holder.”).

56. CAL. CIV. CODE § 2932.5 (West, Westlaw through 2012 Reg. Sess.). Case-law has held that this statute is applicable only to mortgages and not to deeds of trust. *See* Haynes v. EMC Mortg. Corp., 140 Cal. Rptr. 3d 32, 34 (Cal. Ct. App. 2012); Calvo v. HSBC Bank, 130 Cal. Rptr. 3d 815, 818 (Cal. Ct. App. 2011). *But see* Cruz v. Aurora Loan Servs. LLC (*In re* Cruz), 457 B.R. 806, 818 (Bankr. S.D. Cal. 2011) (disagreeing with *Calvo* and holding CAL. CIV. CODE § 2932.5 applicable to deeds of trust); *In re* Salazar, 448 B.R. 814, 821 (Bankr. S.D. Cal. 2011) (same), *rev'd and remanded*, 470 B.R. 557 (S.D. Cal. 2012); Roger Bernhardt, *Midcourse Corrections: The Uncertain Requirements for Recording Assignments of Deeds of Trust*, ROGERBERNHARDT.COM (Nov. 9, 2011) <http://www.rogerbernhardt.com/index.php/ceb-columns/318-recording-dot-assignments-calvo-v-hsbc> (suggesting that the recording requirement is largely useless in any event).

57. GA. CODE ANN. § 44-14-162(b) (West, Westlaw through 2012 Reg. Sess.) (“The security instrument or assignment thereof vesting the secured creditor with title to the security instrument shall be filed prior to the time of sale in the office of the clerk of the superior court of the county in which the real property is located.”); *Duke Galish LLC v. SouthCrest Bank*, 726 S.E.2d 54, 56 (Ga. Ct. App. 2012) (holding failure to record was cured by recording and reforeclosure).

58. IDAHO CODE ANN. § 45-1505(1) (West, Westlaw through 2012 Reg. Sess.).

59. ME. REV. STAT. ANN. tit. 14, § 6321 (West, Westlaw through 2011 Reg. Sess.) (“The mortgagee shall . . . produce evidence of the mortgage note, mortgage and all assignments and endorsements of the mortgage note and mortgage.”); *id.* § 6203-A (providing a statutory form of foreclosure notice requiring a recitation of the foreclosing party’s mortgage recording information and states, “if by assignment . . . give reference.”).

60. MASS. GEN. LAWS ANN. ch.183, § 21 (West, Westlaw through 2012 2d Ann. Sess.) (mortgage may be foreclosed by power of sale by “the mortgagee or his executors, administrators, successors or assigns”), *construed in* U.S. Bank Nat’l Ass’n v. Ibanez, 941 N.E.2d 40, 53 (Mass. 2011) (requiring a written assignment or chain of assignments, but not necessarily recorded).

61. MICH. COMP. L. ANN. § 600.3204(c) (West, Westlaw through 2012 Reg. Sess.); *see* *Arnold v. DMR Fin. Servs., Inc.*, 532 N.W.2d 852, 855-56 (Mich. 1995) (holding foreclosure by holder of note who lacked a recorded chain of assignments was voidable, not void, and would be upheld if the mortgagor was not harmed).

62. MINN. STAT. ANN. § 580.02(3) (West, Westlaw through 2012 Spec. Sess.). *But see* *Jackson v. Mortg. Elec. Registration Sys., Inc.*, 770 N.W.2d 487 (Minn. 2009) (holding that MERS could foreclose by advertisement on behalf of member lenders for whom it was acting as nominee without recording assignments from MERS to the lenders).

apply only to non-judicial (power of sale) foreclosure.⁶⁷ However, why a chain of assignments should be required is not made clear by the statutes. In fact, the requirement seems a bit more logical in states which do not consider the mortgage to follow the note automatically, but instead authorize the foreclosure court to declare that the mortgage is held in trust for the benefit of the noteholder, because in a non-judicial foreclosure there is no court to make that declaration.⁶⁸ Oddly, several other states using non-judicial foreclosure have held, by case law or statute, that a chain of assignments is *not* essential to a proper foreclosure.⁶⁹

63. NEV. REV. STAT. ANN. § 107.086(4) (West, Westlaw through 2011 Reg. Sess.) (requiring mediation for residential deeds of trust as a precondition to foreclosure and providing that the beneficiary of the deed of trust “shall bring to the mediation the original or a certified copy of the deed of trust, the mortgage note and each assignment of the deed of trust or mortgage note”). In what was probably a misconstruction of the statute, the Nevada Supreme Court held that this language mandated that the applicable assignment or assignments be produced at the mediation. *Leyva v. Nat’l Default Servicing Corp.*, 255 P.3d 1275, 1279 (Nev. 2011).

64. OR. REV. STAT. § 86.735 (Westlaw through 2012 Reg. Sess.); *see* *Barnett v. BAC Home Loan Servicing, L.P.*, 772 F. Supp. 2d 1328 (D. Or. 2011) (enjoining a non-judicial foreclosure sale because the foreclosing party lacked a recorded chain of assignments). The statute was construed to disallow assignments by MERS. *McCoy v. BNC Mortg., Inc. (In re McCoy)*, 446 B.R. 453 (Bankr. D. Or. 2011); *Niday v. GMAC Mortg., LLC*, 284 P.3d 1157, 1168 (Or. Ct. App. 2012).

65. S.D. CODIFIED LAWS § 21-48-2 (Westlaw through 2012 Reg. Sess.).

66. WYO. STAT. ANN. § 34-4-103 (West, Westlaw through 2012 Budget Sess.); *see* *Bitker v. First Nat’l Bank*, 98 P.3d 853, 856-57 (Wyo. 2004) (treating actual notice of the assignment to the mortgagor as the equivalent of recording for this purpose).

67. If an assignment is required, it presumably must be completed *before* the foreclosure is commenced. *See* *Jeff-Ray Corp. v. Jacobson*, 566 So. 2d 885, 886 (Fla. Dist. Ct. App. 1990); *U.S. Bank Nat’l Ass’n v. Ibanez*, 941 N.E.2d 40, 54 (Mass. 2011). It could be argued that U.C.C. § 9-203(g) (2012), providing that “[t]he attachment of a security interest in a right to payment or performance secured by a security interest or other lien on personal or real property is also attachment of a security interest in the security interest, mortgage, or other lien[.]” should be held to override other state law requiring the existence or recording of mortgage assignments as a precondition of foreclosure. In fact, however, none of the jurisdictions with such statutory requirements has ever held (or even considered, so far as I can determine) that § 9-203(g) would have this effect.

68. *See supra* note 14 and accompanying text. In Massachusetts, for example, “the holder of the mortgage holds the mortgage in trust for the purchaser of the note, who has an equitable right to obtain an assignment of the mortgage, which may be accomplished by filing an action in court and obtaining an equitable order of assignment.” *Ibanez*, 941 N.E.2d at 54.

69. *See* CONN. GEN. STAT. ANN. § 49-17 (West, Westlaw through 2012 Spec. Sess.), *construed in* *Bankers Trust Co. v. Vaneck*, 899 A.2d 41 (Conn. App. Ct. 2006); *Harton v. Little*, 57 So. 851 (Ala. 1911); *Vasquez v. Saxon Mortg., Inc. (In re*

Overall, it is doubtful that there is any sensible rationale for a statutory requirement of a chain of mortgage assignments. Indeed, such a requirement can be mischievous and produce dramatically unfair results if no assignment was given when the loan was sold, and by the time foreclosure occurs it is practically impossible to obtain one. Consider *Euihyung Kim v. JP Morgan Chase Bank*,⁷⁰ decided in Michigan, which has such a statute applicable to non-judicial “foreclosure by advertisement.” In that case the originating mortgage lender had been taken over by the Federal Deposit Insurance Corporation (“FDIC”) as receiver, and the FDIC in turn had sold all of the lender’s loans, including the mortgage in question, to JP Morgan Chase pursuant to a blanket “Purchase and Assumption Agreement.”⁷¹ Hence, there was no individual assignment of the mortgage for JP Morgan to record. The court found the foreclosure void,⁷² which is an absurd result but one the court thought mandated by the statute. Of course, the bank could now foreclose judicially, but the runaround seems pointless. What would a recorded assignment prove about the bank’s right to foreclose? Nothing at all, but it would satisfy the statute.

6. Conclusion: What are Assignments Worth?

As we have seen above, a recorded assignment or chain of assignments of a mortgage can provide two valuable benefits to the mortgage’s holder: (1) protection against a fraudulent discharge or further encumbrance by a prior holder of the mortgage;⁷³ (2) assurance of receiving notice of the filing of a suit that might affect the holder’s rights.⁷⁴ A third supposed benefit is confidence that a foreclosure of the mortgage will appear in the public records to be credible in the eyes of future title examiners.⁷⁵ But as we have seen, belief in this “benefit” is entirely misplaced, for a recorded assignment actually provides no significant value to title examiners at all. Finally, to carry out a valid non-judicial foreclosure in some states, a chain of assignments may be absolutely mandatory by statute, whether this makes any sense in terms of good policy or not.⁷⁶ Outside the eleven states with such statutes, the incentive for investors to record mortgage assignments is really quite weak.

Vasquez), 266 P.3d 1053, 1055 (Ariz. 2011); see also *In re Tucker*, 441 B.R. 638, 644-45 (Bankr. W.D. Mo. 2010) (reaching the same conclusion under Missouri law).

70. 813 N.W.2d 778, 780-81 (Mich. Ct. App. 2012), *appeal granted*, 811 N.W.2d 498 (Mich. 2012). I am indebted to Robert Bozarth, National Agency Counsel at Fidelity National Title Group, for calling this case to my attention.

71. *Id.* at 779-80.

72. *Id.* at 783.

73. See *supra* notes 32-35 and accompanying text.

74. See *supra* notes 36-42 and accompanying text.

75. See *supra* notes 50-53 and accompanying text.

76. See *supra* notes 55-72 and accompanying text.

Note that only the first two benefits of recording mortgage assignments mentioned above require current, timely recordation when transfers occur. The “chain of title” rationale (even if one accepts it) and the statutory mandates to record apply only when there is a foreclosure or payoff of the loan. For this reason, many secondary market investors have long followed the practice of obtaining assignments, but not bothering to record them at the time of acquisition of the loan. More than 25 years ago, two knowledgeable commentators wrote:

Although assignment[s] must be executed and delivered, recordation for some buyers [of mortgage loans] is not necessary unless it is required by law to perfect the buyer’s ownership interest or is commonly required in the region by other mortgage buyers.⁷⁷

Fannie Mae and Freddie Mac continue, to this day, not to require current recording of assignments of the non-MERS mortgages that they purchase,⁷⁸ and most other investors probably do the same.⁷⁹ Of course, a secondary

77. CHARLES L. EDSON & BARRY G. JACOBS, SECONDARY MORTGAGE MARKET GUIDE § 9.03[1][c] (1986).

78. See FANNIE MAE, SELLING GUIDE: FANNIE MAE SINGLE FAMILY 936 (2012), <http://www.mooreeducation.com/wp-content/uploads/2011/08/Fannie-Mae-Selling-Guide.pdf> (“Lenders must prepare an assignment of the mortgage to Fannie Mae for any mortgage that is not registered with MERS, although the assignment should not be recorded. If the mortgage seller is not going to service the mortgage, the unrecorded assignment to Fannie Mae must be executed by the servicer.”); *Freddie Mac eMortgage Guide*, FREDDIE MAC, 22.14 (Oct. 1, 2009), <http://www.freddiemac.com/sell/guide/> (“The Seller/Servicer is not required to prepare an assignment of the Security Instrument to the Federal Home Loan Mortgage Corporation (Freddie Mac). However, Freddie Mac may, at its sole discretion and at any time, require a Seller/Servicer, at the Seller/Servicer’s expense, to prepare, execute and/or record assignments of the Security Instrument to Freddie Mac. If an assignment of the Security Instrument to Freddie Mac has been prepared, Seller/Servicer must not record it unless directed to do so by Freddie Mac.”).

79. With securitized residential loans, there is a significant gap between what market participants say and what they do. The typical Pooling and Servicing Agreement, which governs the relationship between the securitized trustee and the depositor(s) that are providing the mortgages to the pool, requires recording of assignments of all of the mortgages. See, e.g., LONG BEACH SECS. CORP., LONG BEACH MORTG. CO. & DEUTSCHE BANK NAT’L TRUST CO., POOLING AND SERVICING AGREEMENT: LONG BEACH MORTGAGE LOAN TRUST 2006-3 § 2.01(d) (2006) [hereinafter POOLING AND SERVICING AGREEMENT], available at http://content.edgar-online.com/edgar_conv_pdf/2006/04/21/0001277277-06-000388_PSAALONGBEACH_20063.PDF):

The Depositor does hereby deliver to, and deposit with, the Trustee as custodian . . . the following documents or instruments with respect to each Mortgage Loan so transferred and assigned:

market investor that delays or omits recording of assignments is taking some risk by foregoing the first two benefits mentioned above, but the proportions of that risk may seem quite trivial in comparison to the trouble and expense of immediate recording.⁸⁰

In light of this long-standing practice, a great deal that has been written about mortgage assignments is nonsense. Here is an illustration:

If borrowers receive a notice in the mail indicating that their mortgage has been transferred, they should call their lenders to confirm the sale and ask who the mortgage was sold to. It is also advisable to check the records office to confirm that an assignment of the mortgage has been followed.⁸¹

This author has expressed a fond wish, but the probability that a borrower could confirm the transfer of the mortgage by checking the public records is naïve and completely unrealistic. Another author, condemning the impact of MERS on the public records system, wrote:

When half of the nation’s mortgages are recorded under the name of one company [MERS] that does not publish its own records, the public’s ability (including both consumers and lenders) to use pub-

. . . .
(d) the original recorded Assignment or Assignments showing a complete chain of assignment from the originator to the Person assigning the Mortgage to the Trustee or in blank
. . . .

In fact, however, the practice of the depositors not recording assignments, and the securitized trustees not complaining about it, seems to have been widespread. See David R. Greenberg, *Neglected Formalities in the Mortgage Assignment Process and the Resulting Effects on Residential Foreclosures*, 83 TEMP. L. REV. 253, 253-54 (2010).

80. Moreover, Freddie Mac has all foreclosures performed in its servicers’ names, so recording an assignment to the corporation would be wasteful and counter-productive, since it would simply necessitate another recording to the servicer in the event of foreclosure. FREDDIE MAC SINGLE-FAMILY SELLER/SERVICER GUIDE § 66.17 (2012), available at <http://www.freddie.com/sell/guide/>. Its normal procedure, in the event of foreclosure, is to record a single assignment from MERS to the servicer, or from the originator to the servicer for a non-MERS loan.

81. *What is an Assignment of a Mortgage?*, STOP FORECLOSURE FRAUD, <http://stopforeclosurefraud.com/what-is-an-assignment-of-mortgage/> (last visited Jan. 16, 2013).

lic records to evaluate who owns real property interests will inevitably decline.⁸²

The problem with this statement is that long before MERS was created in 1993, the ability to use the public records system to determine who holds mortgages was lost, a victim of the widespread decisions of secondary market investors not to record mortgage assignments on a current basis.⁸³

Here is one more illustration, taken from a complaint filed by an Ohio county prosecutor against MERS and a large group of mortgage lenders and servicers:

Defendants systematically broke chains of land title throughout Ohio counties' public land records by creating gaps due to missing mortgage assignments they failed to record, or by recording patently false and/or misleading mortgage assignments

. . . Defendants' purposeful failure to record each and every mortgage assignment has resulted in far-reaching, devastating consequences for Ohio counties and their public land records – damage to public records that may never be entirely remedied.⁸⁴

All of the statements quoted above reflect a major misconception concerning the information that the public records system can be expected to adduce. Those records have *never* been a reliable basis for discovering who holds a mortgage loan. The incentives necessary to induce market participants to record their ownership of mortgages on a current basis simply do not exist, and in any event, evidence of ownership of a mortgage proves nothing about holding of the note. The only way for a borrower to be certain who holds his or her note, if it is negotiable, is to demand that the purported holder exhibit the original document – a demand that is completely impractical from the viewpoint of all parties because the note, if it continues to exist, is probably in the vault of some remote custodian.

This is not to say that creation of a system that actually tracks mortgage loan ownership and the holding of notes, and provides transparent access to that information to the public, would not be desirable. It is merely to say that the real estate recording system does not do, was not designed to do, and can-

82. Christopher L. Peterson, *Foreclosure, Subprime Mortgage Lending, and the Mortgage Electronic Registration System*, 78 U. CIN. L. REV. 1359, 1403 (2010).

83. See *supra* notes 78-82 and accompanying text.

84. Tracey Read, *Class Action Suit Filed for Mortgage Records*, NEWS-HERALD, Oct. 14, 2011, <http://www.news-herald.com/articles/2011/10/14/news/doc4e98523da23be992001503.txt?viewmode=default>.

not be expected to do that job.⁸⁵ Criticisms based on the failure of MERS or mortgage investors to make it do so are simply silly.

C. *Transfer of the Note*

As the foregoing discussion shows, the critical thing a secondary market mortgage purchaser needs and wants is the note. Although mortgage assignments have their uses, the mortgage will follow the note and can be foreclosed by its holder, with or without an assignment. I have dealt with mortgage assignments above in considerable detail, simply because so little that is useful has been written about them in the context of the modern secondary market. This is not the case with transfers of notes, so the treatment of notes here can be much briefer. To a great extent, it is covered accurately and thoroughly in a report issued by the Permanent Editorial Board of the Uniform Commercial Code in November, 2011,⁸⁶ (hereafter “the PEB report”), which I will rely on heavily here.

Hence, this section will provide a brief outline of the way U.C.C. Article 3 impacts mortgage notes. It will then consider the strange cases in several states that seem to disregard Article 3’s requirements in non-judicial foreclosures.

1. Summary of Article 3’s Effect on Mortgage Notes

The legal principles applicable to transfer of a note hinge on one critical fact: is the note negotiable or not? Both Article 3 and Article 9 of the UCC apply to notes, but they do not apply to all mortgage notes with equal force. Article 9 deals with the way sales and security transfers of notes occur. It governs *ownership* of notes, as well as security interests in ownership rights. It plainly applies to *all* mortgage notes, whether they are negotiable or not.⁸⁷

Article 3, on the other hand, governs not ownership but “*entitlement to enforce*” a note – a quality that certainly sounds as though it is the thing that mortgage investors and their servicers want and borrowers need to know

85. See Patrick Pulatie, *Is the Current Recording Process Sufficient for Today’s Complex Financial Instruments? Can MERS Resolve the Issues?*, ML-EXPLODE.COM (Nov. 2002), <http://ml-explode.com/2011/11/mers-and-recording-past-present-and-future-pt-1/> (outlining other deficiencies in the public recording system).

86. See PEB REPORT, *supra* note 21. For a similar report, reaching virtually identical conclusions, see generally AM. SECURITIZATION FORUM, TRANSFER AND ASSIGNMENT OF RESIDENTIAL MORTGAGE LOANS IN THE SECONDARY MORTGAGE MARKET (2010).

87. Article 9 uses the term “instrument,” defined by U.C.C. § 9-102(a)(47) (2012) as a document of a “type that in ordinary course of business is transferred by delivery with any necessary endorsement or assignment.” This definition covers all promissory notes, irrespective of their negotiability.

about⁸⁸ – and by its terms Article 3 applies only to negotiable notes.⁸⁹ The distinction drawn in the Code between owning a note and being entitled to enforce it seems strange at first blush, but it is actually quite useful. The two concepts are distinct, and unfortunately, confusing them has produced a good deal of imprecision and nonsense in briefs and judicial opinions.

Entitlement to enforce a note means that a party can sue on it or (if other applicable foreclosure requirements are met) foreclose the mortgage that secures it. The maker of the note (the mortgagor, in the case of a mortgage note) is the party most concerned with who is entitled to enforce the note, for the concept is designed to protect the maker against having to pay twice or defend against multiple claims on the note. If the maker pays in full the person entitled to enforce the note, the note is discharged and the mortgage that secures it is extinguished.⁹⁰ Ownership of the note, on the other hand, is a concept that deals with who is entitled to the economic fruits of the note – for example, who is entitled to the proceeds if it is enforced or collected.⁹¹ In the mortgage context, one obvious application of the distinction is that servicer of a mortgage in a securitized pool might well be entitled to enforce the note (if it met the applicable requirements of Article 3), but the trustee of the securitized trust, as owner, would be entitled to have the proceeds of the enforcement action remitted to it. One court, which got it exactly right, explained as follows:

Under established rules, the maker should be indifferent as to who owns or has an interest in the note so long as it does not affect the maker's ability to make payments on the note. Or, to put this statement in the context of this case, the [borrowers] should not care who actually owns the Note – and it is thus irrelevant whether the Note has been fractionalized or securitized – so long as they do know who they should pay.⁹²

Article 3 says nothing at all about nonnegotiable notes, which are left to the common law of contracts.⁹³ This seems simple enough, but it is problem-

88. See, e.g., *Armacost v. HSBC Bank*, No. 10-CV-274-EJL-LMB, 2011 WL 825151, at *12 (D. Idaho Feb. 9, 2011) (concluding that foreclosing party was required to establish its entitlement to enforce the note, irrespective of its holding of an assignment of the deed of trust).

89. U.C.C. § 3-103(a).

90. PEB Report, *supra* note 21, at 4.

91. See *supra* notes 19-31 and accompanying text (discussing the requirements for ownership under Article 9).

92. *Veal v. Am. Home Mortg. Servicing, Inc. (In re Veal)*, 450 B.R. 897, 912 (B.A.P. 9th Cir. 2011).

93. See, e.g., *JPMorgan Chase & Co., Inc. v. Casarano*, No. 07 MISC 344419 (AHS), 2010 WL 3605427, at *6 (Mass. Land Ct. Sept. 16, 2010) (finding a note nonnegotiable, and hence governed by the common law, where the note had been lost

atic, because it can be extremely difficult to determine with certainty whether a note is negotiable or not. The definition of negotiability is complex and technical, and for many mortgage notes, arguments can plausibly be made either way.⁹⁴ The courts often seem to *assume* that mortgage notes are negotiable and are covered by Article 3, but only rarely do they actually analyze the note language to determine whether negotiability exists. In particular, there are few judicial opinions that thoroughly and competently examine the negotiability of the standard Fannie Mae/Freddie Mac one-to-four-family residential mortgage note, although recent cases that do so seem to be running in favor of its negotiability.⁹⁵

Hence, it is often unclear which body of law governs mortgage notes – Article 3 or the common law. This is a fundamental structural problem with

and no one could remember whether it was a “demand note” or for a definite term), *aff’d*, 963 N.E.2d 108 (Mass. App. Ct. 2012).

94. See U.C.C. § 3-104(a). I have previously explored the complexities of the definition of negotiability, the uncertainty of the classification of many mortgage notes, and the tendency of courts to avoid the issue. See Whitman, *How Negotiability Has Fouled Up the Secondary Mortgage Market*, *supra* note 3. A good example of the complexity of the determination is *Bankers Trust (Delaware) v. 236 Beltway Inv.*, 865 F. Supp. 1186 (E.D. Va. 1994), in which the court made an unusually prodigious effort but probably got it wrong. See also *Ngo v. Park*, 623 S.E.2d 369, 369 (N.C. Ct. App. 2006) (unpublished table decision) (“[B]ecause separate documents have been made a part of the note by its express terms, the promise contained therein is conditional, and the note nonnegotiable”).

95. Perhaps the closest opinion to this ideal is *HSBC Bank USA v. Gouda*, No. A-1983-09T2, 2010 WL 5128666, at *3 (N.J. Super. Ct. App. Div. Dec. 17, 2010), *cert. denied*, 132 S. Ct. 1019 (2012), apparently concluding that the clause obligating the mortgagor to notify the mortgagee of intent to prepay the loan did not render the note nonnegotiable. The opinion is slightly garbled, but at least the court tried. One federal district court, several bankruptcy courts, and the Alabama intermediate appellate court have agreed. See *Picatinny Fed. Credit Union v. Fed. Nat’l Mortg. Ass’n*, No. 09-1295 (GEB), 2011 WL 1337507 (D.N.J. Apr. 7, 2011); *In re Walker*, 466 B.R. 271, 283-84 (Bankr. E.D. Pa. 2012); *Kain v. Bank of New York Mello (In re Kain)*, No. 10-80047-HB, 2012 WL 1098465, at *7-8 (Bankr. D.S.C. Mar. 30, 2012); *Edwards v. Deutsche Bank Nat’l Trust Co. (In re Edwards)*, No. 11-23195, 2011 WL 6754073, at *5 (Bankr. E.D. Wis. Dec. 23, 2011); *Thomas v. Wells Fargo Bank*, No. 2101153, 2012 WL 3764729 (Ala. Civ. App. Aug. 31, 2012). See the discussion of this issue in Whitman, *How Negotiability Has Fouled Up the Secondary Mortgage Market*, *supra* note 3, at 749-50. *Mesina v. Citibank, NA*, No. 10-2304RTL, 2012 WL 2501123 (Bankr. D.N.J. June 27, 2012) agrees with this analysis, and also holds that negotiability was not destroyed by the Fannie Mae-Freddie Mac note’s reference to the accompanying mortgage with respect to rights of acceleration and collateral. *But see Bank of N.Y. v. Romero*, 266 P.3d 638, 644-45 (N.M. Ct. App. 2011) (holding that the assignment of the mortgage also assigned the note, a result that would have been impossible if the note had been negotiable; but the court made no analysis of the negotiability issue), *cert. granted*, 289 P.3d 1254 (N.M. 2011).

the present law that must be dealt with if we are ever to have clarity.⁹⁶ The proposal presented later in this Article will address the point.

For the moment, let us assume (as the courts usually do) that we are dealing with a negotiable note. If this is the case, the PEB Report clearly explains how a party can become entitled to enforce the note. The methods are described here only superficially, and the reader is directed to the PEB Report (and Article 3 itself, of course) for the details and relevant citations. In brief, there are three ways:

1. *Becoming a holder.*⁹⁷ This will occur if the note has been delivered to and is in the possession of the person enforcing it, with an appropriate endorsement (either in blank – which makes the note a “bearer note,” or specially – an endorsement that specifically identifies the person to whom the note is delivered). These actions will constitute the person who takes the note a “holder,” entitling him or her to enforce the note.⁹⁸

2. *Becoming a nonholder who has the rights of a holder.*⁹⁹ This will occur if the note has been delivered to and is in the possession of the person enforcing it, but without an endorsement. In the absence of an endorsement, the person taking delivery cannot be a holder, but can still get the right of enforcement if the delivery was made for the purpose of transferring that right.¹⁰⁰

96. This is, in a sense, a weakness of the PEB REPORT, *supra* note 21. It spells out very clearly the way Article 3 operates on negotiable notes, but it provides no help in determining whether Article 3 applies to any particular note, or exactly what rules will govern if Article 3 does not. The PEB did not consider clarifying these issues to be its responsibility. *See id.*

97. *Id.* at 5.

98. *See In re Walker*, 466 B.R. 271, 280-81 (Bankr. E.D. Pa. 2012) (finding note was endorsed in blank and delivered to securitized trustee, thus constituting it a “holder”); *In re David A. Simpson, P.C.*, 711 S.E.2d 165, 173 (N.C. Ct. App. 2011) (holding securitized trustee attempting to foreclose was not a “holder,” despite having possession of the note, where the note was not endorsed either to the trustee or in blank).

99. PEB REPORT, *supra* note 21, at 5.

100. *See, e.g., Veal v. Am. Home Mortg. Servicing, Inc. (In re Veal)*, 450 B.R. 897, 911-12 (B.A.P. 9th Cir. 2011) (recognizing “nonholder with the rights of a holder” status, but finding that it did not exist in the absence of possession of note); *Aum Shree of Tampa v. HSBC Bank USA, Nat’l Ass’n (In re Aum Shree of Tampa, LLC)*, 449 B.R. 584, 593-94 (Bankr. M.D. Fla. 2011) (finding where foreclosing party proved possession of the note, it was at least a nonholder with the rights of a holder; it was not required to prove that it was a holder in due course); *Bank of Am. v. Kabba*, 276 P.3d 1006, 1009 (Okla. 2012) (“Delivery of the note would still have to occur even though there is no negotiation.”); *Anderson v. Burson*, 35 A.3d 452, 464 (Md. 2011) (permitting enforcement, where possessor of unendorsed note did not prove each prior transfer, but makers conceded that such transfers had occurred); *Leyva v. Nat’l Default Servicing Corp.*, 255 P.3d 1275, 1281 (Nev. 2011) (requiring the servicer to provide specific, affirmative proof that the note was delivered to it for

3. *Providing a "lost note affidavit."* Under section 3-309, a person who does not qualify to enforce the note under (1) or (2) above because of a lack of possession may still enforce it by providing a "lost note affidavit."¹⁰¹ However, the requirements for the affidavit are quite strict: the note must have been destroyed, its whereabouts not discoverable, or it must be in the wrongful possession of an unknown person or one who cannot be served. Before accepting such an affidavit, a court might well demand evidence as to the efforts that have been made to locate the note. In addition, the court can require the enforcing party to provide assurance (typically in the form of a bond) against the possibility that the borrower will have to pay twice.¹⁰²

Fannie Mae and Freddie Mac have developed careful procedures for maintaining custody of mortgage notes,¹⁰³ and lost notes are rare for loans they hold. But other secondary market investors have not been so scrupulous, and it is all too common in foreclosure cases that neither the investor nor a custodian designated by it has possession of the note. Hence the lost note affidavit procedure is extremely important.¹⁰⁴ There is little doubt that in

the purpose of transferring the right of enforcement); *Wells Fargo Bank v. Ford*, 15 A.3d 327, 331 (N.J. Super. Ct. App. Div. 2011) (finding documents proving purpose for which note was delivered were not properly authenticated). *But cf. In re Adams*, 693 S.E.2d 705 (N.C. Ct. App. 2010) (refusing to allow foreclosure by the party in possession of the note, apparently because it was not endorsed).

101. *See, e.g., Allen v. US Bank Nat'l Ass'n (In re Allen)*, 472 B.R. 559 (B.A.P. 9th Cir. 2012) (holding lost note affidavit sufficient to sustain noteholder's claim in bankruptcy); *Bobby D. Assocs. v. DiMarcantonio*, 751 A.2d 673, 675-76 (Pa. Super. Ct. 2000) (finding assignee of lost note may enforce it through lost note affidavit). If the original note is lost and no photocopies of it can be found, a lost note affidavit may be insufficient for purposes of enforcement, because it may be impossible to determine the terms of the original note. *See JPMorgan Chase & Co. v. Casarano*, 963 N.E.2d 108, 110-11 (Mass. App. Ct. 2012).

102. *See, e.g., First Const. Co. v. Tri-S. Mortg. Investors*, 308 N.W.2d 298, 299 (Minn. 1981).

103. *See FANNIE MAE, REQUIREMENTS FOR DOCUMENT CUSTODIANS* (2009); *FREDDIE MAC, DOCUMENT CUSTODY PROCEDURES HANDBOOK* (2012).

104. The need for such affidavits appears to be widespread, since in some areas of the nation original notes were routinely destroyed as a matter of policy. For example, a letter to the Florida Supreme Court from the Florida Bankers Association in 2009 observed, "[t]he reason 'many firms file lost note counts as a standard alternative pleading in the complaint' is because the physical document was deliberately eliminated to avoid confusion immediately upon its conversion to an electronic file." Yves Smith, *FUBAR Mortgage Behavior: Florida Banks Destroyed Notes; Others Never Transferred Them*, *NAKED CAPITALISM* (Sept. 27, 2010), <http://www.nakedcapitalism.com/2010/09/more-evidence-of-bank-fubar-mortgage-behavior-florida-banks-destroyed-notes-others-never-transferred-them.html>. It is not clear to what extent notes were destroyed, but it seems obvious that in many cases the lost note affidavit process has been employed simply to avoid the trouble of looking for the note. One Florida legal aid attorney estimated that 80% of the foreclosure complaints in his locality were accompanied by lost note affidavits. Bob Ivry, *Banks Lose*

some sections of the country it has been the subject of serious abuse, with foreclosing parties using it not because the original note was impossible to find, but merely because it was inconvenient. Prior to the 2002 amendments to section 3-309, some courts took the view that the party attempting to enforce the note had to aver that it lost the note *itself*; a loss of the note by its predecessor (for example, the originator of the note) would not count.¹⁰⁵ This narrow interpretation of section 3-309 was expanded by the 2002 amendments to Article 3, the current version of which allows a person to enforce the note if he or she “has directly or indirectly acquired ownership of the instrument from a person who was entitled to enforce the instrument when loss of possession occurred.”¹⁰⁶ But the 2002 amendments have been adopted in only ten states, so in much of the nation a secondary market investor may still be in serious trouble if the note was lost or destroyed by its predecessor.¹⁰⁷

To return to the first two methods of becoming “entitled to enforce” described above, while they require that the enforcing party possess the note,¹⁰⁸ they do not literally insist that the note be produced in court. Conceivably, the foreclosing party could prove that it had possession of the note by other means, such as oral testimony or affidavits.¹⁰⁹ But one can easily see why

to *Deadbeat Homeowners as Loans Sold in Bonds Vanish*, BLOOMBERG (Feb. 22, 2008), www.bloomberg.com/apps/news?pid=newsarchive&sid=aejJZdqodTCM.

105. See, e.g., *Dennis Joslin Co. v. Robinson Broad. Corp.*, 977 F. Supp. 491, 494-95 (D.D.C. 1997). The situation is well explained in Timothy R. Zinnecker, *Extending Enforcement Rights to Assignees of Lost, Destroyed, or Stolen Negotiable Instruments Under U.C.C. Article 3: A Proposal for Reform*, 50 U. KAN. L. REV. 111 (2001).

106. U.C.C. § 3-309(a)(1)(B) (2012); see *Feltus v. U.S. Bank Nat’l Ass’n*, 80 So. 3d 375, 377 (Fla. Dist. Ct. App. 2012) (holding that even under 2002 amendment to U.C.C. § 3-309, complaint was insufficient because it failed to allege that alleged owner of note “was entitled to enforce the instrument when loss of possession occurred, or has directly or indirectly acquired ownership of the instrument from a person who was entitled to enforce the instrument when loss of possession occurred” (quoting FLA. STAT. ANN. § 673.3091(a) (West, Westlaw through 2012 Reg. Sess.))).

107. *Compare* *State St. Bank & Trust Co. v. Lord*, 851 So. 2d 790, 791 (Fla. Dist. Ct. App. 2003) (holding under prior version of Article 3, mortgagee must prove it had possession of the note when it was lost or destroyed), *with* *EquiCredit Corp. v. Provo*, No. L-03-1217, 2006 WL 2192856 (Ohio Ct. App. Aug. 4, 2006) (finding mortgagee provided satisfactory proof that it was in possession of note at the time it was lost).

108. See, e.g., *HSBC Bank v. Hernandez*, 939 N.Y.S.2d 120, 122 (N.Y. App. Div. 2012) (denying foreclosure where foreclosing party did not prove it had possession of note).

109. See, e.g., *Howard v. PNC Mortg.*, 269 P.3d 995, 997 (Utah Ct. App. 2012) (correctly accepting photocopy of note as proof of its possession, where mortgagor admitted note had been transferred and photocopy showed that it had been properly endorsed).

courts in judicial foreclosure states often demand that the note itself be produced; if you have the note, why not show it to the judge?¹¹⁰

2. Non-judicial Foreclosure Decisions that Disregard Article 3

In states where non-judicial foreclosure is used, the situation becomes more complex. There is no judge to show the note to, unless a suit is filed to enjoin or set aside the foreclosure. If the security instrument is a deed of trust and a trustee conducts the foreclosure, one might assume that the trustee should, at a minimum, determine whether the note is negotiable (perhaps by reviewing a photocopy), and if it is, demand to see the original document or a lost note affidavit. In reality, it is doubtful that this inspection occurs on any regular basis, although I am aware of no evidence on the point.¹¹¹

In light of the discussion of UCC Article 3 requirements discussed above, it may seem perfectly obvious that only a party who is “entitled to enforce” a negotiable note can foreclose the deed of trust that secures it. After all, what could be a plainer example of enforcing a note than a proceeding to foreclose the security attached to it? This view is routine in judicial foreclosures, and in non-judicial proceedings as well in some states.¹¹² Yet rather remarkably, a large number of federal courts dealing with non-judicial deed of trust foreclosures from 2007 to 2012 in Arizona, California, Hawaii, Idaho, Nevada, Virginia, and Texas have held the contrary: no one – neither the trus-

110. See, e.g., *5-Star Mgmt., Inc. v. Rogers*, 940 F. Supp. 512, 520-21 (E.D.N.Y. 1996); *In re Wilhelm*, 407 B.R. 392 (Bankr. D. Idaho 2009) (having a mortgage assignment from MERS is no substitute for delivery of the note). Even if the note is nonnegotiable, a court may demand production of it as proof that it has been transferred to the party that filed the foreclosure action. This idea is an ancient one, not confined to negotiable notes. See, e.g., *Sheehy v. Mandeville*, 11 U.S. 208 (1812) (Marshall, J.) (“The practice of this country is to require that the note should be produced, or its absence accounted for, and the rule is a safe one.”).

111. Some such procedure seems to be demanded by North Carolina law. N.C. GEN. STAT. § 45-21.16(c)(7)(d) (Westlaw through 2012 Reg. Sess.) (requiring that the clerk of court, prior to authorizing foreclosure of a deed of trust, find from evidence submitted by the trustee, “the existence of: (i) valid debt of which the party seeking to foreclose is the holder”); see *In re David A. Simpson, P.C.*, 711 S.E.2d 165 (N.C. Ct. App. 2011) (determining that the required showing was not made).

112. See, e.g., *In re Lacey*, 480 B.R. 13, 34 (Bankr. D. Mass. 2012) (holding that to foreclose under Massachusetts non-judicial procedure, party must either hold the note or be the agent of the note-holder); *Bank of N.Y. v. Raftogianis*, 13 A.3d 435, 438 (N.J. Super. Ct. Ch. Div. 2010) (“[A] party seeking to foreclose a mortgage must own or control the underlying debt”); *U.S. Bank Nat’l Ass’n v. Baber*, 280 P.3d 956, 959 (Okla. 2012) (“It is a fundamental precept of the law to expect a foreclosing party to actually be in possession of its claimed interest in the note”); *U.S. Bank Nat’l Ass’n v. Kimball*, 27 A.3d 1087, 1094 (Vt. 2011) (“It is neither irrational nor wasteful to expect a foreclosing party to actually be in possession of its claimed interest in the note”).

tee conducting the foreclosure sale nor a court reviewing the foreclosure – need be satisfied that that the party instituting the foreclosure holds the note!¹¹³ One federal judge in Idaho disagreed and required compliance with Article 3, distinguishing the other federal cases on the sketchy ground that they deal with the foreclosure procedure, but not with the foreclosing party’s right to initiate that procedure.¹¹⁴

Four state appellate court decisions on this point have come down during late 2011 and 2012, and they largely agree with the federal cases mentioned above that disregard Article 3. In the first, *Residential Funding Co. v. Saurman*, the Michigan Supreme Court held that MERS, as holder of a mortgage in the capacity of nominee for the noteholder, could foreclose in its own name despite not holding the note.¹¹⁵ The reasoning of the opinion is astonishingly garbled:

[A]s record-holder of the mortgage, MERS owned a security lien on the properties, the continued existence of which was contingent upon the satisfaction of the indebtedness. This interest in the in-

113. *Pascual v. Aurora Loan Servs., LLC*, No. 10-00759 JMS-KSC, 2012 WL 3583530, at *3 (D. Haw. Aug. 20, 2012); *Palmerin v. Bank of N.Y. Trust Co.*, 2012 WL 393650, at *5 (E.D. Cal. Feb. 6, 2012) (citing additional cases); *Meyer v. Bank of Am.*, No. 1:10-cv-00632-EJL, 2011 WL 4584514, at *5 (D. Idaho Aug. 29, 2011); *In re Mortg. Elec. Registration Sys. (MERS) Litigation*, No. 09-2119-JAT, 2011 WL 251453, at *5 (D. Ariz. Jan. 25, 2011) (applying Nevada law); *Gallant v. Deutsche Bank Nat’l Trust Co.*, 766 F. Supp. 2d 714, 720-21 (W.D. Va. 2011); *Kan v. OneWest Bank, FSB*, 823 F. Supp. 2d 464, 470 (W.D. Tex. 2011); *Mansour v. Cal-Western Reconveyance Corp.*, 618 F. Supp. 2d 1178, 1181-82 (D. Ariz. 2009); *Diessner v. Mortg. Elec. Registration Sys.*, 618 F. Supp. 2d 1184, 1187 (D. Ariz. 2009), *aff’d*, 384 F. App’x 609 (9th Cir. 2010); *Urbina v. Homeview Lending Inc.*, 681 F. Supp. 2d 1254, 1257-58 (D. Nev. 2009); *Wayne v. HomEq Servicing, Inc.*, No. 2:08-cv-00781-RCJ-LRL, 2008 WL 4642595, at *3-4 (D. Nev. Oct. 16, 2008); *Neal v. Juarez*, No. 06CV0055 J(JMA), 2007 WL 2140640, at *8 (S.D. Cal. July 23, 2007) (“[T]he allegation that the trustee did not have the original note or had not received it is insufficient to render the foreclosure proceeding invalid.”), *aff’d*, 301 F. App’x 683 (9th Cir. 2008). Minnesota apparently agrees under its “foreclosure by advertisement” procedure. See *Jackson v. Mortg. Elec. Registration Sys., Inc.*, 770 N.W.2d 487, 501 (Minn. 2009); *Stein v. Chase Home Fin., LLC*, 662 F.3d 976, 980 (8th Cir. 2011) (“[T]he right to enforce a mortgage through foreclosure by advertisement lies with the legal, rather than equitable, holder of the mortgage. The assignment of the promissory note to another ‘operates as an equitable assignment of the underlying [mortgage],’ but the right to enforce the mortgage remains with the legal holder of the mortgage.” (emphasis omitted) (internal citations omitted) (quoting *Jackson*, 770 N.W.2d at 497)); cf. *Veal v. Am. Home Mortg. Servicing, Inc. (In re Veal)*, 450 B.R. 897, 917-18 (B.A.P. 9th Cir. 2011) (holding a mortgage lender seeking stay relief in bankruptcy must establish its standing by proof that it holds the note).

114. *Armacost v. HSBC Bank USA*, No.10-CV-274-EJL-LMB, 2011 WL 825151, at *10 (D. Idaho Feb. 9, 2011).

115. 805 N.W.2d 183, 184 (Mich. 2011).

debtedness – i.e., the ownership of legal title to a security lien whose existence is wholly contingent on the satisfaction of the indebtedness – authorized MERS to foreclose by advertisement under MCL 600.3204(1)(d).¹¹⁶

It is clear that the court intended to uphold MERS-name foreclosures, and was willing to engage in certain amount of verbal nonsense in order to do so. In any event, the net result is that an assignee of the mortgage need not show that it holds the note to foreclose non-judicially in Michigan.¹¹⁷ The decision betrays no awareness whatever of the demands of UCC Article 3.

In *Hogan v. Washington Mutual Bank*,¹¹⁸ the Arizona Supreme Court held that “the deed of trust statutes impose no obligation on the beneficiary to ‘show the note’ before the trustee conducts a non-judicial foreclosure.”¹¹⁹ While this may seem to ignore the requirements of UCC Article 3, “[t]he trust deed statutes do not require compliance with the UCC before a trustee commences a non-judicial foreclosure.”¹²⁰ These statements may seem extreme, but perhaps they are only about the burden of going forward with evidence. The court pointed out that the borrower “has not alleged that [the lenders] are not entitled to enforce the underlying note; rather, he alleges that they have the burden of demonstrating their rights before a non-judicial foreclosure may proceed. Nothing in the non-judicial foreclosure statutes, however, imposes such an obligation.”¹²¹ Suppose the borrower had alleged in the complaint that the assignee of the deed of trust lacked possession of the note;¹²² would the court have compelled the assignee to produce it? Of course, if this is the court’s position it seems nonsensical; it effectively requires the borrower to bring a lawsuit in order to make such an allegation, and then places the burden of producing evidence as to possession of the note on the borrower – the

116. *Id.* at 183.

117. See *Hargrow v. Wells Fargo Bank*, No. 11-1806, 2012 WL 2552805, at *3 (6th Cir. July 3, 2012) (adopting this understanding of *Saurman*).

118. 277 P.3d 781 (Ariz. 2012).

119. *Id.* at 783.

120. *Id.*

121. *Id.*

122. Would such an allegation, based on nothing more than suspicion, be improper or sanctionable in Arizona? Arizona’s version of the Federal Rules of Civil Procedure, Rule 11, is violated “by the filing of a pleading when the party or counsel knew, or should have known by such investigation of fact and law as was reasonable and feasible under all the circumstances that the claim or defense was insubstantial, groundless, frivolous or otherwise unjustified.” *Gilbert v. Bd. of Med. Exam’rs*, 745 P.2d 617, 631 (Ariz. Ct. App. 1987) (internal emphasis omitted), *superseded by statute on other grounds, as stated in* *Pierce v. Laydon Leasing, Inc.*, No. 1 CA-CV 10-0250, 2011 WL 1631931 (Ariz. Ct. App. Apr. 28, 2011). But what sort of investigation can the plaintiff or his counsel make? Is simply asking the foreclosing party whether it has the original note likely to do any good? It seems probable that such a request would be ignored.

party least likely to have any information or knowledge on the subject. The court's handling of this issue is, to put it mildly, unsatisfactory.

The Idaho Supreme Court took a far more radical view of a trustee's power to foreclose a deed of trust in *Trotter v. Bank of New York Mellon*.¹²³ The borrower asserted that the foreclosing party (the trustee of a securitized trust) was obliged to establish its standing to foreclose by proving that it held the loan.¹²⁴ The court was unimpressed;

nothing in the text of the statute can reasonably be read to require the trustee [of a deed of trust] to prove it has 'standing' before foreclosing. Instead, the plain language of the statute makes it clear that the trustee may foreclose on a deed of trust if it complies with the requirements contained within the Act.¹²⁵

The Act, in turn, has only five requirements: (1) any assignments of the deed of trust or substitutions of trustee has been recorded, (2) there is a default by the borrower, (3) an appropriate notice of default has been recorded, (4) no suit on the debt is pending, and (5) a notice of sale has been given to the proper parties.¹²⁶ Taking literally the bare-bones nature of these requirements, the court reached a truly bizarre conclusion: "a trustee may initiate non-judicial foreclosure proceedings on a deed of trust without first proving ownership of the underlying note or demonstrating that the deed of trust beneficiary has requested or authorized the trustee to initiate those proceedings."¹²⁷

Finally, in *Debrunner v. Deutsche Bank National Trust Co.*,¹²⁸ the California Court of Appeal fully endorsed the federal cases mentioned above that construe California law. Quoting earlier California authority holding that the foreclosure statute sets forth "a comprehensive framework for the regulation of a non-judicial foreclosure sale pursuant to a power of sale contained in a deed of trust,"¹²⁹ the court explicitly rejected the notion that the "person entitled to enforce" provisions of UCC Article 3 played any role in establishing the right to foreclose.¹³⁰ "[W]e are not convinced," the court said, "that the cited sections of the Commercial Code (particularly section 3301) displace

123. 275 P.3d 857 (Idaho 2012).

124. *Id.* at 861.

125. *Id.* at 862.

126. IDAHO CODE ANN. §§ 45-1505, 45-1506 (West, Westlaw through 2012 Reg. Sess.).

127. *Trotter*, 275 P.3d at 862.

128. 138 Cal. Rptr. 3d 830 (Cal. Ct. App. 2012).

129. *Id.* at 835 (quoting *Moeller v. Lien*, 30 Cal. Rptr. 2d 777, 781 (Cal. Ct. App. 1994)).

130. *Id.* at 835-36.

the detailed, specific, and comprehensive set of legislative procedures the Legislature has established for non-judicial foreclosures.”¹³¹

Most of the remaining state courts in non-judicial foreclosure jurisdictions have thus far generally remained silent on the point, and a few have taken the opposite approach, reading their statutes to require possession of the note.¹³² But the decisions discussed above, both federal and state, are extremely troublesome. They either completely ignore UCC Article 3 or give it very short shrift; in effect, they seem to hold that the state’s foreclosure statutes supersede the Uniform Commercial Code, although most of them do not analyze that issue in any rigorous manner. In essence they rely on the literal language of the foreclosure statutes, and assume that no requirement found anywhere else in the state’s codes is relevant.

In addition to the issue of standing to foreclose discussed above, the “lost note” problem mentioned earlier assumes a very different cast in non-judicial foreclosure states. There is no court to which the lender or beneficiary of the deed of trust can present the affidavit, nor any mechanism in most non-judicial foreclosure jurisdictions for requiring the posting of a bond by the lender to protect the borrower against having to pay twice.¹³³ The effect is to render the “adequate protection” provisions of UCC 3-309 meaningless unless the borrower is willing to file a lawsuit.

131. *Id.* at 836.

132. *See In re Allen*, 472 B.R. 559, 569 (B.A.P. 9th Cir. 2012) (construing the Washington non-judicial foreclosure statute to require possession of the note by noting that “an assignment of the DOT is not relevant because under Washington law, the security for an obligation follows the debt. RCW 61.24.005(2) (‘Beneficiary’ means the holder of the instrument or document evidencing the obligations secured by the deed of trust)’); *Ball v. Bank of New York*, No. 4:12–CV–00144–NKL, 2012 WL 6645695 (W.D. Mo. 2012) (under Missouri law, foreclosing party must possess the note); *Anderson v. Burson*, 35 A.3d 452, 460 (Md. 2011) (holding Maryland law requires possession of the note for use of statutory foreclosure procedure); *Eaton v. Fed. Nat’l Mortg. Ass’n*, 969 N.E.2d 1118, 1129 (Mass. 2012) (“[W]e construe the term ‘mortgagee’ in [the non-judicial foreclosure statute] to mean a mortgagee who also holds the underlying mortgage note.”); *In re David A. Simpson, P.C.*, 711 S.E.2d 165 (N.C. Ct. App. 2011) (denying statutory foreclosure, where foreclosing party did not prove it was holder of the note).

133. Virginia is an exception. Under VA. CODE ANN. § 55-59.1(B) (West, Westlaw through 2012 Spec. Sess.) the trustee of the deed of trust must obtain the lost note affidavit from the lender as a prerequisite to foreclosure (if the lender cannot exhibit the note), and must notify the borrower, advising the borrower that she or he may petition the circuit court for an order requiring a bond or other protection. The statute implies, but does not explicitly state, that the trustee should begin this process by demanding to see the note. *See id.* Ironically, a Virginia federal court construed this language in exactly the opposite way – as evidence that, because the note might not be available, the foreclosing beneficiary has no duty to show possession of the note. *See Gallant v. Deutsche Bank Nat’l Trust Co.*, 766 F. Supp. 2d 714, 721 (W.D. Va. 2011).

3. Conclusion: The Sad State of the Law of Secondary Market Note Transfers

In summary, the American legal system handles secondary market trades of mortgage loans in an almost unbelievably inept manner. It is often difficult or impossible to tell what set of rules govern transactions, given the complexities of the definition of negotiability.¹³⁴ If the note is negotiable, the right of enforcement depends on keeping track of the original physical document, which may easily be lost, mislaid, or intentionally destroyed.¹³⁵ Market institutions and some state statutes may put reliance on mortgage assignments, but that reliance is generally misplaced, in the sense that assignments prove little or nothing about the right of enforcement.¹³⁶ In a number of non-judicial foreclosure states, the rules for foreclosure of security instruments and those for determining the right of enforcement of notes seem to operate on different planets, completely inconsistent with each other.¹³⁷ Litigation on all of these issues is rampant. On the whole, it is an appalling mess, completely unsuited for the large-scale secondary mortgage market that exists today.

D. The Cost of Following the Rules.

Assume for a moment that you are responsible for the operations of a secondary mortgage market participant, and you hold a package of loans that you wish to sell to another investor. Moreover, assume that you are determined to do things right; that is, notwithstanding the legal vagaries mentioned above, you are going to provide endorsed notes and recorded assignments for each loan to your purchaser – surely the most conservative position for both seller and purchaser. Consider the steps you need to take:

1. Determine to which of approximately 3,600 recording jurisdictions in the United States the assignment must be sent for recordation. (In several New England states the records are organized on a town, rather than a county basis.)
2. Determine the applicable document standards (margins, font, addresses, cover sheet, etc.) imposed by the recording office of the jurisdiction.
3. Prepare, execute, and acknowledge the assignment of the mortgage. Note that the assignment must be hand tailored to the spe-

134. See *supra* notes 96-97 and accompanying text.

135. See *supra* notes 103-09 and accompanying text.

136. See *supra* notes 57-71 and accompanying text.

137. See *supra* notes 114-35 and accompanying text.

cific mortgage, since the original parties, recording information, and land description must be recited. Do not forget the notarization!

4. Determine the jurisdiction's fee schedule and calculate the correct recording fee.
5. Write a check for the fee.
6. Transmit the assignment for recording, along with the fee.
7. Locate the original wet-ink signed promissory note, likely stored in an off-site vault.
8. Endorse the note to the transferee, including a hand-written signature. If there is insufficient space on the note, it will be necessary to attach an allonge to the note and write the endorsement on it.
9. Physically transmit the note to the transferee.
10. Ensure that the original assignment is forwarded to the transferee after recording. The recording office may perform this service.

The payment of fees to local recorders is a particular burden. Every jurisdiction has its own fee schedule. Fees are constantly being revised, and in all events are usually based on the number of pages to be recorded. The party submitting the document must count the pages, and the recorder's personnel will count them again. If the fee is incorrect, the document will be returned to the sender without recording and the whole procedure will begin again. Considered at a national scale, the system for payment of recording fees is, by itself, almost insanely inefficient.

The overall process is, to put it mildly, cumbersome. None of the steps are impossible or extremely difficult, but in the aggregate they represent a very substantial cost, and there are no "traffic cops" to insist that the steps are performed. The system may have been reasonably acceptable to the mortgage industry when volumes of secondary market transactions were relatively low. During the late 1990s and early 2000s, when volumes of secondary market trades increased greatly as a result of widespread securitization, players in the industry frequently simply quit playing by these rules. Promissory notes were retained by originators, and often lost or perhaps even shredded.

Assignments were not prepared or executed. The system bogged down under its own weight.¹³⁸

II. THE ADVENT AND FALLACIES OF MERS.

In 1993, the principal actors in the secondary mortgage market¹³⁹ came together to form the Mortgage Electronic Registration System (MERS). They were motivated by the increased volumes of secondary market trades and the likelihood that they would grow far greater in number as securitization of residential mortgages became more common.

MERS was designed to eliminate the need for successive recording of assignments as a mortgage loan was transferred from one owner to another in the secondary market. A loan is entered into the system either by making MERS the original mortgagee (as nominee for the note holder), or by recording an assignment of the original mortgage to MERS immediately after it is originated. Thereafter, no assignments are recorded to reflect further sales of the loan; instead, market participants simply report subsequent loan sales to MERS electronically, and MERS maintains a computer database of the reported information. When the mortgage is paid off, a person who is purportedly a MERS officer (but who is employed by the mortgage servicer) executes a release to the borrower. Under the original plan, if the mortgage needed to be foreclosed, MERS would execute and record an assignment to the note holder or its servicer, which in turn would conduct the foreclosure.

Initially, market participants were enthusiastic about MERS' services, and by 2000, the majority of residential mortgages originated in the United States were being registered with MERS.¹⁴⁰ The only significant objections came from local real estate recording officials, who were angered that MERS had eliminated the revenues they had previously collected for recording

138. See, e.g., Gretchen Morgenson, *Audit Uncovers Extensive Flaws in Foreclosures*, N.Y. TIMES, Feb. 15, 2012, http://www.nytimes.com/2012/02/16/business/california-audit-finds-broad-irregularities-in-foreclosures.html?_r=1&nl=todaysheadlines&emc=th2 (reporting an audit of 400 recent foreclosures in San Francisco, and disclosing multiple errors with mortgage assignments); Gretchen Morgenson, *Flawed Paperwork Aggravates a Foreclosure Crisis*, N.Y. TIMES, Oct. 3, 2010, <http://www.nytimes.com/2010/10/04/business/04mortgage.html?pagewanted=all>.

139. Founders included Fannie Mae, Freddie Mac, the Government National Mortgage Association, the Mortgage Bankers Association, and a variety of other industry participants.

140. See Carson Mullen, *MERS: Tracking Loans Electronically*, MORTGAGE BANKING, May 2000, available at <http://www.thefreelibrary.com/MERS%3A+Tracking+Loans+Electronically.-a063975145>. MERS currently estimates that 60% of U.S. mortgages are registered with it. See Michael Powell & Gretchen Morgenson, *MERS? It May Have Swallowed Your Loan*, N.Y. TIMES, Mar. 5, 2011, <http://www.nytimes.com/2011/03/06/business06mers.html?ref=mortgageelectronicregistrationsystemsinc>.

mortgage assignments. The Suffolk County, New York, Clerk of Court took the radical step of refusing to record mortgages or assignments to MERS, but was ultimately ordered to do so by the New York Court of Appeals.¹⁴¹ Some commentators have continued to maintain that MERS should be held liable for the lost recording fees,¹⁴² and several recorders have filed suits to recover lost fees,¹⁴³ but these claims seem both forlorn and absurd.¹⁴⁴ They disregard a fundamental premise of the American recording system – that no one has any obligation to record anything.¹⁴⁵

In terms of market participation, MERS has been highly successful. At the same time, it has become bogged down in seemingly endless litigation, and is so widely castigated on internet blogs that one reading them would conclude MERS is at best illegal and a principal cause of the foreclosure crisis of the late 2000s,¹⁴⁶ and at worst a satanic threat to the American way of

141. *MERSCORP v. Romaine*, 861 N.E.2d 81, 82-83 (N.Y. 2006).

142. See Christopher L. Peterson, *Two Faces: Demystifying the Mortgage Electronic Registration System's Land Title Theory*, 53 WM. & MARY L. REV. 111, 143-55 (2011).

143. See David Dayen, *Dallas County Sues MERS for Unpaid Recording Fees*, FIRE DOG LAKE (Sept. 23, 2011), <http://news.firedoglake.com/2011/09/23/dallas-county-sues-mers-for-unpaid-recording-fees/>; *Bexar County Will Sue MERS over Unpaid Fees*, TEX. FORECLOSURE DEFENSE NETWORK (Oct. 26, 2011), <http://www.texasforeclosuredefensenetwork.com/san-antonio/2011/10/26/bexar-county-will-sue-mers-over-unpaid-fees/>; *Broke Counties Go After Banks and MERS for Filing Fees*, SANDHILLS N.C., <http://www.sandhillsnc.com/broke-counties-go-after-banks-and-mers-for-filing-fees.html> (last visited Jan. 17, 2013).

144. See *Brown v. Mortg. Elec. Registration Sys., Inc.*, No. 6:11-CV-06070, 2012 WL 5416922 (W.D. Ark. Sept. 17, 2012) (holding that county clerks had no standing to claim loss of revenue due to absence of recordings under MERS system or to require recordings of mortgage assignments); *Christian Cnty. Clerk ex rel. Kem v. Mortg. Elec. Registration Sys., Inc.*, No. 5:11CV-00072-M, 2012 WL 566807 (W.D. Ky. Feb. 21, 2012) (same).

145. Unrecorded conveyances are entirely valid as between the parties. The incentive for a grantee to record a conveyance arises from the possibility that, absent recording, the grantor will later make a conflicting conveyance to a bona fide purchaser, who will prevail over the first grantee. See *Cervantes v. Countrywide Home Loans, Inc.*, No. CV 09-517-PHXJATLEAD, 2009 WL 3157160, at *11 (D. Ariz. Sept. 24, 2009) (“Any lack of notice in the public records, however, to future buyers of Plaintiffs’ mortgages does not alter Plaintiffs’ obligations under the mortgages”), *aff’d*, 656 F.3d 1034 (9th Cir. 2011); *STOEBUCK & WHITMAN, PROPERTY*, *supra* note 16, § 11.9.

146. In late 2011 and early 2012 the Attorneys General of New York, Massachusetts, and Delaware sued several large banks and MERS, asserting that the MERS record-keeping system is illegal and fraudulent. See Gretchen Morgenson, *Massachusetts Sues 5 Major Banks over Foreclosure Practices*, N.Y. TIMES, Dec. 1, 2011, <http://www.nytimes.com/2011/12/02/business/major-banks-face-new-foreclosure-suit.html>; *New York Sues 3 Big Banks over Mortgage Database*, N.Y. TIMES, Feb. 3, 2012, <http://www.nytimes.com/2012/02/04/business/new-york-suing-3-banks-over->

life.¹⁴⁷ What went wrong to cause these enormous legal and public relations problems for MERS? There are many answers, but the material below will outline six of the principal issues that have plagued MERS.

A. A Weak Legal Foundation

MERS was founded as an ordinary Delaware stock corporation, with no special statutory basis for its existence.¹⁴⁸ It has no preemptive authority over existing mortgage or commercial law, and instead was designed to operate within the framework of pre-existing law. The architects of MERS elected to characterize it as a “nominee” for the actual holders of the loans. The use of nominees in commercial transactions is not unusual;¹⁴⁹ for example, brokers often hold shares of stock in a “street name” as nominee for the actual investor.¹⁵⁰ Nevertheless, the concept was apparently generally unfamiliar and confusing to judges. This fact gave foreclosure defense lawyers an opening wedge. They filed a multitude of suits attacking MERS’ operations, often arguing that as a nominee, MERS had no authority to execute assignments or

mortgage-database.html; *Complaint, Delaware v. Merscorp Inc. Go Go Beau!*, DEADLY CLEAR BLOG (Oct. 28, 2011), <http://deadlyclear.wordpress.com/2011/10/28/complaint-state-of-delaware-v-merscorp-inc-go-go-beau/>. The principal academic critic of MERS has been Professor Christopher Peterson. See Peterson, *supra* note 82; see also Ariana Eunjung Cha, *Banks’ Legal Right to Foreclose Is Questioned in Testimony Before House Panel*, WASH. POST, Dec. 2, 2010, <http://www.washingtonpost.com/wp-dyn/content/article/2010/12/02/AR2010120205224.html>s.

147. See, e.g., *Bombshell MERS Ruling: Process Illegal*, DAILY KOS (Feb. 14, 2011, 1:50 PM), <http://www.dailykos.com/story/2011/02/14/944523/-Bombshell-MERS-Ruling:Process-Illegal>; Ellen Brown, *Homeowners’ Rebellion: Could 62 Million Homes Be Foreclosure-Proof?*, YES! MAGAZINE, Aug. 18, 2010, <http://www.yesmagazine.org/new-economy/homeowners-rebellion-could-62-million-homes-be-foreclosure-proof>; Yasha Levine, *How an Obscure Outfit Called MERS Is Subverting our Entire System of Property Rights*, ALTERNET (Dec. 15, 2010), <http://www.alta.org/news/news.cfm?newsID=16630>; Scott J. Paltrow, *Life on MERS: Archive Is at Center of Mortgage Mess*, 4CLOSURE FRAUD (July 19, 2011), <http://4closurefraud.org/2011/07/19/life-on-mers-archive-is-at-center-of-mortgage-mess/>; L. Randall Wray, *Anatomy of Mortgage Fraud, Part I: MERS’s Smoking Gun*, HUFFPOST BUSINESS BLOG (Dec. 9, 2010), http://www.huffingtonpost.com/l-randall-wray/mers-smoking-gun-part-1-_b_794713.html.

148. MERS’ principal owners are the Mortgage Bankers Association, Fannie Mae, Freddie Mac, Bank of America, JPMorgan Chase Bank, HSBC Bank, CitiMortgage, GMAC Bank, the American Land Title Association, and Wells Fargo Bank.

149. See, e.g., *Fontenot v. Wells Fargo Bank*, 129 Cal. Rptr. 3d 467, 479 (Cal. Ct. App. 2011) (“A ‘nominee’ is a person or entity designated to act for another in a limited role – in effect, an agent.”).

150. See, e.g., *Smith v. Kisorin USA, Inc.*, 254 P.3d 636, 638 (Nev. 2011) (“[T]he beneficial holder of stock holds equitable title to the stock that is registered under the holder in street name.”).

appoint substitute trustees¹⁵¹ on behalf of the beneficial owner. After several significant initial losses,¹⁵² MERS began to win these cases quite consistently,¹⁵³ and the issue has now died down considerably.

B. Separation of Mortgage from Note

When MERS was created, a decision was made that MERS would hold only the mortgage, but not the associated promissory note. In light of the complexity and legal liability associated with storing and tracking many millions of notes,¹⁵⁴ this decision was entirely understandable; the administrative burdens of acting as custodians of the notes would have been huge. But this decision had the unfortunate result of giving rise to countless arguments about the apparent separation of the note from the mortgage, and about the extent to which a transfer of the mortgage would transfer the note, and vice versa. As with the suits based on MERS' supposed lack of authority to execute valid assignments, these cases have nearly all been ultimately resolved in MERS's favor,¹⁵⁵ but they have also imposed a huge litigation burden.

151. See, e.g., *Groseth v. Madison (In re Madison)*, No. 2:09BK-22225-PHX, 2010 WL 3941858 (Bankr. D. Ariz. Oct. 4, 2010).

152. *In re Agard*, 444 B.R. 231 (Bankr. E.D.N.Y. 2011), *vacated in part sub nom. Agard v. Select Portfolio Servicing, Inc.*, No. BR 8-10-77338 REG, 2012 WL 1043690 (E.D.N.Y. Mar. 28, 2012); *Bellistri v. Ocwen Loan Servicing, LLC*, 284 S.W.3d 619 (Mo. App. E.D. 2009); *Bank of N.Y. v. Alderazi*, 900 N.Y.S.2d 821 (N.Y. Sup. Ct. 2010).

153. See *In re Mortg. Elec. Registration Sys. (MERS) Litigation*, No. MDL 09-2119-JAT, 2011 WL 4550189 (D. Ariz. Oct. 3, 2011); *Velasco v. Sec. Nat'l Mortg. Co.*, 823 F. Supp. 2d 1061 (D. Haw. 2011); *Smith v. Cmty. Lending, Inc.*, 773 F. Supp. 2d 941 (D. Nev. 2011); *In re Lozez*, 446 B.R. 12 (Bankr. E.D. Mass. 2011); *Rogan v. Citimortgage (In re Jessup)*, 72 U.C.C. Rep. Serv. 2d 876 (Bankr. E.D. Ky. 2010); *Crum v. LaSalle Bank*, 55 So. 3d 266 (Ala. Civ. App. 2009); *Peace v. Mortg. Elec. Registration Sys., Inc.*, No. 4:09CV00966 SWW, 2010 WL 2384263 (E.D. Ark. 2010); *US Bank v. Flynn*, 897 N.Y.S.2d 855 (N.Y. Sup. Ct. 2010); *Deutsche Bank Nat'l Trust Co. v. Traxler*, No. 09CA009739, 2010 WL 3294292 (Ohio Ct. App. Aug. 23, 2010).

154. The total number of mortgages current registered with MERS is usually estimated at more than 60 million. See *Powell & Morgenson*, *supra* note 140.

155. Cases rejecting arguments based on separation of the mortgage and note include *King v. Am. Mortg. Network, Inc.*, No. 1:09CV162 DAK, 2010 WL 3516475 (D. Utah Sept. 2, 2010); *Nicholson v. OneWest Bank*, No. 1:10-CV-0795-JEC/AJB, 2010 WL 2732325 (N.D. Ga. Apr. 20, 2010); *Bank of N.Y. v. Raftogianis*, 13 A.3d 435 (N.J. Super. Ct. Ch. Div. 2010); *Deutsche Bank Nat'l Trust Co. v. Pietranico*, 928 N.Y.S.2d 818 (N.Y. Sup. Ct. 2011).

C. Use of Multiple “Corporate Officers”

It would have been literally impossible for MERS employees to execute and record all of the assignments and releases required by its enormous portfolio of registered loans. Instead, MERS adopted the practice of allowing its member lenders and servicers to appoint staff personnel as MERS corporate officers – typically vice presidents or assistant secretaries. By some reports, more than 20,000 such individuals were appointed at one time,¹⁵⁶ although the number has now dropped significantly. The result was, of course, to attach MERS’ name to literally millions of legal acts performed by people whom MERS had no capacity to train or supervise. Anecdotal evidence suggests that many of these “officers” were careless and sloppy in executing, acknowledging, and recording documents. There is no particular reason to think that they would have been any more competent or careful if they had been acting formally for their own employers (which they were, as a practical matter), but at least their shoddy work would not have reflected on MERS.

D. Foreclosure in the Name of MERS.

Until July 2011, when the practice was discontinued,¹⁵⁷ MERS permitted foreclosures of mortgages in its own name through the use of the thousands of supposed “corporate officers” mentioned above with dubious authority. This practice was much litigated,¹⁵⁸ and at the same time dealt MERS a severe public relations blow, because homeowners concluded that, “MERS is taking my house!” The practice was evidently adopted in response to mortgage holders (and particularly Fannie Mae and Freddie Mac) preferring not to be named plaintiffs in foreclosure actions for reputational reasons. This practice spared mortgage holders some of the blame for foreclosures at the expense of MERS.

156. See *MERSCORP CEO “There are 20,000 (Robosigners) of Those Nation Wide”*, STOP FORECLOSURE FRAUD (Nov. 2010), <http://stopforeclosurefraud.com/2010/11/20/video-merscorp-ceo-there-are-20000-robo-signers-of-those-nationwide/>.

157. MERS Policy Bulletin 2011-5, July 21, 2011.

158. Cases upholding MERS’ right to foreclose in its own name: *Velasco v. Sec. Nat’l Mortg. Co.*, 823 F. Supp. 2d 1061 (D. Haw. 2011); *Crafted Homes, Inc. v. Burnett (In re Burnett)*, 450 B.R. 589 (Bankr. W.D. Va. 2011); *Ferguson v. Avelo Mortg., LLC*, 126 Cal. Rptr. 3d 586 (Cal. Ct. App. 2011), *cert. denied*, 132 S. Ct. 2772 (2012); *Residential Funding Co., LLC v. Saurman*, 805 N.W.2d 183 (Mich. 2011). *Contra* *Mortg. Elec. Registration Sys., Inc. v. Graham*, 247 P.3d 223 (Kan. Ct. App. 2010) (rejecting MERS’ right to foreclose on the ground that it had suffered no injury from the default); *Mortg. Elec. Registration Sys., Inc. v. Saunders*, 2 A.3d 289 (Me. 2010) (same); *Weingartner v. Chase Home Fin., LLC*, 702 F. Supp. 2d 1276 (D. Nev. 2010) (“MERS’ ‘beneficial interest’ is nonexistent unless MERS holds the underlying debt, and it does not.”).

Related problems have arisen with MERS in its capacity as a nominal mortgagee for purposes of receiving notice of other legal proceedings affecting the real estate or the loan. MERS operates a “mail room” facility for the purpose of passing along such notices to the real holder of the promissory note. Unfortunately, several courts have held that, because it is a “mere nominee” and not the actual holder, it is not a real party in interest and has no right to be joined or notified of such proceedings.¹⁵⁹ The result has been to deny notice to parties who were obviously in need of it, thereby robbing them of their priority or the opportunity to put on a defense – a spectacularly unjust outcome.

E. Transparency

MERS has traditionally offered only limited transparency to debtors or the public. Its web site’s query system was set up mainly to provide the identity of the servicers of its loans, and it strongly encourages borrowers with questions or concerns to contact their servicers.¹⁶⁰ Until July 2010, it was not possible for a mortgage debtor to discover the identity of the investor who held his or her mortgage (as distinct from the servicer) by a query to the MERS web site.¹⁶¹ Information about investors has now been added,¹⁶² and individual investors are no longer permitted to opt out of the database.¹⁶³

MERS’ traditional reluctance to help borrowers identify investors is understandable. For the most part, investors do not want to communicate with

159. Landmark Nat’l Bank v. Kesler, 216 P.3d 158 (Kan. 2009).

160. See *FAQ: Why Do I Need to Know the Identity of my Servicer?*, MERS, <http://www.mersinc.org/information-for-homeowners/faq-information-for-homeowners#howcanifindout> (last visited Jan. 17, 2013) (“If you are unable to make the payments on your mortgage and wish to negotiate the terms of your loan, you may only do so with your Servicer. Contrary to popular belief, it is your servicer and not the investor that can negotiate the terms of the loan with you”).

161. See Ralph Roberts, *Who Owns My Mortgage?*, REALTY TIMES (Apr. 27, 2009), http://realtytimes.com/rtpages/20090427_ownmortgage.htm (“MERS makes the name and contact information of the servicer available, but not the name and contact of the investor. That information is for the servicer or investor to disclose, not MERS”). Note that this statement is no longer entirely correct. See *infra* note 162.

162. See Karmela Lejarde, Press Release, MERS, MERS Expands Website to Disclose Loan Investor Information, (July 16, 2010), available at <http://www.mersinc.org/media-room/press-release/archives-2010/27-media-room/press-release-archives/2010-articles/263-mers-expands-website-to-disclose-loan-investor-information>.

163. E-mail from Bill Beckman, President, MersCorp Holdings, Inc., to author (March 28, 2012) (on file with author) (“MERSCORP discloses 100% of servicers and over 98% of investors via our website or toll free line to borrowers (it’s no longer an investor opt-in) . . . a change made last year due to the groundswell of concern over ‘transparency.’”).

mortgage borrowers; rather, they want their servicers to perform this task. Many of them are banks serving as trustees of securitized mortgage trusts. They lack the staffs and resources to carry on such communications, and if they attempt it, they run the risk of making statements or taking actions that will run counter to their own servicers' decisions.

Borrowers are apt to view the situation quite differently. In many cases they have received abysmally poor assistance and communication from servicers,¹⁶⁴ and they understandably want satisfaction from those who employ those servicers. As a consequence of recent changes in MERS policy, they can now identify the relevant investors. The statement of MERS' former president that "the MERS process of tracking mortgages and holding title provides clarity, transparency and efficiency to the housing finance system,"¹⁶⁵ once wildly optimistic, is now much closer to the truth.

F. Loan Tracking Accuracy

It is widely asserted that MERS' records of mortgage ownership, even when they are available, are often inaccurate. It is difficult to assess the truth of this claim with any precision, but it would hardly be surprising if it were so. MERS has no leverage to require its members to report loan transfers to it, and it is likely that large numbers of transfers go unreported. Until a mortgage needs to be foreclosed or released, MERS simply does not need information about who holds the loan. Hence, one cannot treat MERS as a source of correct information about the identity of mortgage loan investors, just as (and for the same reason that) local public real estate records often did not provide correct information identifying investors in the pre-MERS era.¹⁶⁶ This fact has clearly undermined MERS' credibility.

In summary, MERS labors under serious structural problems which make it a far cry from the sort of transparent, accurate, and reliable system of mortgage loan registration that many expected it to become when it was founded. While these problems have widely been attributed to bad faith or bad motives, those criticisms are largely unfair and unwarranted. Given the fact that MERS had no statutory foundation for its creation, its decisions may generally have seemed reasonable when they were made, even though many of them have worked out poorly. Conceivably a statutory revamping of

164. See Nelson D. Schwartz, *Some Doubt a Settlement Will End Mortgage Ills*, N.Y. TIMES, Feb. 20, 2012, http://www.nytimes.com/2012/02/21/business/some-doubt-a-settlement-will-end-mortgage-ills.html?_r=1 (recounting difficulties of borrowers in communicating with mortgage servicers).

165. See Karmela Lejarde, Press Release, MERS, Statement by R.K. Arnold, President and CEO of MERSCORP, Inc. (Oct. 9, 2010), available at <http://www.mersinc.org/media-room/press-release/archives-2010/27-media-room/press-release-archives/2010-articles/261-statement-by-r-k-arnold-president-and-ceo-of-merscorp-inc>.

166. See *supra* notes 77-80 and accompanying text.

MERS could be accomplished, but by now MERS' public reputation is so tarnished that such an effort seems likely to be frustrating and ultimately fruitless.

At the same time, it is more obvious than ever that some sort of MERS-like organization is needed to track the movements of the more than sixty million mortgages in the national secondary market. What is needed is a fresh approach – one that will take the lessons of MERS into account, and will create a nationwide mortgage registration system without the limitations and defects of MERS – in other words, MERS done right. That is the subject of the next section of this Article.

III. FEATURES OF A NATIONAL MORTGAGE LOAN REGISTRY

I propose to outline here the features of a national mortgage loan Registry¹⁶⁷ that would be efficient and transparent; that is, it would be simple and inexpensive to register and transfer mortgage loans in the system, and the system would quickly and conveniently provide information about loan ownership and servicing authority to those who need it. I have provided in an Appendix a draft of a statute that I believe would achieve these ends, and numerous footnotes in this section refer to the provisions of that statute.

A. Federal Preemption.

The system I envision must be enacted by Congress in order to preempt state law.¹⁶⁸ While in theory changes in state law could accomplish the goal of creating a national registry, there are at least four reasons why a state-oriented approach would likely be exasperatingly slow and uncertain in outcome, and why preemption is necessary.

First, state law is bogged down with the inherent ambiguities of the UCC Article 3's definition of negotiability, and the fact that only negotiable notes are governed by Article 3.¹⁶⁹ One of the primary tasks of a federal statute would be to eliminate this distinction so far as mortgage notes are concerned, and to treat all mortgage notes alike. The uncertainty concerning what state law governs their transfer would become irrelevant.

Second, a federal statute would eliminate the necessity for physical delivery of the original promissory note as a means of transferring the right of enforcement, as is now required by UCC Article 3 for negotiable notes.¹⁷⁰ The embodiment of the legal right in the physical instrument made sense in

167. I have capitalized the term "Registry" throughout this section when using it to refer to the registry that would be created by the Draft Statute, and to distinguish it from MERS and other possible registration systems.

168. Draft Statute § 112.

169. See *supra* notes 89-96 and accompanying text.

170. See *supra* notes 98-112 and accompanying text.

the era in which it was invented, but it is absurdly archaic in a time when records of virtually all property rights are maintained in electronic databases. The burdens and risks of transferring such huge volumes of paper are unnecessary and unacceptable. Again, federal preemption can readily eliminate the need for this practice.

Third, federal preemption can short-circuit the ongoing avalanche of litigation over precisely what proof is needed to foreclose a mortgage or bring a suit on a mortgage note. American law is a confused morass on this issue. In a single stroke, a federal statute can provide that an appropriate certificate issued by a national mortgage Registry is adequate proof of the right to foreclose in every jurisdiction in the country.¹⁷¹

Fourth, a federal statute could immediately eliminate the confusion that has arisen about the supposed separation of the note and mortgage under the MERS system.¹⁷² A proper national registration system would not need to engage in the “nominee” sophistry on which MERS is based: it would track the right to enforce, but would not become the owner or an agent of the owner, of notes or mortgages. Moreover, the governing statute could declare unambiguously that the mortgage and note cannot be separated, and that holding one is always holding both.¹⁷³

Is federal law really needed for these purposes? Could not modifications of state law accomplish the same things? In theory, the answer is yes, but only in part, and only if we are willing to wait a very long time. Work has already begun on some elements of the task outlined above. In January 2012, the National Conference of Commissioners on Uniform State Laws announced the formation of a drafting committee to work on a uniform act dealing with the proof that must be adduced to foreclose a mortgage.¹⁷⁴ Tentatively entitled the Residential Real Estate Mortgage Foreclosure Process and Protections Act, this effort will almost certainly take at least two years to complete.¹⁷⁵ It is not yet clear what form the act will take, and whether the result will gain traction with state legislatures is anyone’s guess. State enactment is at best an incremental process requiring many years to complete.¹⁷⁶

171. Draft Statute § 112(a).

172. See *supra* notes 154-55 and accompanying text.

173. Draft Statute § 102(4).

174. See *Mortgage Foreclosure: Resolution to Create Drafting Committee and Issues List*, UNIFORM L. COMMISSION (Jan. 20, 2012), http://www.uniformlaws.org/shared/docs/mortgage%20foreclosure/2012may_RREMFPP_Resolution%20and%20Issues%20List.pdf.

175. Each uniform act must be considered at no less than two annual meetings before adoption by the Conference. *ULC Drafting Process*, UNIFORM L. COMMISSION, <http://www.uniformlaws.org/Narrative.aspx?title=ULC%20Drafting%20Process> (last visited Jan. 17, 2013). Many acts have required more than two years to complete. See *id.*

176. This is well illustrated by the “progress,” such as it is, of the 2002 amendments to U.C.C. Article 3, which among other things broaden the basis upon which a

National uniformity is highly desirable from the viewpoint of mortgage servicers, who otherwise must keep track of and qualify under multiple state law variations, as they do now. But some states may never adopt the act, leaving uniformity a chimerical goal. By comparison, congressional action can provide nationwide uniformity immediately.

What of the other state law changes mentioned above – those that depend on the operation of UCC article 3? Again, in theory the state law answer is simple: the Permanent Editorial Board of the Uniform Commercial Code could recommend, and a drafting committee could then adopt, appropriate changes to Article 3. One straightforward approach would be simply to declare that all promissory notes secured by real property are nonnegotiable.¹⁷⁷ I have previously recommended this step.¹⁷⁸ However, the Permanent Editorial Board has shown no disposition to recommend any action with respect to mortgage notes, and the matter appears to be in stasis. The reasons for this unwillingness to act are unclear, and it is uncertain whether any change in attitude is likely in the foreseeable future.¹⁷⁹ Even if it were to occur, the time required to make the changes applicable throughout the states would probably be lengthy.

Registering and tracking mortgage loans in the United States is a national issue that requires a nationwide solution. No existing federal agency has the authority to create such a solution, nor the power to preempt state law in the process of doing so. When mortgage loans were assets traded only at the local level, or not at all, state law may have been satisfactory. Today that

“lost note affidavit” under U.C.C. § 3-309(g) may be employed by a party enforcing a negotiable note. *See supra* notes 101-07 and accompanying text. Ten years after adoption by the Permanent Editorial Board, this amendment has been enacted in only ten states.

177. This step would eliminate the need to characterize individual mortgage notes as negotiable or not, and also eliminate the necessity for physical delivery of the note as a means of transferring the right of enforcement.

178. *See Whitman, How Negotiability Has Fouled Up the Secondary Mortgage Market, supra* note 3, at 770.

179. On May 9, 2011, a “stakeholder’s meeting” was held in Washington, D.C., sponsored jointly by the American Law Institute and the National Conference of Commissioners on Uniform State Laws. The meeting was attended by representatives of most of the major federal agencies and trade organizations that deal with the mortgage market. Its purpose was to discuss proposals for resolving some of the uncertainties that have generated litigation surrounding the secondary market and foreclosures. At that meeting, several other speakers and I recommended that the Permanent Editorial Board review the status of mortgage notes under UCC Article 3 with a view to clarifying the ambiguities and inefficiencies mentioned in the text. Following the meeting, the Commissioners on Uniform Laws created a study committee that led, some eight months later, to the formation of the drafting committee mentioned previously. *See supra* note 174 and accompanying text. However, the American Law Institute did not elect to take any specific action in response to these comments, and without ALI direction, it appeared unlikely that the PEB would take action.

era has passed. Only action by Congress can address the needs of the national market that now exists.

B. What is Being Registered – Ownership or the Right to Enforce?

It is important to be perfectly clear about what legal attributes are to be registered in a new registration system. We sometimes use the term “ownership” to describe the rights of mortgage investors, but it should be employed only in a colloquial sense. The Uniform Commercial Code distinguishes between ownership and the “entitlement to enforce” a note.¹⁸⁰ In essence, any third party who can identify the person “entitled to enforce” the note can deal safely with that person. Thus, the basic obligation under the note is to pay that person, and payment to him or her will discharge the note, while failure to pay that person when due will constitute dishonor – in effect, a default on the note.¹⁸¹

It is this quality that needs to be tracked in a mortgage Registry, so that all third parties can determine, by reviewing the Registry that they are dealing with the correct person for all purposes. Ownership, as the UCC understands the term, is a different matter; it determines who is entitled to the economic benefits of the note – the money received when the note is paid, for example. While this is usually the same as the “person entitled to enforce,” it is not necessarily so.¹⁸² But third parties who look up a loan in the national Registry have no particular interest in learning the identity of the “owner” of the note in this sense. They simply need to know that if they pay, or agree to a modification with, or are foreclosed by, the person identified in the Registry, they are dealing with (or being dealt with by) the person with the proper authority. Once the note is paid, for example, the person who has paid it simply does not care if the person receiving the payment has a duty to hold the funds for, or remit them to, someone else – an “owner” in UCC parlance, as distinct from a person entitled to enforce.

In the Draft Statute in Appendix A, I have chosen to use the term “holder” as a shorthand way of describing the person that UCC Article 3 would say is “entitled to enforce” the note.¹⁸³ This usage is similar to Article 3’s use of the same term, and thus has the advantage of familiarity.¹⁸⁴ The Draft Statute, however, expands the grant of authority of the holder to include all forms of enforcement of the mortgage itself as well as the note, so as to

180. See *supra* notes 91-93 and accompanying text.

181. See PEB REPORT, *supra* note 21, at 4.

182. See *supra* notes 90-92 and accompanying text.

183. Draft Statute § 102(3).

184. This is not to say that the Draft Statute’s requirements for becoming a holder are identical to U.C.C. Article 3’s requirements. See U.C.C. § 3-301 (2012). Under the Draft Statute, unlike U.C.C. Article 3, a person need not have taken physical delivery of the note in order to be a holder, and there is no provision for (and no need for) a “lost note affidavit” procedure if the original note cannot be produced.

make it completely clear that the same party can enforce both instruments, and that the two instruments are bound together as if they were one. The most obvious illustration of this expansion is the positive statement in the Draft Statute that the holder can foreclose the mortgage securing the note.¹⁸⁵ Likewise, the holder of the note and mortgage can agree to a modification of the obligation, or consent (under the authority of a due on sale clause) to a transfer of the real estate securing the note. The holder can also bring an action to enforce any covenant in the mortgage (as well as the note, of course), although admittedly such actions are not very common. Overall, the concept adopted in the Draft Statute is that the holder can safely be dealt with by the maker-mortgagor or any other person for any purpose related to the note or the mortgage.¹⁸⁶ Finally, only the holder can make a transfer of the mortgage loan to another holder.¹⁸⁷

Thus, the Draft Statute is about registering *holders*. The Registry need not be concerned with relations between holders and owners (in the cases in which they are, indeed, different), for anyone who deals with the holder will be assured that the resulting bargain is binding on the owner as well. Indeed, the Draft Statute provides in effect that an owner who is not also a holder has no authority to deal with the maker or other parties.¹⁸⁸ UCC Article 9 governs the rights of owners as such, and provides, in substance, that one who buys the rights to a note may become an owner either by taking possession of the note or by a written agreement signed by the transferor.¹⁸⁹ This approach will continue to be entirely satisfactory if the Draft Statute is adopted, and there is no need for the Registry to preempt it or deal with it further.

The Registry must also accommodate “transferrable electronic records.” This concept was developed to permit the use of electronic promissory notes in lieu of paper notes, primarily in real estate loan transactions. The distinguishing feature of a “transferrable electronic record” is that only one authoritative electronic copy can exist at a time. When such a note is transferred, the copy held by the transferee becomes authoritative, while any copy retained by the transferor becomes non-authoritative. The result is the practical equivalent of physical delivery of an original paper note, and satisfies the delivery requirement for negotiable notes under UCC Article 3.¹⁹⁰ The person to whom the note is issued or transferred is said to have “control” of the record, and only that person can authorize a further transfer or a modification of the

185. Draft Statute § 109(1). U.C.C. Article 3 seems to imply this, but never states it directly, and as we have seen, a cluster of cases appears to deny that it is so. See *supra* notes 112-31 and accompanying text.

186. Draft Statute § 109.

187. Draft Statute § 103(b), (c).

188. Draft Statute § 109.

189. See U.C.C. § 9-203; PEB REPORT, *supra* note 21, at 9-10.

190. See *supra* notes 97-100 and accompanying text.

record. Both the Uniform Electronic Transactions Act (UETA)¹⁹¹ and the federal eSign¹⁹² statute authorize transferrable electronic records in virtually identical language.

Because the use of electronic note is gradually growing, it is obviously desirable for the federal mortgage loan Registry to recognize and register promissory notes in electronic form. Under existing statutory definitions, the person having “control” of the record is the holder of the note for purposes of UCC Article 3.¹⁹³ Hence, the Registry must maintain a record of, and certify the identity of, that person. The Draft Statute defines “holder” to mean the person with control in the case of a transferrable electronic record,¹⁹⁴ so that a certificate from the Registry identifying the holder will *ipso facto* certify the identity of the person with control.

C. Registration or Recording?

There are two kinds of land records system in the United States, recording and registration.¹⁹⁵ This section will explain the conceptual differences between them, and will explain why the registration model is the one on which a national mortgage Registry should be based.

By far the more prevalent system for American land records is termed “recording.” A recording system is much like a public library. Individuals (usually grantees or recipients of land interests) may enroll their documents in the system, and other individuals are free to consult the system and try to locate the documents that are relevant to their plans (usually to buy or take a security interest in a parcel of land). The officials who operate the system are responsible only for accepting documents and indexing them in an organized fashion so that they can be located later; they make no attempt to determine who holds ownership rights or other interests in any particular parcel of land, and they make no averment of such rights to persons searching or inquiring of the system. In effect, members of the public are invited to search the records and draw their own conclusions, an activity in which they typically get the assistance of attorneys or title insurers.

In a recording system, no one is legally obligated to record anything and documents are fully valid as between their parties without recording. However, persons receiving documents that transfer interests to them have a strong incentive to record those documents because if one fails to record,

191. UNIF. ELECTRONIC TRANSACTIONS ACT § 16 (2012). UETA has been adopted in all states except Illinois, New York, and Washington, which have locally-tailored legislation that is roughly equivalent. *Uniform Electronic Transactions Act*, NAT’L CONF. ST. LEGISLATURES, <http://www.ncsl.org/issues-research/telecom/uniform-electronic-transactions-acts.aspx> (last visited Nov. 26, 2012).

192. 15 U.S.C. § 7021 (2006).

193. *Id.* § 7021(d); UNIF. ELECTRONIC TRANSACTIONS ACT § 16(d).

194. Draft Statute § 103(c), (f).

195. See generally STOEBUCK & WHITMAN, PROPERTY, *supra* note 16, § 11.9.

one's grantor may later make a conflicting conveyance of the same property to a different grantee who, if properly qualified, may prevail over the original (but unrecorded) recipient.¹⁹⁶

A registration system is an entirely different creature.¹⁹⁷ The public officials who operate a registration system are responsible to track, not merely documents, but actual property interests. They issue certificates of *title* to persons acquiring interests in land, and those certificates are legally conclusive. Most of the developed world uses title registration systems,¹⁹⁸ but in the United States it is available in only nine states, and is little used in most of them.¹⁹⁹

The Draft Statute would create a registration system, not a recording system. The principal advantage of registration is that the certificates of the Registry would be conclusive.²⁰⁰ In effect, this means that they could not be legally incorrect. If the Registry's certificate states that a mortgage is held by a certain party, then that party *is* the holder. This is a powerful feature; it means that anyone relying on the Registry can do so with complete confidence.

At the same time, there are powerful disadvantages. Any system of title registration can make mistakes, either because of human error or because it has received fraudulent information. If such mistakes have the effect of vesting the holding of a mortgage loan in the hands of someone who is not entitled to it, someone else will have been wrongfully deprived of that mortgage loan. The deprived party will not be happy, and may come to the Registry and seek compensation. To be fair and just, the Registry must provide such compensation, and must have funds out of which compensation can be paid.

This is the feature that, probably more than any other, made the existing Torrens land title registration systems in the United States unsatisfactory. It was widely asserted that compensation funds were inadequate, and compensation was hard – sometimes bordering on impossible – to obtain, often requiring litigation.²⁰¹ However, there are some aspects of a *mortgage* registration system, as compared with a land title registration system, that greatly ameliorate these problems. First, there is the fact that we are only talking about money. Land is different: people have personal, family, and social

196. *Id.*

197. See generally *id.* § 11.15.

198. See Tim Hanstad, *Designing Land Registration Systems for Developing Countries*, 13 AM. U. INT'L L. REV. 647, 649 (1998).

199. STOEBUCK & WHITMAN, PROPERTY, *supra* note 16, § 11.15.

200. Draft Statute § 110.

201. See BARLOW BURKE, REAL ESTATE TRANSACTIONS: EXAMPLES AND EXPLANATIONS 221 (4th ed. 2006); Comment, *The Torrens System of Title Registration: A New Proposal for Effective Implementation*, 29 UCLA L. REV. 661, 680-81 n.95 (1982); Report 76 - *Torrens Title: Compensation for Loss*, NEW S. WALES L. REF. COMMISSION (1996), <http://www.lawlink.nsw.gov.au/lrc.nsf/pages/r76toc>.

attachments to land,²⁰² and money may be a poor substitute for those attachments. But no one has a personal attachment to a mortgage loan, and money is always a perfectly acceptable substitute.

A second distinction between land title registration and mortgage registration is that it is entirely unnecessary for the mortgage loan Registry to be concerned about land titles or land descriptions. One of the most challenging aspects of administering a Torrens land registration system arises from the need to identify unambiguously the parcel or parcels of land affected by any transaction. This requires a great deal of training and skill, particularly when one considers all of the ways in which land parcels can be subdivided and combined. It is easy to make a mistake.

A mortgage loan, on the other hand, can easily be assigned a unique identifying number when the loan is originated or registered, and that number can be used to track it throughout its life. We have been doing this with the Vehicle Identification Numbers on motor vehicles for many decades.²⁰³ MERS has used just such a system of mortgage identification numbers, and in that respect MERS seems to have worked exceptionally well. A further simplifying factor is that the holding of mortgage loans, unlike land, is never consolidated or subdivided. The mortgaged land's description or identification will be completely outside the scope of the Registry's operations. Investors in mortgage loans will continue to rely on title insurance, as at present, for land title security.

Other steps can be taken to minimize the risk of the Registry's issuing erroneous certificates. Fraudulent submissions to the Registry can be discouraged, if not entirely avoided, by the existence of heavy criminal penalties and civil liability.²⁰⁴ Standardized data sets and electronic formats can help avoid errors; indeed, the Federal Housing Finance Agency has been working aggressively on developing just such data sets.²⁰⁵ Moreover, if the Registry

202. See, e.g., *Lobato v. Taylor*, 71 P.3d 938, 942-43 (Colo. 2002) (holding that a 77,000 acre parcel in southern Colorado held by way of Torrens title was subject to easement rights of several thousand descendants of the original Mexican settlers).

203. Motor vehicle title histories are maintained and tracked by the National Motor Vehicle Title Information System, established by the Anti Car Theft Act of 1992, and operated under the authority of the U.S. Department of Justice by the American Association of Motor Vehicle Administrators. See 49 U.S.C. §§ 30502, 30503 (2006). The functions of the agency are nicely explained in the preamble to 28 C.F.R. § 25.51 (2010).

204. Draft Statute § 113.

205. The Federal Housing Finance Agency has described its efforts to develop mortgage information standards as follows:

The Uniform Mortgage Data Program will improve the consistency, quality, and uniformity of data collected at the beginning of the lending process. Developing standard terms, definitions, and industry standard data reporting protocols will decrease costs for originators

issues an erroneous certificate, it should have the power to revoke it if no person has relied upon it detrimentally and in good faith.²⁰⁶

No system is perfect, and doubtless errors will sometimes occur, requiring the payment of compensation. But it seems entirely plausible to assume that errors will be rare and manageable, and that the system can readily build their cost into its fee structure.

D. Initial Recording of Mortgages

The Draft Statute requires, as a condition of the registration of any mortgage loan in the Registry, that the mortgage itself first be recorded or registered in the land records under state law in order to establish its priority.²⁰⁷ This is absolutely essential, for the Registry is not intended to determine the mortgage's validity or priority as against other interests under state law, or to be a substitute for local recording of the mortgage itself. The existing state recording system works well enough for that purpose, and attempting to supplant it with a federal system would vastly expand the Registry's role, and would create conflicts and complexities that are entirely unnecessary. In theory, it would be possible for the Draft Statute to treat an unrecorded mortgage as acceptable for registration in the federal Registry, but no one except a fool takes a mortgage on land without recording it, and there is no need for the Registry to serve fools.

E. Electronic Registration and Transfer and the Problem of Document Authenticity.

The Registry, as envisioned in the Draft Statute, will be a paperless operation.²⁰⁸ Initial registrations and all transfers from one holder to another

and appraisers and reduce repurchase risk. It will allow new entrants to use industry standards rather than having to develop their own proprietary data systems to compete with other systems already in the market. Common data definitions, electronic data capture, and standardized data protocols will improve efficiency, lower costs and enhance risk monitoring. Standardizing data will be a key building block of housing finance reform.

News Release, Fed. Housing Fin. Agency, FHFA Sends Congress Strategic Plan for Fannie Mae and Freddie Mac Conservatorships 10 (Feb. 21, 2012), *available at* <http://www.fhfa.gov/webfiles/23344/StrategicPlanConservatorshipsFINAL.pdf>.

206. Draft Statute § 110(c).

207. Draft Statute § 103(a).

208. The Draft Statute permits paper registrations, but it is expected that they will be rare. *Id.*

will be accomplished electronically. This means that the reliability and authenticity of the original registration process is critical.²⁰⁹ The Registry can identify an entity registering a mortgage loan, and verify the authenticity of the message containing the registration data, through the use of public key cryptography. There are a number of experienced, reliable providers of digital signatures based on this technology, and if their services are properly used, one can have extremely high confidence in the identity of the sender and the fact that message as received was exactly what was transmitted. The same procedure can be used when a holder wishes to transfer an already-registered loan. While the technical details of these operations are outside the scope of the present Article, they are readily available from other sources.²¹⁰

This leaves the question of the authenticity of the original loan documents. The party submitting the mortgage loan for registration can and should be required to attach scans of the note and mortgage, including their signature pages.²¹¹ But that does not prove that the documents are not forgeries. A mortgagee title insurance policy provides protection against forgery of the mortgage, at least in the hands of a transferee from the original mortgagee. But title insurance does not cover the note,²¹² and a mortgage without an accompanying authentic note is worthless.

Of course, this problem is not unique to an electronic Registry. A paper document purporting to be an original promissory note might be also a forgery, and there have surely been instances of such false notes being sold on the secondary market.²¹³ Almost universally, under the purchase and sale agreement the seller of such a note is obligated to buy it back and reimburse the purchaser.²¹⁴ But this is cold comfort if the seller has been dissolved or is insolvent, as crooked sellers of mortgage loans tend to be.

209. Draft Statute § 103(d).

210. See, e.g., R.J. Robertson, Jr., *Electronic Commerce on the Internet and the Statute of Frauds*, 49 S.C. L. REV. 787, 820-21 nn.197-209 (1998); Dale A. Whitman, *Are We There Yet? The Case for a Uniform Electronic Recording Act*, 24 W. NEW ENG. L. REV. 245, 258-59 nn.60-63 (2002).

211. Draft Statute § 107. Other essential documents in the preregistration “chain of title” of the loan, such as mortgage assignments, note endorsements or allonges, and any modification, substitution, or assumptions agreements should also be submitted with registration. *Id.* § 107(a).

212. See *First Am. Title Ins. Co. v. XWarehouse Lending Corp.*, 98 Cal. Rptr. 3d 801 (Cal. Ct. App. 2009) (finding title insurance policy provided no compensation to holder of forged promissory note); see also *Reyes v. Stewart Title of Cal.*, No. B224192, 2011 WL 3305974, at *3 (Cal. Ct. App. Aug. 3, 2011) (unpublished) (absolving an escrow company of liability in a scheme by which a mortgage broker obtained a borrower’s forged or fraudulent signature on a promissory note).

213. See, e.g., *Maddox v. Summit Mortg. Corp.*, No. 09-00-771 CV, 2001 WL 1805883 (Tex. Ct. App. Mar. 7, 2002).

214. See, e.g., POOLING AND SERVICING AGREEMENT, *supra* note 79, § 2.03:

Upon discovery or receipt of notice of any materially defective document . . . the Trus-

Perhaps the best answer to this question is for the Registry not to assume liability for the legal authenticity of the underlying documents. This would leave the Registry to say, in effect, “We assure anyone relying on our records that the holder of this note and mortgage is indeed the person our records indicate. However, we do not provide assurance that the note and mortgage themselves are authentic documents signed by the maker and mortgagor.”²¹⁵ This position should not produce any great shock in the market; after all, the traditional recording system provides no protection against forged or fraudulent documents, either. Indeed, for forged notes (as distinct from mortgages, for which title insurance is available) there is no protection to investors except to use caution in deciding with which originators or sellers they will do business.

F. Registration of Servicing

In most cases, it is not very useful for a mortgagor to know the identity of the investor who holds his or her loan. The reason is that the investor has usually delegated to a servicer the authority to deal with the mortgagor; indeed, the investor typically is not equipped to, and does not wish to, have direct contact with borrowers.²¹⁶ Hence, for a Registry to be helpful to borrowers, it must reveal the servicer’s name and contact information as well as that of the holder of the loan.

This is not to suggest that anyone has been trying to hide this information. MERS, for example, proclaims itself keen to help mortgagors contact their servicers.²¹⁷ Federal law requires notification to the mortgagor of a “federally-related” mortgage loan each time servicing is transferred.²¹⁸

tee shall promptly notify . . . the Seller . . .
and request that the Seller . . . cure such defect or breach [and upon its failure to do so]
. . . the Trustee[] shall enforce the obligations of the Seller under the Mortgage Loan Purchase Agreement to repurchase such Mortgage Loan.

See also, e.g., Lehman Bros. Holdings, Inc. v. 1st New England Mortg. Corp., No. 09-11082-GAO, 2012 WL 3984413 (D. Mass. Sept. 12, 2012) (upholding a loan originator’s repurchase obligation where the loan was based on a fraudulent loan application).

215. *See* Draft Statute § 110(a).

216. *See supra* notes 160-65 and accompanying text.

217. *See* the *MERS ServicerID*, MERS, <https://www.mers-servicerid.org/sis/> (last visited Jan. 18, 2013).

218. The Real Estate Settlement Procedures Act (RESPA), 12 U.S.C. § 2605 (2006), requires the existing servicer to notify the borrower no less than 15 days before the transfer, and the new servicer to notify the borrower within 15 days after the transfer. Under 2009 amendments to the Truth in Lending Act, 15 U.S.C. §

Servicers are usually eager to keep mortgagors up to date, because they want to avoid any excuse for late or missing payments.

The term “servicer” is not, however, self-defining. A servicer is an agent with specific authority, and it is desirable for the holder of the loan to spell out that authority in a way that is available and intelligible to the public. For this reason, the Draft Statute allows holders to designate servicers in the Registry’s records²¹⁹ (as they have a strong self-interest in doing), but requires that those doing so must provide a brief description of the servicer’s authority.²²⁰ This could easily be accomplished with a “check the box” system for the usual powers, along with an opportunity to provide a textual explanation of any unusual authority. There would be no objection to a holder identifying multiple servicers, perhaps with different scopes of authority.

G. Capturing the Entire Loan File

To be truly useful to investors and servicers, the Registry should encourage registrants to submit the entire loan file to the Registry’s custody. As mentioned above, full scanned images of the note and mortgage – the two documents that form the legal core of the loan transactions – should be held by the Registry.²²¹ Secondary market investors typically insist on receiving copies of a number of other documents from the loan file as well: the appraisal, credit report, lender’s title insurance policy, mortgage insurance application and certificate, and any pre-registration assignments, modifications, or assumption agreements.

Standards have been developed or are currently in development by the Mortgage Industry Standards Maintenance Organization (MISMO) for the representation of all of these types of documents in digital form.²²² MISMO, established in 1999, was created “to coordinate the development and maintenance of Internet-based Extensible Markup Language (XML)” data sets for

1641(g)(1) (Supp. III 2009), consumer borrowers are also entitled to mailed notice of the identity of the new creditor (investor) within 30 days after a transfer of the loan itself.

219. Draft Statute § 106.

220. *Id.* For example, does the servicer have authority to modify the loan? To subordinate it to other liens? To approve a sale of the real estate under the mortgage’s due-on-sale clause? To issue a satisfaction when the loan is paid? To foreclose? This information should assist borrowers in being certain that they are seeking answers from the right entity.

221. Draft Statute § 107.

222. For example, the MISMO standard data sets for the common documents in residential mortgage transactions may be seen online. See *Residential Specifications*, MISMO, <http://www.mismo.org/Specifications/ResidentialSpecifications.htm> (last visited Jan. 18, 2013).

all of the usual documents employed in mortgage loan transactions.²²³ Using MISMO's standards, it would be feasible for a national mortgage Registry to capture and preserve the essential elements of any loan file, residential or commercial, in a standardized, compact, and efficient form.²²⁴ There would be no need for scanned images of these documents, as the XML data would contain all of the variable information from them.

Of course, inclusion of this additional data would be optional with the registrant, but there is reason to expect it to be extremely popular. Centralizing this data in a national Registry would mean that it would be unnecessary for one mortgage holder to transfer photocopies of the file documents to another when a loan was sold on the secondary market. A transfer of the loan in Registry would automatically make the full file available to the loan's new holder. There are huge efficiencies to be gained by such a procedure, and it might be one of the most attractive features of a national Registry to the mortgage industry.

H. Transparency

In the United States we have long been accustomed to the notion that the identity of a mortgage holder is a matter of public record. As discussed earlier, in recent decades this has been far from universally true, as mortgage investors have increasingly abandoned the practice of recording mortgage assignments on a current basis.²²⁵ Of course, virtually all mortgages are recorded, and assignments sometimes continue to be recorded as well. This salutary practice should be carried over to a national mortgage Registry. Any member of the public should be able to inquire, via the internet, and determine the identity of any mortgage's holder and servicer, and to request copies of the basic mortgage and other mortgage-related documents, such as pre-registration assignments, modifications, assumption agreements, and the like – all of the documents which were traditionally recordable and recorded in the existing real estate records.²²⁶

Ready availability of information about servicer identity would be a particular boon to those who pay off mortgage loans. Most payoffs are done by "settlement agents," of course, title companies, escrow companies, and lawyers. In the present environment they are often uncertain of the identity of the loan servicer to whom payment should be made, and find themselves relying on information of dubious credibility. An accurate and transparent online source of this information would be a great advantage to them.

223. *FAQ, What is MISMO?*, MISMO, <http://www.mismo.org/GettingStarted/FAQs.htm> (last visited Jan. 18, 2013).

224. Draft Statute § 107.

225. See *supra* notes 76-79 and accompanying text.

226. Draft Statute § 108(a).

With respect to the other information held by the Registry, beyond the identity of the investor and servicer and the traditionally recorded documents, privacy concerns outweigh the public's need to know. For example, promissory notes are not ordinarily recorded under state law, and making them available to the public on the Registry would be open to serious criticism from both lenders and borrowers, who may often wish to keep the details of their loan agreement confidential. Hence, the note and the remainder of the information held on a particular loan should be accessible only to the registered holder of the loan, the servicer, the borrower, and any successor owner of the mortgaged real estate.²²⁷

I. Fees

A national Registry should be financially self-sustaining, and hence should be authorized to charge fees appropriate to pay its costs of operation, including a sufficient indemnity or insurance fund to cover payouts required by errors.²²⁸ A fee structure similar to that currently charged by MERS might be appropriate.²²⁹ MERS charges an annual membership fee that varies from \$150 to \$7,500, depending on the volume of loans registered each year.²³⁰ In addition, there is a charge of \$11.95 for each registration or transfer.²³¹ It is likely that fees on this order could sustain a new Registry adequately. Of course, some federal appropriation of startup funds will be needed.

J. Notice of Registered Information

In order to protect the registered holder of a loan from a fraudulent release by the original mortgage,²³² and to ensure that the registered holder will get notice of litigation or other proceedings that may affect the loan,²³³ it is essential that the registration provide notice of its contents. Perhaps, as an official public-accessible record, a federal registration would be construed to have that effect under existing state law, but the cases defining whether a particular record gives constructive notice are variable and unpredictable.²³⁴

227. Draft Statute § 108(b).

228. Draft Statute § 111.

229. *Fee Schedule*, MERS, <http://www.mersinc.org/mersproducts/pricing.aspx?mpid=1> (last visited Jan. 18, 2013).

230. *Id.*

231. *Id.*

232. *See supra* notes 32-35 and accompanying text.

233. *See supra* notes 36-43 and accompanying text.

234. *See, e.g.,* Hahn v. Alaska Title Guar. Co., 557 P.2d 143 (Alaska 1976) (holding public land order filed with the federal registrar in Washington, D.C. imparted constructive notice); New England Fed. Credit Union v. Stewart Title Guar. Co., 765 A.2d 450 (Vt. 2000) (holding the failure to obtain a subdivision permit in violation of state public health regulations was a matter of public record, imparting constructive

It is better to include in the governing federal statute a clear statement that the registration imparts notice; the Draft Statute does so.²³⁵

Of course, in a sense this provision complicates title searches, because now there is one additional place a searcher must look for relevant title information. Fortunately, this task could be completed quickly online, and will impose only a minor additional burden. Particularly for those who are about to commence foreclosures, the transparency and certainty provided by the Registry will be a highly advantageous.

When a prior lien is being foreclosed judicially, the date of the procedure's inception – and hence the date on which junior interests must be of record in order for their holders to be entitled to notice of the senior foreclosure – is usually obvious.²³⁶ However, non-judicial foreclosures do not, by definition, involve a judicial filing, and they often require a combination of acts (mailed notice, posting on the real estate, publication, and/or recording) as prerequisites to the holding of a foreclosure sale. Hence, state non-judicial foreclosure statutes must state some specific date for ascertaining who is entitled to notice. If they require notice to holders of junior liens at all,²³⁷ they usually provide that the person filing the foreclosure is required to notify only those whose junior liens are of record at the beginning of a specific time period, such as 30 to 120 days, prior to the announced date of the foreclosure sale.²³⁸

notice). *But see* City of Lakewood v. Mavromatis, 817 P.2d 90 (Colo. 1991) (holding delivery of road petition to county clerk gave no constructive notice); Ioannou v. Southold Town Planning Bd. (*In re* Ioannou), 758 N.Y.S.2d 358 (N.Y. App. Div. 2003) (holding covenants filed with town planning board gave no constructive notice); First Am. Title Ins. Co. v. J.B. Ranch, Inc., 966 P.2d 834 (Utah 1998) (holding road maps filed with county clerk's office gave no constructive notice).

235. Draft Statute § 112(c).

236. *See, e.g.*, Citicorp Mortg., Inc. v. Pessin, 570 A.2d 481 (N.J. Super. Ct. App. Div. 1990). The foreclosing lender prepared its complaint on October thirteenth, but did not file it until October nineteenth. *Id.* at 482. Meanwhile, an assignment of a junior mortgage to Pessin was recorded on October sixteenth. *Id.* The court held that Pessin was not bound by the foreclosure decree. *Id.* at 485. The effect of the ruling is to require the foreclosing party to search down to the very moment the foreclosure complaint is filed. Parties whose junior interests go on record after the date of filing of the senior proceeding are bound by the doctrine of *lis pendens*, and no personal service or notice need be given to them. *Id.* at 482.

237. Only a little more than half of the non-judicial foreclosure statutes provide for personal notice to holders of junior interests, and even those vary considerably with respect to the types of junior interest holders entitled to notice. *See* Nelson & Whitman, *Reforming Foreclosure*, *supra* note 47, at 1431 n.124.

238. *See, e.g.*, IDAHO CODE ANN. § 45-1506 (West, Westlaw through 2012 Reg. Sess.) (requiring 120 days prior to date of sale); OKLA. STAT. ANN. tit. 46 § 45 (West, Westlaw through 2012 Reg. Sess.) (requiring 30 days prior to date of sale); VA. CODE ANN. § 55-59.1 (West, Westlaw through 2012 Spec. Sess.) (requiring 30 days prior to date of sale).

The language of the draft statute is intended to take these variations in state law into account by making the information in the Registry constructive notice as of the date the person instituting the non-judicial foreclosure of a prior mortgage is required to notify junior interest holders.²³⁹ While this language was drafted with non-judicial foreclosure of senior mortgages in mind, it would apply to any sort of proceeding in which notice must be given to affected parties ascertained as of a date prior to the filing of the proceeding. Note that nothing in the draft statute changes state foreclosure law or redefines who is entitled to notice of a foreclosure proceeding. It merely allows the Registry to act just as state recording systems act to impart constructive notice of recorded documents and the facts they contain.

K. A Bureaucratic Home

One of the most challenging questions involved in creating a national mortgage Registry is deciding where it will be housed. At least three approaches to this problem may be envisioned. First, the Registry might be made a part of an existing federal government agency. The Draft Statute assumes that this method will be employed, but does not identify a particular agency. Obviously, an agency that already has some experience with the mortgage market makes most sense. Possible candidates include the Federal Reserve Board,²⁴⁰ the Office of the Comptroller of the Currency,²⁴¹ the Department of Housing and Urban Development,²⁴² the Federal Housing Finance Agency,²⁴³ and the new Consumer Financial Protection Bureau.²⁴⁴

There are clear advantages to placing the Registry within an existing agency: it will already have some level of expertise in dealing with the secondary mortgage market, and will have a degree of permanence and stability that market participants can rely upon. On the other hand, many federal

239. Draft Statute § 112(c)(2).

240. The “Fed” supervises state-chartered banks that are members of the Federal Reserve System, among many other responsibilities. *See* 12 C.F.R. § 208 (2012).

241. The OCC, housed within the Department of the Treasury, is the primary supervisor of national banks and federal savings associations. *See* 12 C.F.R. § 1-1.

242. HUD is the home of the Federal Housing Administration and the Government National Mortgage Association, which issues guarantees of mortgage-backed securities, as well as many other mortgage-related programs. *See* 24 C.F.R. §§ 200.1, 300.3.

243. FHFA supervises Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. *See* 12 C.F.R. § 1282.1.

244. The CFPB, created by the Dodd-Frank Act, Public Law 111-203, has inherited a number of mortgage-related regulatory responsibilities from other federal agencies, including the Truth-in-Lending Act, the Home Mortgage Disclosure Act, the Fair Credit Reporting Act, and the Real Estate Settlement Procedures Act. *See* 12 C.F.R. § 1082.1. A complete list is found at *Regulations*, CONSUMER FIN. PROTECTION BUREAU, <http://www.consumerfinance.gov/regulations/> (last visited Jan. 2, 2013).

agencies have reputations for timidity and sluggishness in decision-making, which might lead members of the mortgage industry to doubt whether the Registry will be responsive to their practical needs.

A second approach is to simply clothe MERS with the authority and responsibility of the new Registry. After all, MERS has nearly twenty years of experience as a mortgage registry, and in most ways has proven itself efficient in meeting the industry's needs. It has a technical staff that is probably better equipped than any federal agency to put in place the changes needed to operate a federal Registry of the type outlined in this Article. One might think of the new Registry as "MERS on steroids," and there are surely great efficiencies in allowing MERS to implement the needed alterations instead of starting from ground zero in some other agency.

At the same time, MERS has a dramatically negative public image, if largely for reasons beyond its control.²⁴⁵ If it is given the task of operating the new Registry, a clear first order of business would be a name change. But this may not be enough to squelch the critics, who tend to equate MERS with the incompetence, carelessness, and cupidity that have characterized the secondary market during the past decade. Any nongovernmental entity like MERS, with a history of close connection to the mortgage finance industry, is likely to be the object of abiding distrust from consumer advocates.

If MERS is given the job, this might be accomplished by "federalizing" MERS – in effect, converting it from a private corporation into a federal agency or a quasi-federal government-sponsored enterprise.²⁴⁶ Alternatively, MERS might remain a fully private corporation but enter into a contract with a federal agency to operate the registry for it, much in the manner that the American Association of Motor Vehicle Administrators operates the National Motor Vehicle Title Information System under contract with the Department of Justice.²⁴⁷ While there may be concerns about delegating this much federal authority to a private entity, MERS is obviously in a unique position,

245. See *supra* notes 141-47 and accompanying text.

246. The appetite of Congress for creating government-sponsored entities (GSEs) has surely been greatly dampened, if not destroyed, by the necessity of placing Fannie Mae and Freddie Mac, by far the two largest GSEs, into federal conservatorship because of their insolvency. See Zachary A. Goldfarb et al., *Treasury to Rescue Fannie and Freddie*, WASH. POST, Sept. 7, 2008, <http://www.washingtonpost.com/wp-dyn/content/article/2008/09/06/AR2008090602540.html?hpid=topnews>. The political atmosphere has been rife with rancorous attacks on the fundamental concept of GSEs. See, e.g., Paul Krugman, Op-Ed., *Fannie, Freddie and You*, N.Y. TIMES, July 14, 2008, http://www.nytimes.com/2008/07/14/opinion/14krugman.html?_r=2&oref=slogin&oref=slogin; Edward Pinto, *Cleaning House: The Financial Crisis and the GSEs*, THE AMERICAN, Dec. 20, 2011, <http://www.american.com/archive/2011/december/cleaning-house-the-financial-crisis-and-the-gses>.

247. See 74 Fed. Reg. 5740 (Jan. 30, 2009) (discussing the system and the role of the American Association of Motor Vehicle Administrators in operating it).

with extremely broad industry (if not public) support and a long history of engagement in an essentially similar activity.

A third possibility is to delegate the federal authority described in the Draft Statute to one or more private companies that might elect to enter the field. For example, a company now in the business of maintaining records of secondary market sales of credit card accounts receivable might be given a contract to engage in the essentially similar activity of registering transfers of mortgage loans.²⁴⁸ Conceivably more than one company could be granted identical federal authority and several could operate in the market simultaneously, as credit reporting companies do today.²⁴⁹ However, the analogy is far from perfect; credit reporting companies operate under federal regulation (the Fair Credit Reporting Act²⁵⁰), but they have no special grant of federal authority, as the mortgage loan Registry must have if it is to do its job properly. Whether Congress would be willing to make such grants to unproven private companies is questionable. Moreover, having more than one mortgage loan registry seems an obvious and unnecessary inefficiency.

Ultimately, the decision about where to house a federal mortgage loan Registry is political in nature, and there is little purpose in trying to predict its outcome here. Any of several possible models could work well.

L. The Holder in Due Course Doctrine

Where would this proposal for a national mortgage loan Registry leave the holder in due course doctrine? That doctrine, applicable only to negotiable notes and embodied in Article 3 of the Uniform Commercial Code,²⁵¹ permits secondary market investors to take notes free of certain “personal” defenses that the maker of the note might raise.²⁵² In the context of mortgage notes, perhaps the most salient illustration is a note the execution of which

248. One such company, Global Debt Registry, has an expressed interest to the author in getting into the mortgage loan registry business; conversation of the author with Mark Parsells, C.E.O. of Global Debt Registry, Feb. 29, 2012. It currently maintains account-level chains of title for secondary market sales of credit card and other consumer and commercial debt. *See Debt Buying, Register Debt, Mortgage Ownership-Mission*, GLOBAL DEBT REGISTRY, <http://www.globaldebtregistry.com/mission> (last visited Jan. 2, 2013).

249. There are three principal national credit reporting companies: Transunion, Experian, and Equifax. *See Credit Report Companies*, CREDIT SOURCE ONLINE, <http://www.creditsourceonline.com/credit-report-companies.html> (last visited Jan. 2, 2013).

250. 15 U.S.C. § 1681 (2006).

251. U.C.C. § 3-302 (2012).

252. The “personal” defenses usually identified by commentators (because they are not listed in the Code itself) are failure or lack of consideration, breach of warranty, unconscionability, and fraud in the inducement. *See* JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 15-1 (6th ed. 2010).

was induced by fraudulent statements. A holder of due course of such a note can collect the note (and foreclose the accompanying mortgage) notwithstanding the maker's defense that he or she was defrauded into signing it.

The doctrine was designed to allow notes issued by moneylenders, banks, and other financial institutions to pass freely in commerce. Whether it should ever have been applied to notes issued by consumers is doubtful at best.²⁵³ In 1975, it was effectively repealed by the Federal Trade Commission for most types of consumer debt,²⁵⁴ but it remains the law for mortgage notes. There are real cases (although not very many of them, it seems) in which secondary market investors raise it to assist them in foreclosing mortgages that quite arguably should not, in terms of fairness and justice, be enforceable.²⁵⁵ I, along with many other commentators, have argued that the doctrine should be repealed for mortgage notes,²⁵⁶ but that has not occurred.

The Registry proposal presented here would have no formal impact, positive or negative, on the holder in due course doctrine. The doctrine has always required that the secondary market investor must be a "holder" in the Article 3 sense, which in turn means that the investor must have taken possession of the original promissory note.²⁵⁷ The experience of the past decade suggests that the doctrine is not viewed as having much value for investors in

253. See Kurt Eggert, *Held Up in Due Course: Codification and the Victory of Form over Intent in Negotiable Instrument Law*, 35 CREIGHTON L. REV. 363, 414-15 (2002).

254. Preservation of Consumers' Claims and Defenses, 16 C.F.R. § 433 (2011); Michael M. Greenfield & Nina L. Ross, *Limits on a Consumer's Ability to Assert Claims and Defenses Under the FTC's Holder in Due Course Rule*, 46 BUS. LAW. 1135, 1136 (1991).

255. See, e.g., *Dupuis v. Fed. Home Loan Mortg. Corp.*, 879 F. Supp. 139, 146-47 (D. Me. 1995) (holding borrowers could not raise defense based on failure to disburse full loan proceeds against FHLMC, which was a holder in due course); *Hunt v. NationsCredit Fin. Servs. Corp.*, 902 So. 2d 75, 86 (Ala. Civ. App. 2004) (holding borrowers could not raise defenses of failure of consideration and lack of mutual assent against note buyer who was holder in due course); *Gonzales v. Am. Title Co.*, 104 S.W.3d 588, 594-95 (Tex. Ct. App. 2003) (holding borrowers could not raise defense of fraud in the inducement against note buyer who was holder in due course); *White v. Gilliam*, 419 S.E.2d 247 (Va. 1992) (similar).

256. Whitman, *How Negotiability Has Fouled Up the Secondary Mortgage Market*, *supra* note 3, at 766-69; Siddhartha Venkatesan, Note, *Abrogating the Holder in Due Course Doctrine in Subprime Mortgage Transactions to More Effectively Police Predatory Lending*, 7 N.Y.U. J. LEGIS. & PUB. POL'Y 177, 216, 216 n.223 (2003). Several other similar comments are cited in Greenlee & Fitzpatrick IV, *supra* note 3, at 47 n.194.

257. U.C.C. § 3-203 (2012); PEB REPORT, *supra* note 21, at 5-6.

notes²⁵⁸ because there has been a widespread pattern of failure to ensure that the original note is delivered when a loan is sold.

Of course, under traditional commercial and mortgage law, there has been a much more important reason for an investor to insist on a delivery of the note: only by delivery can the entitlement to enforce a negotiable note be transferred.²⁵⁹ Under the Registry proposal made here, that will no longer be true. A properly registered holder of a loan will have the right to enforce the note and foreclose the mortgage whether possession of the original note has been delivered or not. Indeed, under this proposal, becoming a holder in due course would be the *only* remaining reason for an investor to bother taking possession of the note. This fact suggests that taking possession would be likely to happen very rarely indeed, and that the holder in due course status of mortgage investors as a class would probably wither and die like Marx's capitalist state. But there would be nothing in the Registry system that would prevent an investor from demanding possession of the note, if that should be the investor's desire.

M. Constitutionality

The creation of a federal loan Registry by act of Congress raises two constitutional questions, although neither is very difficult. First, is this action within the power of Congress under the Commerce Clause? Second, if existing mortgage loans can be registered, do the changes in legal expectations and contractual relationships that result violate the Due Process clause of the Fifth Amendment? The answers to these questions are reasonably clear: Congress is free to act in this area, and no allegation of a Due Process violation can be seriously raised.

It may be well to begin with a review of what the Draft Statute does and does not do. The primary activity that it authorizes is record-keeping, not regulation. It is intended to replace a dysfunctional state-law system of records with a functional federal system. It makes no substantive change in state law legal systems that assign priority to liens, create mortgage foreclosure processes, or release or modify mortgages and their corresponding debts. Participation in the Registry would be completely voluntary on the part of mortgage holders, who would be entirely free to continue to rely on the existing system of note delivery and recording of mortgage assignments, or for that matter on MERS if it continues to exist.

While participation would be optional, certain legal consequences would flow from the exercise of that option. Once a loan was registered, it could be transferred only by means of the Registry. The designation of a servicer

258. This suggestion was first made more than 15 years ago by Ronald J. Mann. See Ronald J. Mann, *Searching for Negotiability in Payment and Credit Systems*, 44 UCLA L. REV. 951, 970-71 (1997).

259. See *supra* notes 99-100 and accompanying text.

would be ineffective until registered. Obligations would arise on the part of mortgage investors to provide information to the Registry concerning loan modifications, assumptions, and substitutions of parties, and concerning limitations on the modification powers of investors. Civil liability would attach for failure to provide this information, and both criminal and civil penalties would arise for providing knowingly false or fraudulent information or documents. Finally, the Draft Statute would preempt contrary state law to the extent necessary to ensure that the Registry's determinations identifying loan holders and servicers are accepted for state law purposes.

Ultimately, then, the purpose of the Registry and the legislation creating is to facilitate commerce, and to impose such regulations as are necessary to achieve this purpose. There can scarcely be any doubt about the "interstate" nature of the enterprise; while not every secondary market sale of a mortgage is across state lines, it is obvious that the vast majority are, and that the secondary mortgage market is one of "those activities that substantially affect interstate commerce."²⁶⁰ Perhaps the most analogous U.S. Supreme Court case is *Reno v. Condon*,²⁶¹ upholding the constitutionality, under the Commerce Clause, of the federal Driver's Privacy Protection Act of 1994 (the DPPA), which restricts the states' ability to sell or share personal information from their automobile driver data bases without the driver's consent.

The majority opinion of Mr. Justice Rehnquist noted that,

[T]he DPPA does not require the States in their sovereign capacity to regulate their own citizens. The DPPA regulates the States as the owners of databases. It does not require the South Carolina Legislature to enact any laws or regulations, and it does not require state officials to assist in the enforcement of federal statutes regulating private individuals.²⁶²

The similarities of the draft statute to the DPPA are obvious. Like the DPPA, the Draft Statute deals with an information database; if drivers' license information is an article in commerce, as the Court found, surely mortgage holding information is as well. The Draft Statute would initiate a narrow federal preemption of state law to accomplish a valid federal objective. It would impose no burdens at all on the states to spend money, enact regulations, or assist in the enforcement of the federal statute. Indeed, it would not

260. This is the standard under current Commerce Clause jurisprudence. See *United States v. Lopez*, 514 U.S. 549, 558-59 (1995); see generally Grant S. Nelson, *A Commerce Clause Standard for the New Millennium: "Yes" to Broad Congressional Control over Commercial Transactions; "No" to Federal Legislation on Social and Cultural Issues*, 55 ARK. L. REV. 1213, 1248 (2003).

261. 528 U.S. 141 (2000).

262. *Id.* at 151.

order the states to take any action at all.²⁶³ Thus, it seems well within the boundaries of federalism that the U.S. Supreme Court has defined.

Now let us turn to the Due Process issue. It is highly desirable that existing mortgages be registerable under the legislation proposed here; otherwise, a great deal more time will be required for the Registry to become truly useful. In a sense, then, the legislation would apply retroactively to preexisting contracts. Because registration would be optional with mortgage holders, they could hardly complain that their rights are being modified. From the borrower's viewpoint, however, registration by the mortgage holder would work one significant change. The borrower must now employ a different procedure to determine the identity of the holder and servicer of his or her mortgage. The procedure may well be easier, more convenient, and more accurate, but it is different. Nothing else would change: the mortgage obligation and the methods for foreclosing, modifying, or discharging the mortgage would be the same as before, still governed by the same state law.

Does this change create a Due Process issue? Surely the answer is no. As the Supreme Court noted in 1984,

Provided that the retroactive application of a statute is supported by a legitimate legislative purpose furthered by rational means, judgments about the wisdom of such legislation remain within the exclusive province of the legislative and executive branches. . . . [R]etroactive legislation does have to meet a burden not faced by legislation that has only future effects. . . . But that burden is met simply by showing that the retroactive application of the legislation is itself justified by a rational legislative purpose.²⁶⁴

Here, the legislative purpose behind retroactive application of the law would be to bring to quicker fruition the benefits – transparency, ease of transfer, and certainty of rights – which the new Registry would provide. Surely this is enough to justify the registration of preexisting mortgages.

A useful point of reference is provided by Congress' enactment of the Multifamily Mortgage Foreclosure Act of 1991.²⁶⁵ This legislation, applicable to mortgages held by the federal government on apartment projects, provided an alternative method of foreclosure that was quicker and cheaper than

263. This fact distinguishes the Draft Statute from *New York v. United States*, 505 U.S. 144 (1992), in which the Court struck down a federal statute mandating that the states either regulate the storage and disposal of radioactive waste, or alternatively, take possession and title to the waste. Likewise, the Draft Statute is distinct from *Printz v. United States*. See 521 U.S. 898 (1997) (involving a Congressional enactment that imposed on state law enforcement officials a duty to make background checks on firearms purchasers).

264. *Pension Benefit Guar. Corp. v. R.A. Gray & Co.*, 467 U.S. 717, 729-30 (1984).

265. 12 U.S.C. § 3701 (2006).

that available under state law in many jurisdictions. Because it completely supplanted state foreclosure proceedings, it was a far greater modification of borrower's rights and expectations than the national mortgage Registry proposed here. Moreover, it was available to the government retroactively in the sense that preexisting mortgages could be foreclosed under the new procedure.

In sustaining the foreclosure act against a Due Process challenge, the Federal District Court noted,

Congressional legislation "adjusting the burdens and benefits of economic life" is presumed constitutional, and the burden is on the complaining party to establish that the legislation is arbitrary and irrational. This applies to the retroactive application of a statute as well as long as it is "supported by a legitimate legislative purpose furthered by a rational means." This is so even if the legislature's readjusting of rights and burdens "upsets otherwise settled expectations."²⁶⁶

Compared to the Multifamily Mortgage Foreclosure Act, the changes in borrowers' rights that would result from adoption of the federal Registry legislation described in this paper would be minimal. If anything, the changes would be beneficial to borrowers; anyone with internet access could now obtain full and immediate information about any loan. There would be a minor procedural modification, but no added burden. Finding a Due Process violation seems inconceivable on these facts.

In sum, the national Registry proposal made here will raise no serious constitutional issues under either the Commerce Clause or the Due Process clause. Congress has a long history of legislating in the mortgage market, and many of the existing statutes have a much stronger impact on the rights of borrowers and lenders than the Registry concept.²⁶⁷

266. *Lisbon Square v. United States*, 856 F. Supp. 482, 490 (E.D. Wis. 1994) (internal citations omitted). See the excellent discussion in Grant S. Nelson, *Confronting the Mortgage Meltdown: A Brief for the Federalization of State Mortgage Foreclosure Law*, 37 PEPP. L. REV. 583, 629-30 (2010).

267. Illustrations include the Garn-St.Germain Depository Institutions Act of 1982, § 341 (preempting state law governing the enforcement of due-on-sale clauses); The Alternative Mortgage Transaction Parity Act of 1982, 12 U.S.C.A. § 3801 (permitting state-chartered financial institutions to make alternative mortgage loans under the same regulations governing federally-chartered institutions); and the Depository Institutions Deregulation and Monetary Control Act of 1980, §§ 308, 324, 12 U.S.C.A. § 1735f-7 (preempting state usury ceilings).

IV. CONCLUSION

A national mortgage loan Registry structured along the lines outlined here would resolve all of the major legal problems that beset the secondary mortgage market today. To be specific, the following problems would be put to rest.

1. The lack of clarity in the distinction between negotiable and nonnegotiable notes that exists today would become irrelevant for purposes of loan transfer. Negotiable and nonnegotiable notes would be treated exactly alike and would be transferred in the same manner.

2. The need to physically deliver original notes in order to transfer the right of enforcement – an extremely burdensome and inconvenient requirement for negotiable notes in today’s market – would be eliminated. Transfers would take place electronically with assurance that they would be recognized by local law in all jurisdictions.

3. The necessity of recording mortgage assignments in local recording offices would be eliminated. MERS was designed to remove the need for such assignments (except at the point when foreclosure was necessary), but the national Registry would accomplish this without the artificiality and confusion engendered by MERS’ “nominee” status.

4. Borrowers would be protected against competing claims by purported mortgage holders because the Registry’s records of loan holdings would be conclusive. Whether in cases of loan modification, payoff and discharge, approval of a short sale, or foreclosure, a borrower would know with certainty whether a purported holder’s claim to the loan was authentic, and whether its purported servicer was authorized to act.

5. All foreclosures, both judicial and non-judicial, could be conducted with assurance that the correct party was foreclosing. The Registry’s certificate could be recorded under state law and become a part of the chain of title of property passing through foreclosure,²⁶⁸ thus permitting future title examiners to verify that the foreclosure was conducted by the person authorized to do so. Concerns of title insurers about the validity of titles coming through foreclosure, currently a major worry,²⁶⁹ would be largely eliminated.

6. The current confusion and litigation about separation of notes from their mortgages, and about what proof is needed to foreclose a mortgage, would be brought to an end. The Registry’s certificate would provide all of the documentary evidence necessary to foreclose.

268. Draft Statute § 112(b).

269. See, e.g., Ron Lieber, *After Foreclosure, a Focus on Title Insurance*, N.Y. TIMES, Oct. 8, 2010, <http://www.nytimes.com/2010/10/09/your-money/mortgages/09money.html?pagewanted=all>; Stephanie Armour, *Lack of Title Insurance Could Slow Sales of Foreclosed Homes*, USA TODAY, Oct. 3, 2010, http://www.usatoday.com/money/economy/housing/2010-10-01-boa-delays-foreclosures_N.htm.

7. The holder in due course doctrine, with its potential for unfair harm to borrowers, would probably disappear in the context of mortgage loans as secondary market participants abandoned the practice of physical delivery of mortgage notes.

The system for transferring mortgage loans with which we are saddled today is a shambles. The result has been enormous uncertainty and likely huge financial loss for investors, servicers, and title insurers. It is time for Congress to act to create a sensible, simple, and efficient alternative.

APPENDIX: DRAFT STATUTE

National Mortgage Loan Registry Act

An Act to provide for the establishment of a National Mortgage Loan Registry and to grant legal powers and duties to such Registry.

Preamble.

The Congress hereby finds that the existing systems for establishing, maintaining, and updating records of the holders of mortgage debt in the United States are cumbersome, inefficient, and often uninformative to borrowers. Confusion arising from this system has impaired the functioning of foreclosure proceedings and has made mortgage modifications more difficult to accomplish. It is therefore desirable to establish a single, unified national system of records of the holders of mortgage debt.

Section 101. Registry established.

There is established in the [Name of agency], a bureau to be known as the “National Mortgage Loan Registry,” which shall accept and maintain records of the holders of debt secured by real property, and of information relating to such debt.

Section 102. Definitions

For purposes of this Title the following definitions shall apply:

(1) **BORROWER.** – The term “borrower” means the person or persons making or guaranteeing a note or granting a mortgage on real property, and any successor owners of the real property while the mortgage continues to encumber it.

(2) **FEDERALLY RELATED MORTGAGE LOAN.** – The term “federally related mortgage loan” shall have the meaning given in 12 U.S.C. section 2602(1).

(3) **HOLDER.** – The term “holder” means a person or legal entity that is entitled to enforce a note and the mortgage which secures the note, and in the case of a transferrable electronic record, means the person having control of the record.

(4) LOAN. – The term “loan” means the combination of a note and mortgage, as registered with the Registry in the name of the holder. The note and mortgage comprising a loan registered with the Registry may not be separated from one another.

(5) MORTGAGE. – The term “mortgage” means any instrument creating an interest in real property to secure performance of an obligation, including without limitation a mortgage, deed of trust, or security deed.

(6) NOTE. – The term “note” means any instrument creating an obligation to pay money, or reducible to monetary terms, and secured by a mortgage. It includes without limitation a promissory note, bond, or contract, and a transferrable electronic record that complies with 15 U.S.C. section 7021 or equivalent state law.

(7) REGISTRY. – The term “Registry” means the National Mortgage Loan Registry, as created by this Title.

(8) SERVICER. – The term “servicer” means a person or entity that is authorized to provide some or all of the following services for the holder of a loan: maintenance of borrower payment records, remittance of borrower payments to the holder, maintenance of accounts for payment of taxes and insurance, collection of delinquent payments, modification of loan terms, approval of transfers of the real property subject to the mortgage, or foreclosure.

Section 103. Acceptance, transfer, and termination of registrations.

(a) The Registry is authorized to accept registrations of loans from holders. No loan may be registered unless its mortgage has first been recorded or registered under state law to establish the priority of the mortgage. Registrations may be accepted on paper or electronically. Transmittal of the note to the Registry is not necessary to register a loan.

(b) The holder of a loan that is registered with the Registry may transfer the loan to a new holder on the records of the Registry by submitting an application to transfer.

(c) The holder of a loan that is registered with the Registry may terminate the loan’s registration by submitting an application to terminate registration.

(d) The Registry shall establish standards for loans accepted for registration and for applications to transfer and terminate registration. Such standards shall require adequate information security protection to ensure that electronic documents are accurate, authentic, adequately preserved, and resistant to tampering, and that applications to transfer and terminate registrations are authentic requests of the holder of the loan. All initial registrations, applications to transfer, and applications to terminate registration shall comply with the rules and procedures established by the Registry. Such rules and procedures shall be designed to facilitate efficient bulk registrations, transfers, and terminations of multiple loans.

(e) The Registry may enter into contracts with “trusted submitters” requiring them to employ specific security procedures, and thereafter permitting

them to submit applications and subsequent documents to the Registry under rules less burdensome than are required of other submitters.

(f) The holder of a federally related mortgage loan shall not make a transfer of the loan to another holder or designate a servicer for the loan except by registration or transfer in the Registry.

(g) If the holder of a loan holds it as a trustee, a nominee, or in any other fiduciary or representative capacity, the name or description of the specific trust or other relationship shall be stated as part of the holder's identity in the records of the Registry. If such a holder is restricted by its governing documents from modifying a loan, a copy of the relevant restrictions shall be submitted to the Registry within ten days after the registration of the transfer to that holder.

Section 104. Outright and security transfers.

An application to transfer a loan on the records of the Registry may request either an outright transfer or a transfer for security or collateral purposes. The application, and the records of the Registry, shall clearly designate which form of transfer is intended. If the transfer is for security purposes, the application and the records of the Registry shall include a brief description of the obligation for which the transfer serves as security, and shall state whether the transferor or the transferee is authorized to exercise the rights listed in Section 109. The designation of a transfer as outright or for security purposes shall constitute evidence of the intent of the person making the registration, but shall not conclusively establish the purpose of the transfer.

Section 105. Notification of borrowers.

Each loan registration accepted by the Registry shall include a street address and an electronic mail address of each borrower, if available. The Registry shall also accept, and include in its record of each loan, the names, street addresses, and electronic mail addresses of any additional borrowers who submit such information to the Registry from time to time. When any loan is transferred or terminated on the records of the Registry, or when any servicer of the loan is added or terminated, the Registry shall send notification of the change to all persons shown on its records as borrowers with respect to that loan by electronic mail or, if no electronic mail address is available, by US Postal Service mail.

Section 106. Records of servicers.

(a) A current loan holder that designates one or more servicers to represent the holder in relationships with the borrower of a loan shall register with the Registry the identity of such servicers. With any such registration of a servicer, the holder shall describe, in summary form, the activities in which the servicer is authorized to engage on behalf of the holder.

(b) A current loan holder may, from time to time, terminate the authority of any previously designated servicer of the loan.

(c) No purported servicer of a registered loan shall have any authority to represent the holder in dealing with the borrower unless the servicer's identity and authority have been registered as provided in this section.

Section 107. Loan information.

(a) Each loan registered with the Registry shall be accompanied by copies of the note and the mortgage, together with copies of any mortgage assignments, note endorsements or allonges, and modification, substitution, or assumption agreements executed prior to registration of the loan with the Registry, if the registrant is a party to or possesses a copy of such documents.

(b) If the loan is modified, a party is substituted, or the loan is assumed by a new borrower after registration with the Registry, the loan holder shall transmit copies of the applicable documents to the Registry within ten days after completion of the modification, substitution, or assumption.

(c) At the option of the registrant, a loan may also be accompanied by copies of or information about other documents related to or associated with the loan, including but not limited to loan applications, appraisals, credit reports, closing statements, title insurance policies, and hazard insurance policies.

(d) Copies of all documents referred to in this section may be transmitted electronically, and all copies shall be maintained by the Registry in a loan file associated with the loan to which they relate.

Section 108. Access to Registry information.

(a) The Registry, shall issue, upon request, a certificate applicable to any registered loan, stating the identity of the loan holder and the identity of any servicers, and describing the authority of such servicers as stated by the loan holder in the records of the Registry. Any person may request such a certificate with respect to any loan. If the person so requests, the certificate shall be accompanied by:

(1) a statement of the identities of any successive holders that have held the loan since the time of its original registration in the Registry and prior to the present holder; and/or

(2) electronic copies of the mortgage and any mortgage assignments or modification, substitution, or assumption agreements held by the Registry relating to the loan.

(b) Copies of other documents in the loan file shall be made available by the Registry only to the current loan holder, any servicer of the loan, and the borrower, and to any court under subpoena or court order.

(c) Additional documents relating to a loan may be placed in the loan file, as provided in Section 107, only by the current loan holder, any servicer of the loan, and the borrower.

(d) The Registry shall certify that any copy of a document provided by the Registry to any person or court is an accurate and authentic copy of the document as originally submitted to the Registry.

Section 109. Rights of loan holder and servicer.

Only the current loan holder or any authorized servicer of the loan acting within the scope of its authority, as shown on the records of the Registry, may take the following actions with respect to a registered loan:

- (a) foreclose the mortgage;
- (b) pursue an action for recovery of any amount owing on the note;
- (c) pursue an action for recovery of damages for breach of a covenant in the note or the mortgage;
- (d) enter into a modification agreement with the borrower;
- (e) release or discharge the note or the mortgage, whether for the balance due or for a lesser amount;
- (f) approve or consent to the transfer of the mortgaged real property;

Section 110. Conclusiveness of Registry's certificates.

(a) Except as provided in subsection (c), a certificate issued by the Registry shall be conclusively be deemed correct with respect to:

- (1) its statement of the identity of loan holder and any servicers;
- (2) its statement that the authority of any servicers is as stated by the loan holder registering such servicers;
- (3) its representation that the content of any document provided with the certificate is an accurate and authentic copy of the document as originally submitted to the Registry.

(b) A certificate issued by the Registry shall not guarantee the authenticity of any documents executed prior to registration of the loan.

(c) Any person who suffers actual damage as a consequence of deprivation of legal rights due to an error made by the Registry may maintain an action in Federal District Court for recovery of such damages.

(d) If a certificate is issued by the Registry erroneously, the Registry may revoke the certificate by notice to the person to whom it was furnished if no person has relied upon it in good faith to his detriment.

Section 111. Fees and charges.

The Registry may establish and collect fees and charges for initial registration of loans, acceptance of additional documents into loan files, terminations of registrations and servicer authority, and issuance of certificates. Fees and charges shall be established, and may be modified from time to time, so as to produce revenue that will approximate the Registry's expenses of operation, taking into account the need to provide reserve funds for the payment of damages as provided by Section 110(b).

Section 112. Preemption of State law.

(a) A certificate of loan holder identity, issued under Section 108, shall be conclusive proof under the law of all States that –

- (1) the identified loan holder is the original mortgagee or recorded assignee of the mortgage, is entitled to enforce the note and the mortgage in any

proceeding, judicial or non-judicial, and to engage in any other action authorized under Section 109; and

(2) the identified servicer, if any, is entitled to act on behalf of the loan holder in any proceeding, judicial or non-judicial, and any other action authorized under Section 109 that is within the scope of the authority granted to the servicer as stated in the certificate.

(b) A certificate issued by the Registry under Section 108 shall be entitled to be recorded or registered in the real property records under the laws of any State or subdivision of a State.

(c) all persons acquiring an interest in a registered mortgage loan or the mortgaged real property, and all persons instituting a judicial, administrative, or non-judicial proceeding affecting a registered mortgage loan or the mortgaged real property, are deemed to have notice of the information in a certificate that would be issued by the Registry under Section 108 as of the earlier of:

(1) the time of acquisition of such interest or the time such proceeding is instituted; or

(2) in the case of a proceeding, the date on which the person instituting the proceeding must notify holders of subordinate interests in order to bind them to the proceeding.

(d) Any contrary State constitution, law, or regulation is preempted to the extent necessary to establish the entitlements described in this Act.

Section 113. Criminal and civil penalties.

(a) Any person who shall knowingly submit to the Registry any false, forged, or fraudulent document or information:

(1) shall be fined not more than \$10,000, or imprisoned for not more than one year, or both, for each violation; and

(2) shall be held civilly liable for any loss or damage caused to the Registry or any person by such document or information, and for the Registry's attorneys fees and costs in any civil action in which the Registry shall prevail.

(b) Any person who shall knowingly fail to submit to the Registry any document required to be submitted by Section 103(g) or Section 107(a) or (b) shall be held civilly liable for any loss or damage caused to the Registry or any person on account of failure to submit such document or information, and for the Registry's attorneys fees and costs in any civil action in which the Registry shall prevail.

(c) Any person who engages in a pattern or practice of violation of subsections (a) or (b) of this section may be barred by the Registry from the right to register additional mortgage loans. Such debarment may be for a limited time or may be permanent. Debarment may be ordered by the Registry only upon a finding of such pattern or practice in a hearing comporting with the federal Administrative Procedure Act.