DECONSTRUCTING THE BLACK MAGIC OF SECURITIZED TRUSTS: HOW THE MORTGAGE-BACKED SECURITIZATION PROCESS IS HURTING THE BANKING INDUSTRY'S ABILITY TO FORECLOSE AND PROVING THE BEST OFFENSE FOR A FORECLOSURE DEFENSE*

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I. INTRODUCTION

From 2003 to 2007, Florida experienced the largest real estate boom in its history.[1] Real estate sold at astonishing prices as people were sold a bill of goods known as the "American dream."[2] But for many, that American dream turned out to be the American nightmare. Subprime-mortgage lending, predatory practices by mortgage brokers and lenders, and the improper securitization of mortgages all contributed to the largest crash of

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1. Robert Trigaux, *Florida's Housing Bubble, Is It Ready to Burst?* St. Petersburg Times D1 (May 25, 2005) (reporting a year-over-year increase of twenty-six percent in Florida's runaway real estate market).

2. Pierre Tristam, *On a Ponzi Joyride to the Brink with American Dream in Tow*, Daytona News J. A3 (June 7, 2005) (comparing the real estate boom to a criminal Ponzi scheme).

the real estate market in history[3]—a crash from which Florida has yet to recover and to which we have not yet seen the end.[4] The full extent of the damage inflicted by these practices has not yet been felt, but millions of homeowners nationwide have suffered from financial crisis, foreclosure, and bankruptcy.[5] Worse yet, the systemic fraud and illegal conduct of the banks continues to pervasively infect our national judicial system; further, the Florida court system has suffered extreme abuse at the hands of the banks that have hijacked it and effectively turned it into a private collection agency for the banking industry.[6]

Mortgage securitization is possibly one of the least understood areas of the real estate industry, and for good reason. With obscure phrases such as "mortgage bundling" and "securitized trusts," and a tax-exempt structure known as a Real Estate Mortgage Investment Conduit (REMIC), the industry employs many terms to describe the massive collections of bundled mortgages that were broken up and sold off in pieces.[7] While this method of bundling mortgages was once looked upon as perhaps the best thing to ever happen to the mortgage industry—allowing large-scale investors, such as pensions and retirement funds, to own

3. Roy D. Oppenheim, S. Fla. L. Blog, *Florida Housing Crisis Worse than Great Depression?* http://southfloridalawblog.com/2011/06/16/from-bad-to-worse-securitized-trusts-face-scrutiny-and-housing-crisis-now-worse-than-the-great-depression/ (June 16, 2011, 7:30 a.m. ET). As of June 2011, home prices had fallen more than thirty-three percent, which is two percent lower than the hit the market received in the 1930s. *Id.* In addition, prices in South Florida have likely not reached their low point: home prices could decrease an additional ten to fifteen percent as thousands of foreclosures continue to occur. *Id.*

4. *See* Jeff Ostrowski, *The Housing Bust: What We Lost*, Palm Beach Post (Aug. 21, 2011) (indicating that nearly half of South Florida homeowners owe more than the current market value of their home with no signs of recovery).

5. *See generally* Robbie Whelan, Dawn Wotapka, Mitra Kalita & Nick Timiraos, *U.S. News: Faces of the Home-Foreclosure Crisis: In the Wave of Delinquencies That Began Four Years Ago, Mortgage Holders Followed Many Different Routes to Default*, Wall St. J. A4 (Dec. 29, 2010) (chronicling the effects of foreclosures on all segments of the population).

6. Roy D. Oppenheim, S. Fla. Law Blog, *Roy Oppenheim to the Wall Street Journal: "Your Editorial Will Make Future Investors Think Twice about Entire System*,*"* http://southfloridalawblog.com/2010/10/19/roy-oppenheim-to-the-wall-street-journal-%E2%80%9Cyour-editorial-will-make-future-investors-think-twice-about-entire-system%E2%80%9D/ (Oct. 19, 2010, 5:05 p.m. ET) [hereinafter Oppenheim, *Roy Oppenheim to the Wall Street Journal*]; Roy D. Oppenheim, Ltr. to the Ed., *Foreclosure Jurisprudence*, Fla. B. News (July 1, 2011); Jose Pagliery, *Canady Returns to Well to Replenish State Courts*, Daily Bus. Review A1 (Sept. 30, 2011).

7. *See generally* Adam J. Levitin & Tara Twomey, *Mortgage Servicing*, 28 Yale J. on Reg. 1 (2011) (examining the problems created by mortgage securitization).

interests in mortgages in a way that was deemed "safe"[8]—the securitization process has become a nightmare for the American homeowner fighting foreclosure.[9] In fact, the securitization process has made it impossible in many, if not all, cases in which a mortgage is held in a securitized trust to determine who actually owns a mortgage and note—a fact that until recently, has done little to slow down the foreclosure "rocket docket."[10]

There is a great deal that should be understood about securitized trusts, however, which can aid in the foreclosure defense and provide the judiciary with further insight—especially when it comes to the constitutional and judicial requirement of standing, which derives from "case and controversy" requirements in Article III of the U.S. Constitution.[11] This Article reviews the creation of subprime-mortgage lending and securitized trusts, the nature of standing in foreclosure actions, the process of securitization of mortgages, and the problems the foregoing have created for foreclosing lenders who lack the proper documentation and chain of title to properly foreclose.

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8. Jenny Anderson, *In Reversal, Safe Is Risky, Risky Is Safe*, N.Y. Times C1 (Nov. 23, 2007) (reporting on the devastating financial losses incurred by mortgage securities, once thought to be a safe investment). Ironically, these securities were deemed safe because they had triple-A ratings (similar to U.S. Treasury bills). *See e.g. Abu Dhabi Com. Bank v. Morgan Stanley & Co.*, 651 F. Supp. 2d 155, 165 (S.D.N.Y. 2009). Now, neither mortgage securities nor Treasury bills have triple-A ratings due in part to the imploding economy caused by the financial crisis. Had these securities never been given inflated triple-A ratings, the entire crisis may have been averted. *See generally* Kia Dennis, *The Ratings Game: Explaining Rating Agency Failures in the Build up to the Financial Crisis*, 63 U. Miami L. Rev. 1111 (2009) (discussing legal, regulatory, and market incentives as creating a systemic underestimation of risk by the rating agencies).

9. Levitin & Twomey, *supra* n. 7, at 69–70.

10. Yves Smith, *How the Banks Put the Economy Underwater*, N.Y. Times Op-Ed (Oct. 30, 2010) (reporting on the systemic failures of banks that failed to file proper paperwork when transferring loans to new owners). This failure prevented homeowners and the government from creating a true solution to the crisis through mortgage modifications by making it so unclear who owned the mortgages that investor approval could never be obtained. *See* Alan M. White, *Deleveraging the American Homeowner: The Failure of 2008 Voluntary Mortgage Contract Modifications*, 41 Conn. L. Rev. 1107, 1127–1131 (2009) (enumerating a variety of reasons why mortgage modifications consistently fail). On the other hand, title underwriters seem to ignore the issue and gladly write title insurance over foreclosed properties that may not have a clear chain of title. Gary Blankenship, *Who Owns the Note?: Paperwork Problems Still Plague Foreclosure Actions*, Fla. B. News (Sept. 15, 2011) (explaining why title insurers are still writing policies in Florida).

11. U.S. Const. art. III, § 2. It is also important to note that the Florida Constitution limits cases to those in which a party has proper standing, and provides constitutional protections similar to those of the U.S. Constitution to its residents. Fla. Const. art. I, § 21.

II. SETTING THE STAGE: A BRIEF HISTORY OF SUBPRIME MORTGAGE LENDING AND THE BEGINNING OF THE SECURITIZATION CRISIS

Subprime lending is "a fancy financial term for high-interest loans to people who would otherwise be considered too risky for a conventional loan."[12] These risky loans included enticingly low rates—often for the first few years of the loan with an adjustable rate after that initial honeymoon period. With shortsightedness, borrowers often were lured with these attractive rates only to be shocked by "exploding adjustable rates" that they could not possibly afford on their low salaries—and especially could not afford once many homeowners in lower and middle class families became unemployed.[13]

A. Bait and Switch: The Rise of Subprime Lending

Although the subprime-mortgage-lending practices developed gradually over time, the start of the industry was paved by three major events. In the 1980s, Congress passed several key pieces of legislation that deregulated the mortgage industry in an effort to encourage homeownership by the American public.[14] First, the Depository Institutions Deregulation and Money Control Act of 1980 (DIDMCA)[15] was passed, allowing the subprime-mortgage industry to flourish by charging rates that had previously been illegal.[16] Further, although the current Congress has been quick

12. John Atlas, *The Conservative Origins of the Sub-Prime Mortgage Crisi*s, The Am. Prospect (Dec. 17, 2007) (available at http://prospect.org/cs/articles?article=the_conservative_origins_of_the_subprime_mortgage_crisis).

13. *Id.* The borrowers often relied to their detriment on the broker or lender, whom they felt had superior knowledge and experience when it came to a mortgage-loan transaction, particularly in light of the fact that most Americans only go through such a transaction a few times in their lives. *Id.* What they failed to realize is that these parties had such a vested interest in selling higher priced loans with exploding rates and getting inflated appraisals that they were putting their own interests before those of the borrower, to the borrower's ultimate detriment. *Id.* Further, because the lenders were no longer holding and servicing their own loans, the high risk of default no longer discouraged them from such practices. *Id.*

14. Richard Bitner, *Confessions of a Subprime Lender: An Insider's Tale of Greed, Fraud, and Ignorance* 23 (John Wiley & Sons, Inc. 2008).

15. Pub. L. No. 96–221, § 501, 94 Stat. 132, 161–163 (1980).

16. Bitner, *supra* n. 14, at 23; *See generally*, Fed. Reserve Bank of Bos., *Depository Institutions Deregulation and Monetary Control Act of 1980* (Apr. 1980) (available at http://www.bos.frb.org/about/pubs/deposito.pdf) (providing a summary of the Act). Further,

to point out that the banks' predatory lending practices are responsible for the current housing slump, it has failed to place some of the blame in its own lap for the legislation that contributed to the problem. Patricia McCoy, a professor of law at the University of Connecticut, pointed out in a CNN Money article published toward the beginning of the crisis in 2008 that "neither the expansion of the subprime market nor the proliferation of exotic interest-only or option-ARM mortgages would have been possible without federal laws passed in the 1980s."[17] In 1982, the restrictions on mortgage lending were further decreased in what McCoy notes was the worst of the federal laws passed during the 1980s: the Alternative Mortgage Transaction Parity Act (AMPTA),[18] which made adjustable rate mortgages (ARMs) and balloon payments legal for the first time.[19] Finally, the Tax Reform Act (TRA) of 1986[20] encouraged more homeownership by making the mortgage-interest deduction more prevalent, "increasing the demand for mortgage debt."[21] Further, the Job Growth Tax Relief and Reconciliation Act of 2003[22] cut the tax rate on capital gains to fifteen percent, which added fuel to the fire by

while most states place a cap on usury interest rates, these changed laws increased the ceiling on those rates, effectively increasing the chances that homeowners would get hit with higher interest than they could handle. John Birger, *How Congress Helped Create the Subprime Mess*, http://money.cnn.com/2008/01/30/real_estate/congress_subprime.fortune/ (Jan. 31, 2008).

17. Birger, *supra* n. 16.

18. Pub. L. No. 97–320, §§ 801–807, 96 Stat. 1469, 1545–1548 (1982).

19. Bitner, *supra* n. 14, at 23. Before AMPTA, banks were limited to traditional fixed-rate loans, making it easy for borrowers to know exactly how much their payment was going to be and how long it was going to take to pay off their mortgage. Birger, *supra* n. 16. With the passing of AMPTA, new loans, which made the true nature of the debt owed confusing and unclear, greatly increased the chance of default by unsuspecting borrowers. *Id.* The newly allowed loans included adjustable-rate mortgages, balloon-payment mortgages, interest-only mortgages, and the option-ARM. *Id.* As McCoy points out, the greatest danger came not from the deregulation itself, but from the failure to create any kind of new regulations to prevent these new practices from becoming exploitative. *Id.*

20. Roger Lowenstein, *Tax Beak: Who Needs the Mortgage-Interest Deduction?* N.Y. Times Mag. 79 (Mar. 5, 2006). The Tax Reform Act of 1986 made the mortgage deduction more important by ending the deductibility of interest on credit card and other consumer loans. *Id.* President Reagan, in his address to the National Association of Realtors in 1984, made clear that the goal of the Act was to increase homeownership, stating, "I want you to know that we will preserve the part of the American dream which the home-mortgage-interest deduction symbolizes." *Id.* As noted by Roger Lowenstein, however, "[h]e didn't mention that it also symbolized the American love affair with debt; after all, it encourages people to pay for their homes with a mortgage instead of with equity." *Id.*

21. Bitner, *supra* n. 14, at 23.

22. Pub. L. No. 108–27, § 301, 117 Stat. 752, 758–760 (2003).

encouraging speculative investment in real estate due to the disparity in tax rates on regular income versus capital gains from real estate investment.[23]

Significant changes within the mortgage industry itself were creating a system ripe for making high-risk loans because the potential payoff to the bank justified the high rate of default for such loans.[24] First, interest rates began climbing, which made it more difficult for people to get traditional mortgage loans. Second, mortgages were bundled and sold as mortgage-backed securities (MBS).[25] As securitization took off on Wall Street, for the first time lenders could make loans and then sell them off in packages, maximizing their gains while allocating various levels of risk to investors.[26] At a lightning-fast rate, mortgage loans went from being illiquid to liquid assets, and for the first time mortgage brokers began making a premium for selling or disposing of the loans upon origination instead of only earning the up-front fees they charged to borrowers.[27]

There are several players within the subprime mortgage industry who contributed to the current crisis.[28] In *Confessions of a Subprime Lender: An Insider's Tale of Greed, Fraud, and Ignorance*, former industry insider Richard Bitner documents what he called the "mortgage industry 'food chain,'" which sets forth the position and importance of various players who were involved in creating, packaging, and selling subprime mortgages as mortgage-backed securities.[29] The base of the food chain, like all food chains, begins with the small animals that serve as building

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23. *Id.* Further, because the tax on capital gains made from buying and selling real estate, held for at least one year, was capped at fifteen percent, it encouraged investment in real estate as income tax rates on regular income were capped at thirty-five percent, more than twice the rate as capital gains. *See generally* Tax Found., *Federal Capital Gains Tax Rates, 1988–2011* (2010) (available at http://taxfoundation.org/files/fed_capgains_taxrates-20100830.pdf). This disparity made it more than worth the risk of real estate investing as the tax on any investment return was significantly lower than that paid for hard labor.

24. Bitner, *supra* n. 14, at 23–24.

25. *Id.* "Securitization" is the process and financial product of bundling mortgages into MBSs. *Id.*

26. *Id.* at 24. Risk transferred to investors because the investments were secured through consumers' mortgage payments, which depended on consumers timely making their mortgage payments. *Id.*

27. *Id.*

28. *Id.* at 25–28.

29. *Id.* at 27–28.

blocks for the larger, predatory animals.[30] In this food chain, the small animals include borrowers, mortgage brokers, and small-time lenders. The larger animals include big lenders and investors, government agencies such as Fannie Mae and Freddie Mac, investment banks, rating agencies, and financial institutions.[31] And of course Congress, at the very top of this food chain, gorges itself on the largess from these institutions that lavish significant campaign contributions on individual congressional members.[32] It is all of these players working together that created the "gun-slinging business of subprime lending" and as a by-product, mortgage-backed securities.[33]

B. That Old Black Magic: Traditional Mortgage Loans before the Subprime Lending Crisis and the Securitization Takeover

Traditional mortgage loans before the subprime mortgage-lending crisis were created and serviced by the same lender. Thus, the lender had a vested interest in making sure that the borrower to whom it was making a loan could support the monthly payments and would not default on the loan obligations. These lenders are called portfolio lenders and are now a dying breed. After subprime lending took over, however, portfolio lending became the exception rather than the rule in the mortgage-lending industry, and lenders lost incentives to keep loans in-house and on track. As Professor Adam J. Levitin, an associate professor of law at Georgetown University and an expert on mortgage securitization, explains:

> [s]ecuritization is a financing method involving the issuance of securities against a dedicated cashflow stream, such as mortgage payments, that is isolated from other creditors' claims. Securitization links consumer borrowers with capital market financing, potentially lowering the cost of mortgage capital. It also allows financing institutions to avoid the

30. *Id.* at 27.
31. *Id.* at 28 fig. 2.1.
32. *See generally* Gretchen Morgenson & Joshua Rosner, *Reckless Endangerment: How Outsized Ambition, Greed, and Corruption Led to Economic Armageddon* (1st ed., Times Books, Henry Holt & Co., LLC 2011) (chronicling the government's partnership with private industry).
33. Bitner, *supra* n. 14, at 20.

> credit risk, interest-rate risk, and liquidity risk associated with holding the mortgages on their own books.[34]

It is of course the very nature of securitization that made it so appealing to mortgage lenders.[35] As larger financial institutions figured out how to securitize mortgages to allocate the risk to different investors by selling securities based on different levels of risk, called tranches, they began purchasing subprime loans from small mortgage lenders.[36] "Mortgage brokers, the street hustlers of the lending world," would find borrowers and get paid a premium for creating subprime loans, "seduc[ing] millions of people into signing on the dotted line."[37] Then, instead of holding onto the loans as traditional lending practices had called for before, subprime lenders sold the loans, and the very high risk of default that goes with them, to investors who were looking to buy these types of loans—investors such as pension funds and 401k plans.[38] As noted by John Atlas in *The Conservative Origins of the Sub-Prime Mortgage Crisis*:

> [t]he whole scheme worked as long as borrowers made their monthly mortgage payments. When borrowers couldn't or wouldn't keep up the payments on these high-interest loans, what looked like a bonanza for everyone turned into a national foreclosure crisis and an international credit crisis. For millions of families, the American Dream of homeownership has become a nightmare.[39]

III. SELLING THE AUDIENCE: SO WHAT IS "SECURITIZATION"?

Perhaps the most confusing issue when dealing with securitized trusts and what those trusts mean with regard to foreclosure standing is understanding what "securitization" is.[40]

34. Levitin & Twomey, *supra* n. 7, at 11 (2011).
35. Atlas, *supra* n. 12, at 6; Levitin & Twomey, *supra* n. 7, at 6–7, 11.
36. Levitin & Twomey, *supra* n. 7, at 21.
37. Atlas, *supra* n. 12, at 2.
38. *Id.* at 3–4.
39. *Id.* at 2.
40. Although "securitization" is one process, the ramifications and intricacies are different depending on whether one is addressing it from a foreclosure defense standpoint, tax standpoint, or seeking loss mitigation alternatives as a borrower. For a detailed expla-

While there are many explanations, some lengthy and others brief, understanding the process of securitization and the repercussions from a defensive perspective can truly allow for a crucial offensive strategy.[41] Further, it is essential for any lawyer or judge involved in the foreclosure process to understand the process of securitization; the key components, deadlines, and contractual obligations of a trustee and a servicer; and how the failure of certain procedures or parties can lead to a nightmare for a foreclosing trust and potential salvation for homeowners trying to escape a financial nightmare.[42]

A simplified definition of securitization is that it is a "process where thousands of mortgage loans are bundled together into financial products called mortgage-backed securities."[43] This is an over-simplified definition, however, that does not give true credit to the structural complexities of MBS.

The complex definition of the securitization process requires an explanation of the key steps and how they interact with one another.[44] The first stage occurs when a "sponsor" financial institution bundles mortgage loans together. This bundle is created from loans either originated by the sponsor or purchased from third-party originators, such as small lenders or mortgage brokers. The next step involves a sale of the bundled mortgages to a subsidiary created specifically for this purpose, known as a "depositor."[45] The depositor is created for this purpose because it has no assets or liabilities other than this single bundle of mortgages, and this step is very important because it ensures bankruptcy protection for the sponsor.[46] The third step occurs when the intermediary depositor sells the loans to a passive

nation of securitization as it relates to problems with loss mitigation, consult Levitin & Twomey, *supra* n. 7, at 28–31.

41. *See generally id.* at 3–4 (noting that an understanding of the servicing business and its "principal-agent conflict" is required to avoid unnecessary home foreclosures).

42. *See generally* Atlas, *supra* n. 12, at 3–5 (noting many areas that need to be addressed to avoid a future crisis caused by subprime lending).

43. Bitner, *supra* n. 14, at 23–24.

44. *See* Levitin & Twomey, *supra* n. 7, at 13–14 (explaining a simplified version of the mortgage securitization process).

45. *Id.* at 13.

46. H.R. Subcomm. on Hous. & Community Opportunity, Fin. Servs. Comm., *Robo-Signing, Chain of Title, Loss Mitigation, and Other Issues in Mortgage* Servicing, 111th Cong. 267 (Nov. 18, 2010) (available at http://www.gpo.gov/fdsys/pkg/CHRG-111hhrg63124/pdf/CHRG-111hhrg63124.pdf); *see* Levitin & Twomey, *supra* n. 7, at 13 n. 34 (explaining why bankruptcy remoteness is a key component to this process).

entity,[47] in the case of residential mortgages a "trust," which is designed to hold the mortgages and to issue securities that are repaid from the mortgage payments made on the loans.[48] The initial purchase of securities provides the capital to pay the depositor and sponsor for the loans. The trust can issue securities one of two ways: directly to the depositor as payment for the loans, who is then responsible for reselling the securities; or to investors directly, using the funds from the direct sale to pay the depositor.[49] The November 2010 Congressional Oversight Report notes that for proper securitization:

> [t]here are at least three points at which the mortgage and the note must be transferred during the securitization process in order for the trust to have proper ownership of the mortgage and the note and thereby the authority to foreclose if necessary.[50]

The final stage of securitization involves the sale of the mortgage-backed securities based on the risks they presented.[51] Each bundle of mortgages is divided into different levels, in what are commonly referred to in the finance industry as "tranches," and then rated based on their credit-worthiness.[52] Tranches are then

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47. The passive entity component has extensive tax ramifications that are unrelated to the standing issues raised in this Article. In general, the passive entity that the trust becomes for tax purposes is a REMIC pursuant to I.R.C. §§ 860A–G (2006). Failure to maintain the passive status of a REMIC results in loss of entity-level tax exemptions designed to promote these types of investments by a trust, as well as significant liability potential for both the trustee and the servicer of any loan that is improperly managed. "A variety of reasons—credit risk (bankruptcy remoteness), off-balance sheet accounting treatment, and pass-through tax status (typically as a [REMIC] or grantor trust)—mandate that the SPV be passive; it is little more than a shell to hold the loans and put them beyond the reach of the creditors of the financial institution." Levitin & Twomey, *supra* n. 7, at 15 (internal footnotes omitted). In fact, the IRS has taken notice and already initiated an investigation into the activities of these trusts and the tax implications from them. Scot J. Paltrow, *Exclusive: IRS Weighs Tax Penalties on Mortgage Securities*, http://www.reuters.com/article/2011/04/27/us-usa-mbs-taxes-idUSTRE73Q7UX20110427 (posted Apr. 27, 2011, 4:43 p.m. ET).

48. Levitin & Twomey, *supra* n. 7, at 13–14.

49. *Id.* at 14.

50. Cong. Oversight Panel, *Examining the Consequences of Mortgage Irregularities for Financial Stability and Foreclosure Mitigation* 52 (Oversight Rpt. Nov. 16, 2010) (available at http://www.gpo.gov/fdsys/pkg/CPRT-111JPRT61835/pdf/CPRT-111JPRT61835.pdf).

51. Levitin & Twomey, *supra* n. 7, at 14.

52. Fed. Reserve Bank of N.Y., *Understanding the Securitization of Subprime Mortgage Credit*, Staff Rpt. 318 at 29 (Mar. 2008) (available at http://www.newyorkfed.org/research/staff_reports/sr318.pdf). Of course, the credit-rating agencies had their own

assigned a different credit rating by a credit-rating agency.[53] Each tranche is a portion of the risk on the loan:[54] the higher-rated portion, those given a triple-A rating; and the lower-rated portion, those given an Equity rating.[55] Those who receive a portion with the triple-A rating are repaid first and have the least risk of loss, but also receive the lowest possible return on their investment.[56] The lower you go in the ratings, the higher the rate of possible return, but the greater the risk.

Once the securities are broken down into tranches, the rating agency has to try to judge the quality and value of the assets in each tranche. Bitner uses the following analogy:

> [t]hink of it this way: Imagine taking [ten] different vegetables and pureeing them in a food processor until you have something close to soup. Ask someone to identify the ingredients but don't let him taste it—make him rely strictly on his sense of sight. Your concoction is sure to make him wonder what's inside.[57]

As noted in the New York Times article *Triple-A Failure*, published in 2008 when the ratings began dropping drastically on mortgage-backed securities following the beginning of the real estate implosion:

> [o]bscure and dry-seeming as it was, this business offered a certain magic. The magic consisted of turning risky mort-

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vested interest in giving securities an inflated credit rating, considering that they were paid by large lenders to rate these securities. Simply put, if they did not give high enough ratings to sell the securities, they would not be hired to rate more. Eventually, the credit-rating agencies became so large that no one questioned the ratings they were giving to less than ideal mortgage-backed securities, which were still receiving credit ratings of triple-A, the same rating given to the U.S. Treasury bond. In 1996, Thomas Friedman, a New York Times columnist, stated, "There are two superpowers in the world today in my opinion. There's the United States and there's Moody's [bond-rating service]. The United States can destroy you by dropping bombs, and Moody's can destroy you by downgrading your bonds. And believe me, it's not clear sometimes who's more powerful." *The NewsHour with Jim Lehrer*, TV Broad. (PBS Feb. 13, 1996) (transcript available at http://www.pbs.org/newshour/gergen/friedman.html).

53. Bitner, *supra* n. 14, at 108–109; Roger Lowenstein, *Triple-A Failure: The Ratings Game*, N.Y. Times Mag. 36 (Apr. 27, 2008).

54. Bitner, *supra* n. 14, at 108–109.

55. *Id.* at 109.

56. *Id.*

57. *Id.*

> gages into investments that would be suitable for investors who would know nothing about the underlying loans. To get why this is impressive, you have to think about all that determines whether a mortgage is safe. Who owns the property? What is his or her income? Bundle hundreds of mortgages into a single security and the questions multiply; no investor could begin to answer them. But suppose the security had a rating. If it were rated triple-A by a firm like Moody's, then the investor could forget about the underlying mortgages. He wouldn't need to know what properties were in the pool, only that the pool was triple-A—it was just as safe, in theory, as other triple-A securities.[58]

When mortgages held in securitized trusts began defaulting at alarming rates, the rating agencies began performing mass downgrades on their ratings, adding fuel to the belief held by many experts that the ratings had been artificially inflated from the beginning. While the rating agencies are certainly to blame, government regulation by the SEC was also lacking, making it easier for rating agencies to rely on bad or incomplete information to inflate ratings. Of course, long after the damage was done, the SEC began investigating whether the ratings agencies committed fraud by failing to meet their due diligence requirements, which would have allowed them to adequately rate the mortgage-backed securities.[59] All in all, it just goes to show that numerous institutions on Wall Street and in the United States government, through its various agencies, all contributed to this mass crisis—a crisis for which the American public is paying the price.

IV. THE SHELL GAME: THE POOLING AND SERVICING AGREEMENT AND WHAT THE BIG BANKS DON'T WANT THE JUDICIAL SYSTEM TO KNOW

In general, the securitization process and resulting trust are governed by what is known as a Pooling and Servicing Agreement (PSA). A PSA sets forth the exact steps necessary for a trust to be created, for the bundled mortgages to be transferred into the

58. Lowenstein, *supra* n. 53.

59. Roy Oppenheim, S. Fla. L. Blog, *Meet the Wall Street Enablers: Credit Rating* Companies, http://southfloridalawblog.com/2011/06/21/meet-the-wall-street-enablers-credit-rating-companies/ (June 21, 2011, 8:51 a.m. ET).

trust, for securities to be issued by the trust to the depositor or on the open market—generally to institutional investors—and to maintain the trust once created to maintain favorable tax status.[60]

In a foreclosure filed by a trustee on behalf of a securitized trust, the PSA is the key piece of documentation needed from the bank in order for the judge to determine whether the trust owns the loan being foreclosed.[61] In general, the PSA is a public record and can be found through the SEC website as an exhibit to SEC filings made by each individual trust.[62] But the true essential component of the PSA is not a public record; it is a document known as the Master Loan Schedule. While the PSA is essential because it sets forth the rules for each bundle of mortgage loans—and defending a foreclosure based on bad securitization entails demonstrating to the court that the sponsor, depositor, trustee, or servicer has violated those rules, which makes the transfer to the trust defective—the Master Loan Schedule establishes whether the subject mortgage *was ever transferred to that particular trust*.[63] Therefore, while both are essential, if the loan was never transferred to the trust, this is the home run of all foreclosure defense strategies, because the trust, simply put, cannot sue to collect on something it does not own.[64]

Although they play no role in actually creating the securitized mortgage bundled loans, the trustee and servicer are in a position to do the most damage to the trust when it comes to establishing proper standing in a mortgage foreclosure action. Once the bundled mortgages are given to a depositor, the PSA and IRS tax code provisions require that the mortgages be transferred to the trust within a certain time frame, usually ninety days from the date the trust is created. After such time, the trust closes and any subsequent transfers are invalid.[65] The reason for this is purely

60. Levitin & Twomey, *supra* n. 7, at 31–32.

61. *Id.*

62. *See generally* U.S. Secs. & Exch. Comm'n, *Filings and Forms*, http://www.sec.gov/edgar.shtml (accessed July 22, 2012) (providing access to filings).

63. Stephen S. Kudenholdt, Stephen F.J. Ornstein & John P. Holahan, *The Massachusetts Supreme Judicial Court Foreclosure Decisions: The Impact on the Securitization Documentation Process*, 128 Banking L.J. 195, 197 (2011).

64. *Id.* at 202.

65. *Id.* The ninety-day requirement is imposed by the Internal Revenue Code (IRC) to ensure that the trust remains a static entity. *Id.* Because the PSA requires that the

economic for the trust.[66] If the mortgages are properly transferred within the ninety-day open period, and then the trust properly closes, the trust is allowed to maintain REMIC tax status.[67] REMIC tax status is essential for trusts because it provides for an entity-level tax exemption, allowing the income derived in the trusts from the payment of mortgage interest to be taxed only at the investor level, whereas most corporations are taxed at both the corporate level and again when income is passed to shareholders.[68] The largest key to REMICs, however, is that they are required to be passive vehicles—meaning that mortgages cannot be transferred in and out of the trust after the closing date—unless the trust can meet very limited exceptions under the Internal Revenue Code.[69] Professor Levitin describes the conflict the following way:

> The trustee will then typically convey the mortgage notes and security instruments to a "master document custodian," who manages the loan documentation, while the servicer handles the collection of the loans. Increasingly, there are concerns that in many cases the loan documents have not been properly transferred to the trust, which raises issues about whether the trust has title to the loans and hence standing to bring foreclosure actions on defaulted loans. Because, among other reasons, of the [REMIC] tax status of many private-label securitizations ("PLS") . . . it would not be possible to transfer the mortgage loans (the note and the security instrument) to the trust after the REMIC's closing date without losing REMIC status.[70]

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trustee and servicer not do anything to jeopardize the tax-exempt status, however, PSAs generally state that any transfer after the closing date of the trust is invalid. *Id.*

66. *See generally id.* (discussing the rights to interest payments, tax on income from foreclosure property, and economic considerations).

67. *See* 26 U.S.C. § 860D(a) (2006) (defining, in part, a REMIC as an entity "as of the close of the 3rd month beginning after the startup day and at all times thereafter, substantially all of the assets of which consist of qualified mortgages and permitted investments").

68. *See id.* at § 860A(a) ("Except as otherwise provided in this part, a REMIC shall not be subject to taxation under this subtitle (and shall not be treated as a corporation, partnership, or trust for purposes of this subtitle).").

69. *See* Levitin & Twomey, *supra* n. 7, at 14 n. 35 (stating loans transferred after the closing date will lose REMIC status).

70. *Id.*

Further, he points out:

> As trust documents are explicit in setting forth a method and date for the transfer of the mortgage loans to the trust and in insisting that no party involved in the trust take steps that would endanger the trust's REMIC status, if the original transfers did not comply with the method and timing for transfer required by the trust documents, then such belated transfers to the trust would be void. In these cases, there is a set of far-reaching systemic implications from clouded title to the property and from litigation against trustees and securitization sponsors for either violating trust duties or violating representations and warranties about the sale and transfer of the mortgage loans to the trust.[71]

It is also crucial to note that under the PSA, the trustee and the servicer bear liability if they transfer mortgages in violation of the PSA requirements, causing the trust to lose REMIC tax status.[72] As a recent Reuters Exclusive article on how the IRS is investigating these lapses noted, "If the IRS did impose penalties, the REMICs could turn around and sue the banks for causing the problems and not living up to the terms of the agreements establishing each REMIC, thus transferring the costs to the banks."[73]

V. PULLING A RABBIT OUT OF A HAT: THE FUNDAMENTAL CONCEPT OF STANDING AND HOW SECURITIZATION HAS RUN AMOK WITH A BASIC LEGAL REQUIREMENT

Standing is one of five traditional legal requirements a person must meet to bring suit in a court of law.[74] Of the five

71. *Id.*
72. *See* Paltrow, *supra* n. 47 (stating that REMICs can sue banks for failing to meet their obligations under the agreements establishing each REMIC, but noting that there are strict time limits on when the banks can be sued for a deficiency). The indemnification provisions of the PSA have not passed the notice of the investors who purchased many of these mortgage-backed securities. *See e.g. Bank of N.Y. Mellon v. Walnut Place, LLC*, 2011 WL 4953907 at *1 (S.D.N.Y. Oct. 19, 2011). More than ninety lawsuits have already been filed against servicers and trustees for improper practices in violation of the PSAs that governed their conduct, with claims totaling over $197 billion as of August 2011. Louise Story & Gretchen Morgenson, *A.I.G. to Sue Bank on Loss In Fiscal Crisis*, N.Y. Times A1 (Aug. 8, 2011).
73. Paltrow, *supra* n. 47.
74. *See United States v. Students Challenging Reg. Agency Procs. (SCRAP)*, 412 U.S. 669, 686–688 (1973) (discussing "injury in fact" and that "standing is not to be denied

requirements, standing is perhaps the most crucial because it requires the aggrieved party to prove that it has the *right* to seek redress.[75] Under Article III of the United States Constitution, standing is often characterized by the statement that a plaintiff must show that there is "a case or controversy."[76] There are three requirements a plaintiff must prove: first, that there is a legally cognizable injury; second, that the injury is concrete and particularized; and third, that a causal relationship exists between the injury and the conduct of the defending party.[77]

During the robo-signing crisis, in which the banks on Wall Street fraudulently "verified" millions of documents in order to fix their mistakes, some of the biggest names in the news media made light of the significant repercussions that such practices have for the history of the American legal and recording system.[78] On October 9, 2010, the Wall Street Journal published an editorial titled "The Politics of Foreclosure."[79] The author of the editorial, with latent sarcasm, wrote:

> [t]alk about a financial scandal. A consumer borrows money to buy a house, doesn't make the mortgage payments, and then loses the house in foreclosure—only to learn that the wrong guy at the bank signed the foreclosure paperwork. Can you imagine? The affidavit was supposed to be signed by the nameless, faceless employee in the back office who reviewed the file, not the other nameless, faceless employee who sits in the front.[80]

The South Florida Law Blog published a response to this outlandish opinion, pointing out the extreme disregard this editorial

simply because many people suffer the same injury"); The 'Lectric L. Lib., *Standing*, http://www.lectlaw.com/def2/s064.htm (accessed July 22, 2012) ("The legal right to initiate a lawsuit.").

75. *See Students Challenging Reg. Agency Procs. (SCRAP)*, 412 U.S. at 686–688 (elaborating on standing's injury requirement).

76. *See id.* at 686 (stating that in the statutory context, standing requires an actual injury to the party bringing suit and that the injury must be one that the concerned statute contemplates protecting).

77. *See id.* (discussing various aspects of an inquiry into standing).

78. *See* Editorial, *The Politics of Foreclosure*, Wall St. J. A14 (Oct. 9, 2010) (noting that President Obama refused "to sign a previously noncontroversial measure to have states recognize notarized documents from other states").

79. *Id.*

80. *Id.*

gives to the legal requirement of standing, and the consequences such blatant disregard for our constitutional protections could have:[81]

> Your editorial completely disregards an important constitutional concept of legal standing. Standing is the substantive due process notion of what a party must do in order to have the legal right to bring a legal action through our judicial system. Without the protective concept of standing, anyone could sue anyone at any time, ultimately causing legal anarchy. To fabricate standing, the banks used fraudulent assignments, bad notaries, and allowed for perjured documents to be presented to judges. The banks were forced to engage in such conduct because . . . the banks broke the mortgage into different parts, splitting the Note from the Mortgage by assigning the Mortgages to a third party (MERS) and selling the Notes to another entity. The Notes were than further sold off in traunches [sic]. . . . Questions will be asked for a generation how banks literally hijacked the judicial system turning it into their own collection system while dispensing with the rules of law that have protected property right owners from the day our great nation was founded.[82]

Ironically, the robo-signing crisis was an attempt to placate the recording system requirements in Florida in light of the fact that there was significant question as to whether the assignments from MERS[83] would provide an effective chain of title.[84] By generating new bogus assignments dated years after the trusts were created and closed, the banking industry created a smoking gun and literally got its hands caught in a larger and messier cookie jar than the one it was trying to avoid—providing undeniable evi-

81. Oppenheim, *Roy Oppenheim to the Wall Street Journal*, *supra* n. 6.

82. *Id.*

83. MERS is an acronym used for Mortgage Electronic Registration System, a system put into place by some of the largest U.S. banking institutions to avoid traditional state recordation systems.

84. *See* Memo. from Citi, *Foreclosures Gone Wild* 1 (Oct. 12, 2010) (copy on file with *Stetson Law Review*) (providing an "Overview of the Key Legal Issues" involved in the foreclosure freeze); *see generally* Milton A. Vescovacci, *Servicing Real Estate Mortgage Investment Conduits in U.S. Mortgage Securitizations*, http://www.worldservicesgroup.com/publications.asp?action=article&artid=1598 (Nov. 2006) (describing REMICs and their relationship to securitized mortgages).

dence that the transfers into the trust were invalid or had never occurred.[85]

VI. THE TRICK IS NOT A TRICK: WITH SECURITIZATION, SUBSTANCE IS THE FORM AND THE FORM IS THE SUBSTANCE

Perhaps one of the most frustrating things about explaining securitization is getting people to understand that with the securitization process, the *substance is the form*.[86] Often, as exemplified by editorials such as the one referenced earlier in this Article, the general public does not understand that while it may seem trivial that person A signed the foreclosure documents and really person B should have, it is these distinctions that are crucial to proper securitization.[87] The same argument is then made for a trust that missed the closing deadline but got the assignment done eventually.[88] The true question becomes, "where do we draw the line?" While the lenders who improperly securitized mortgages would love for the public and judiciary to believe that it is "close enough," the whole point is that in securitization, close enough just does not cut it. As Professor Levitin succinctly stated in his written testimony to the House Financial Services Committee Subcommittee on Housing and Community Opportunity:

> Securitization is the legal apotheosis of form over substance, and if securitization is to work it must adhere to its proper, prescribed form punctiliously. The rules of the game with securitization, as with real property law and secured credit

85. *See* Levitin & Twomey, *supra* n. 7, at 4 ("[I]n the fall of 2010 . . . it came to light that major servicers had employed professional affiants for foreclosure cases who would sign as many as 10,000 affidavits a month without any personal knowledge of the facts to which they attested in the affidavits."); Memo. from Citi, *supra* n. 84, at 2 ("It now appears that in many cases (1) the paperwork was not properly transferred and (2) it is unclear in many cases where the actual paperwork actually rests today."); Vescovacci, *supra* n. 84 (explaining what a REMIC is and the consequences for noncompliance with REMIC requirements).

86. *See* H.R. Subcomm. on Hous. & Community Opportunity, *supra* n. 46, at 3 (stating that "[s]ecuritization is the legal apotheosis of form over substance, and if securitization is to work it must adhere to its proper, prescribed form punctiliously").

87. *See* Editorial, *supra* n. 78 (stating sarcastically that "[t]he affidavit was supposed to be signed by the nameless, faceless employee in the back office who reviewed the file, not the other nameless, faceless employee who sits in the front").

88. *See* Levitin & Twomey, *supra* n. 7, at 14 n. 35 (stating that transferring a mortgage loan to a "trust after the REMIC's closing date" will result in a loss of REMIC status).

> are, and always have been, that dotting "i's" and crossing "t's" matter, in part to ensure the fairness of the system and avoid confusions about conflicting claims to property. Close enough doesn't do it in securitization; if you don't do it right, you cannot ensure that securitized assets are bankruptcy remote and thus you cannot get the ratings and opinion letters necessary for securitization to work. Thus, it is important not to dismiss securitization problems as merely "technical;" these issues are no more technicalities than the borrower's signature on a mortgage. Cutting corners may improve securitization's economic efficiency, but it undermines its legal viability.[89]

On September 15, 2011, the Florida Bar News published an article titled *Who Owns the Note?: Paperwork Problems Still Plague Foreclosure Actions*.[90] The article starts with an introduction that exemplifies the very nature of the problem presented by the "substance over form" mentality that plagues the Florida judicial system when it comes to foreclosures:

> John Adams, as a new lawyer, was very nervous when he tried his first case in court, according to biographer David McCullough. The future second president of the United States was representing a man whose crops were damaged when a neighbor's horses broke through a fence. He lost the case because, in preparing the necessary writ, Adams omitted the required words "the county in the direction to the constables of Braintree.". . . There's an echo of Adams' woes resounding in mortgage foreclosures and the scandals surrounding faulty paperwork filed in Florida and around the country by lenders and those servicing mortgages.[91]

The article went on to point out the repercussions that following the rule of "form over substance" in securitizations could have upon the Florida court system, noting that the answers to some of the questions being asked regarding proper documentation could greatly affect the ability of the Florida court system to handle the more than four-hundred thousand foreclosures still

89. *See* H.R. Subcomm. on Hous. & Community Opportunity, *supra* n. 46, at 3 (noting that securitization requires strict adherence to its prescribed form).

90. Blankenship, *supra* n. 10.

91. *Id.*

pending in the courts.[92] In addition, the author noted that the courts have become dependent on the filing fees for foreclosures, strengthening the belief that the court system has become dependent rather than independent, thus potentially clouding the unbiased judgment of the judiciary.[93] Furthermore, when questioning foreclosure defense attorneys, some noted that the biggest downfall for the banks is homeowners who are willing to defend their property rights because banks "fight tooth and claw to avoid discovery," knowing that if they are forced to explain their documents they will not be able to.[94] One went so far as to say, "If you know what you're looking for, you can find the fraud on the face of the document. It's systemic . . . [i]t's like paperwork HIV; everyone has the same virus because it was so systemic."[95] In addition, the judiciary's failure to step up and protect homeowners seriously undermines faith in the American judicial system—an effect that could be felt long after the crisis has passed.

A. Handcuff Secrets: Lenders Recognize Their Own Illusion, So Why Is the Judiciary Still Being Taken in?

Another interesting thing to note is that many of the big lenders who securitized mortgages, and the high-priced law firms who represent them, have internal documents discussing and warning of the repercussions of failing to properly securitize and the impact that creating new mortgage assignments could have.[96] In October 2010, Citi published an internal document called *Foreclosures Gone Wild*.[97] Summarizing a conference call, Citi stated,

> It appears that in many instances during the mortgage securitization process over the past few years, the paperwork was not properly transferred. If the paperwork was not transferred in the legally required manner, it raises ques-

92. *Id.*
93. *See id.* (stating that a slowdown in foreclosure filings resulted in Florida courts having to borrow money).
94. *Id.* at 2.
95. *Id.*
96. *See* Vescovacci, *supra* n. 84 (discussing these firms and internal practices).
97. Memo. from Citi, *supra* n. 84.

> tions . . . about the validity and tax exempt status of the trusts in which the mortgages reside.[98]

Further, Citi pointed out that by attempting to fix the problems created by the bad transfers, the bank may have inadvertently provided proof that this argument is valid:

> Banks have attempted to remedy the aforementioned problems by having employees sign affidavits that they have personal knowledge that the trust was once in possession of the necessary documents. Two problems have emerged with regards to these affidavits. First, several news stories have reported that the people signing these affidavits had no knowledge of the matters in question despite the fact that there [sic] were legally swearing that they did. Second, the affidavits may be irrelevant because the issue is not that the documents were lost but that they were never properly transferred at each step of the aforementioned securitization process.[99]

To test the theory that the securitization failure was systemic, Abigail Field, with *Fortune Magazine*, did a field study on hundreds of foreclosure documents. This study, of course, confirmed what securitization experts and foreclosure defense attorneys have been saying for years—that this is a system-wide failure.[100] The article was prompted following the testimony of a former Countrywide employee, Linda DeMartini, being made public.[101] DeMartini stated on the record that the trustee at the time of the foreclosure, and in fact since the loan's origination, had never had possession of the note for a particular mortgage.[102] Further, DeMartini testified that the allonge transferring the note to the trustee was not prepared until three years after the loan originated and that it was only prepared in anticipation of the

98. *Id.*
99. *Id.*
100. Abigail Field, *At Bank of America, More Incomplete Mortgage Docs Raise More Questions*, http://finance.fortune.cnn.com/2011/06/03/at-bank-of-america-more-incomplete-mortgage-docs-and-more-questions/ (posted June 3, 2011, 11:49 a.m. ET).
101. *Id.*
102. Hrg. Transcr., *Kemp v. Countrywide Home Loans* (*In re Kemp*), http://cdn.americanbanker.com/media/pdfs/CountrywideDiMartini112910.pdf at 14:14 to 14:25 (Aug. 11, 2009) (No. 08-18700, 440 B.R. 624 (Bankr. D.N.J. 2010)).

foreclosure action so that the trustee would have proper standing.[103] In light of this testimony, the judge threw out the case on the grounds that the trustee did not have proper standing to foreclose.[104]

Although Bank of America, the purchaser of Countrywide and all of its problems, was quick to deny the claims of its former employee, DeMartini, *Fortune*'s examination of hundreds of court documents verified DeMartini's claims.[105] Bank of America issued the following in response to DeMartini's testimony:

> Bank of America's policy is to conduct foreclosures in accordance with all applicable laws. After halting foreclosures last year, we reviewed our process with regulators and continue to do so as we incorporate improvements. Reviews have shown that foreclosed loans were seriously delinquent and that we could support our legal standing to foreclose. We believe the files referenced contain appropriate documentation. We offer home retention options and foreclosure avoidance programs to our distressed customers. Foreclosure is our last resort.[106]

The funny thing is that no one really expected it to say anything different. It is not as if one of the largest banks in the country is actually going to own up to its mistakes and say, "Oops, we messed up and now we can't foreclose on any of these properties. Have your house for free." And in fact, this is the same stance it took through each public failure, including robo-signing—the "we did nothing wrong" stance. But the fact that it continues to represent that *nothing* went wrong, that "reviews" show it has followed all proper procedures, is also patently false. After all, if such reviews exist, no one in the public has seen any. And, if the investigation of *Fortune* is any indication of the system-wide failure of major lenders such as Bank of America to properly securitize, the liability of these lenders far exceeds shareholder equity. Both of the steps that DeMartini states did not occur are essential to proper securitization, and *Fortune* notes

103. *Id.* at 16:18 to 16:22; Field, *supra* n. 100.
104. *Kemp v. Countrywide Home Loans* (*In re Kemp*), 440 B.R. 624, 634 (Bankr. D.N.J. 2010).
105. Field, *supra* n. 100.
106. *Id.*

that "[b]oth steps are required, in one form or another, under all securitization contracts."[107] The continued denial by Bank of America of any failure or wrongdoing certainly makes it clear that it will continue to try to pull rabbits out of a hat when it comes to proper documentation to support standing in foreclosure actions and that Bank of America and other large lenders will do so by asking the judiciary to sacrifice age-old property law and constitutional protections.[108]

Fortune examined 130 cases in which Bank of America was foreclosing on Countrywide mortgage-backed securities allegedly held by securitized trusts. In 104 of the original 130 cases, Countrywide was the originator. The findings were a perfect example of the blatant failure to properly securitize:

> None of the 104 Countrywide loans were endorsed by Countrywide—they included only the original borrower's signature. Two-thirds of the loans made by other banks also lacked bank endorsements. The other third were endorsed either directly on the note or on an allonge, or a rider, accompanying the note.
>
> The lack of Countrywide endorsements, combined with the bank's representation to the court that these documents are accurate copies of the original notes, calls into question the securitization of these loans, as well as Bank of New York's right, as trustee, to foreclose on them. These notes ostensibly belong to over 100 different Countrywide securities and worse, they were originally made as long ago as 2002. If the lack of endorsement on these notes is typical—and 104 out of 104 suggests it is—the problem occurs across Countrywide securities and for loans that pre-date the peak-bubble mortgage frenzy.[109]

Foreclosure defense attorneys were less than shocked by the results of the investigation by *Fortune*. Fortune quoted one such attorney:

107. *Id.*
108. *Id.*
109. *Id.*

> As for the endorsements, foreclosure defense attorneys say a troubling phenomenon has been happening: 'magically' appearing endorsements. That is, the note originally given the court has no endorsement, but after the defense points out the problem, an endorsed note is submitted.[110]

Another Florida foreclosure defense attorney stated that in numerous cases, the same phenomenon had been noted and ignored by members of the judiciary who were more interested in moving cases along on their dockets than in protecting the property rights of the homeowners before them.[111]

B. The Prestige: The American Securitization Forum and Private Sector Experts Disagree on the Basics

On November 16, 2010, in response to numerous articles being published regarding foreclosure defense strategies, including problems with securitization of MBS, The American Securitization Forum (ASF) published an article in the ASF White Paper Series titled "Transfer and Assignment of Residential Mortgage Loans in the Secondary Mortgage Market."[112] In an effort to repair the damage being inflicted by foreclosure defense attorneys and securitization experts who were attacking improper securitization methods, the ASF outlined the securitization industry's position on why perfect securitization is not necessary to enforce a note and mortgage.[113] The ASF cited alternative rules, such as the Uniform Commercial Code (UCC) and common con-

110. *Id.*

111. *Id.* ("Magically appearing endorsements happen so often in Florida that I expect the banks' explanation to begin with: 'Once upon a time, in a land far, far away.' Unfortunately, the courts often turn a blind eye to the banks' shell game and homeowners are left with the empty shell.").

112. ASF White Paper Series, *Transfer and Assignment of Residential Mortgage Loans in the Secondary Mortgage Market* 1 (Nov. 16, 2010) (available at http://www.americansecuritization.com/uploadedFiles/ASF_White_Paper_11_16_10.pdf). The ASF White Paper Series article was presented along with the testimony of Tom Deutsch, the Executive Director of the American Securitization Forum to the House Financial Services Committee Subcommittee on Housing and Community Support, and was offered to rebut the testimony of Adam Levitin, who testified before the subcommittee early in the week and offered his own written testimony in support of his arguments against the securitization practices used by the banking industry and supported by the ASF.

113. *Id.*

tract law, under which they argued those methods were more than sufficient.[114]

The largest problem with these arguments is of course the PSA, which governs and supersedes both the UCC and common law. The traditional rule has always been that parties are free to elect the law that applies to contract and to contract around common law principles. Further, the UCC was designed as a default to be used when contract terms were not determined by the parties properly before the contract was performed or when the parties intended the UCC to govern. Even if this argument is valid, however, the banks did not even follow the fundamental concepts of the UCC.[115]

Another interesting point is that the PSA was specifically designed to govern a securitized *trust* because contract common law combined with trust law is virtually indestructible when it comes to the intent of the contracting parties, which in this case intended very specific rules of transfer. Combined, trust law and contract law set forth extremely rigid principles for the transfer of interests, requirements that are significantly relaxed under the UCC and other types of law over which the ASF is claiming control. Besides the general understanding that both types of law apply, PSAs contain *very specific* language called a recital of the transfer that outlines step-by-step the process of transferring the mortgage to the trustee of a trust.[116]

While the ASF is adamantly holding its position that the failures of the securitization process were minor and do not affect standing of a trustee or servicer to foreclose, experts on the other side seem to be winning the debate, especially in the forum of public opinion, and even in some court decisions.[117] Legal bloggers have been especially receptive of arguments made by Levitin; Ira Mark Bloom,[118] another law professor specializing in trust law;

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114. *Id.* at 5.

115. H.R. Subcomm. on Hous. & Community Opportunity, *supra* n. 46, at 23.

116. *Id.*

117. *See generally* John Leamons, *Adam Levitin Replies to ASF: What Is the Meaning of "Showing a Complete Chain of Endorsement?"* (Dec. 7, 2010) (on file with *Stetson Law Review*) (showing that experts disagree with the position that the ASF is taking).

118. Ira Mark Bloom is the current Justice David Josiah Brewer Distinguished Professor of Law at the Albany Law School. He is considered an expert in trust law and has filed affidavits on behalf of homeowners in cases involving improper securitization and the standing issues deriving therefrom. Albany L. Sch., *Faculty Directory*, http://www

and Thomas J. Adams,[119] a partner with the firm Paykin, Krieg & Adams in New York who specializes in securitization and was a former insider who worked on some of the first pooling and servicing agreements ever created, in the late 1980s.[120]

One such legal blogger, John Leamons, compared the battle between the ASF and Levitin as the equivalent of a "battle between a samurai sword and a grapefruit, where Levitin is the sharper of these objects."[121] In fact, it is tantamount to the biblical story of David versus Goliath in that the ASF is backed by thirteen major United States law firms and represents the interests of all major lenders who securitized mortgages. This battle pits billions of dollars in lobbying and research capabilities against underfunded law professors, with the law professors winning.[122] These bloggers then mock statements made by Executive Director Deustch of the ASF, including those that allege that a complete chain of endorsements exists if the allonge goes from A to D, instead of from A to B to C to D as required by the PSA.[123]

VII. "ABRACADABRA" JUST ISN'T CUTTING IT IN SOME COURTS

A. Judge Boyko Not Fooled by the Illusion, Tells Lender That the Court Has an Independent Responsibility to Protect Judicial Integrity

One of the first courts to recognize the failure of the banks was Judge Christopher Boyko sitting in the United States District

.albanylaw.edu/sub.php?navigation_id=157&user_id=85&view=public (accessed July 22, 2012).

119. Thomas Adams is a partner with the firm of Paykin, Krieg & Adams in New York specializing in securitization. He too has opined via affidavit in numerous securitizations that the lender attempting to foreclose lacks proper standing due to improper chain of title transfers as part of the securitization process. Bus. Insider, *Thomas K. Adams*, http://www.businessinsider.com/author/thomas-k-adams (accessed July 22, 2012).

120. Aff. & Test. of Thomas J. Adams, *Horace v. LaSalle Bank*, No. cv-2008-362 (Va. Cir. Oct. 13, 2010) (explaining his experience in working with some of the first pooling and servicing agreements).

121. Leamons, *supra* n. 117 (showing the disparity in the epic battle between Adam Levitin and the ASF).

122. *Id.* (explaining that the thirteen major law firms backing the ASF have a substantial stake in the controversy).

123. *Id.* (detailing the fact that there needs to be a showing of a complete chain of endorsement, and this does not happen by simply having an endorsement by A in blank).

Court for the Northern District of Ohio Eastern Division in the case *In re Foreclosure Cases*.[124] At the time of the decision in 2007, securitization and the debate that raged between experts on both sides of the fence had not even reached the public forum.[125] The case consisted of fourteen foreclosure actions brought in federal court by a securitized trustee.[126] Finding that the bank lacked proper standing, Judge Boyko set forth the traditional legal principal of standing and explained its relationship to the federal court jurisdiction concept of diversity jurisdiction.[127] Because the bank could not prove who owned the mortgage and note, it could not establish the diversity jurisdiction of the court, and therefore lacked standing.[128]

Notably, it is clear that the decision was unexpected in light of the previous decisions from state courts in that jurisdiction, which had turned a blind eye to the documentation problems that were already plaguing the court system even before the robo-signing crisis.[129] In his opinion, Judge Boyko made clear that the federal court would not be swayed by the arguments of big banks and that failure to prove standing was simply elemental to invoking the jurisdiction of the court, stating:

> In the above-captioned cases, *none* of the Assignments show the named [p]laintiff to be the owner of the rights, title and interest under the Mortgage at issue as of the date of the foreclosure Complaint. The Assignments, in every instance, express a present intent to convey all rights, title and interest in the Mortgage and the accompanying Note to the [p]laintiff named in the caption of the Foreclosure Complaint upon receipt of sufficient consideration on the date the Assignment was signed and notarized. Further, the Assignment documents are all prepared by counsel for the named [p]laintiffs. These proffered documents belie [p]laintiffs'

124. No. 1:07-cv-2282 et al. (N.D. Ohio Oct. 31, 2007) (detailing the preeminent bankruptcy proceeding to determine that the banks had not properly shown that they had standing to bring the action).

125. Robert J. Coughlin, *Caught in the Cross-Fire: Securitization Trustees and Litigation during the Subprime Crisis* 2, Nixon Peabody LLP, http://www.nixonpeabody.com/linked_media/publications/securitization_litigation_subprime_crisis.pdf (Sept. 18, 2009).

126. *Id.*

127. *In re Foreclosure Cases*, 1:07-cv-2282 et al., at 2.

128. *Id.* at 5–6.

129. Coughlin, *supra* n. 125, at 2.

> assertion they own the Note and Mortgage by means of a purchase [that] pre-dated the Complaint by days, months or years.[130]

Further, in support of his decision despite conflicting state decisions, Judge Boyko stated:

> This Court acknowledges the right of banks, holding valid mortgages, to receive timely payments. And, if they do not receive timely payments, banks have the right to properly file actions on the defaulted notes—seeking foreclosure on the property securing the notes. Yet, this Court possesses the independent obligations to preserve the judicial integrity of the federal court and to jealously guard federal jurisdiction. Neither the fluidity of the secondary mortgage market, nor monetary or economic consideration of the parties, nor the convenience of the litigants supersedes those obligations . . . [u]nlike . . . [s]tate law and procedure, as [p]laintiffs perceive it, the federal judicial system need not, and will not, be "forgiving in this regard."[131]

On that note, all fourteen actions were properly dismissed because the plaintiff banks failed to prove standing.[132]

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130. *In re Foreclosure Cases*, 1:07-cv-2282 et al., at 3 (emphasis in original).

131. *Id.* at 4. Judge Boyko included a footnote concerning his decision that notes the condescending manner in which the plaintiffs and their counsel expected the court to fall in line:

> Plaintiff's "Judge, you just don't understand how things work," argument reveals a condescending mindset and quasi-monopolistic system where financial institutions have traditionally controlled, and still control, the foreclosure process . . . financial institutions . . . rush to foreclose, obtain a default judgment and then sit on the deed, avoiding responsibility for maintaining the property while reaping the financial benefits of interest running on a judgment . . . [t]here is no doubt every decision made by a financial institution in the foreclosure process is driven by money. . . . Unlike the focus of financial institutions, the federal courts must act as gatekeepers . . . [c]ounsel for the institutions . . . utterly fail to satisfy their standing and jurisdictional burdens. The institutions seem to adopt the attitude that since they have been doing this for so long, unchallenged, this practice equates with legal compliance.

Id. at 5–6 n. 3.

132. *Id.* at 6.

B. The Wise Man Does at Once What the Fool Does Finally: Magic Tricks No Longer Fool Bankruptcy Courts

Bankruptcy courts in several states were the next to begin seeing through the banks' veiled efforts to establish standing when it did not exist.[133] In one such case, *In re Kemp*,[134] the court considered whether the proper steps were taken in securitizing the underlying mortgage for purposes of expunging the trustee's proof of claim.[135] Quoting the PSA for the underlying securitized trust, the opinion entered by the court notes that the PSA recital of the transfer required:

> "[T]he original Mortgage Note, endorsed by manual or facsimile signature in blank in the following form: 'Pay to the order of ____________ without recourse,' with all intervening endorsements that show a complete chain of endorsement from the originator to the Person endorsing the Mortgage Note." PSA §2.01(g)(i) at 56. Most significantly for purposes of this discussion, the note in question was never endorsed in blank or delivered to the Bank of New York, as required by the Pooling and Servicing Agreement.[136]

At the trial, a new undated allonge was produced purporting to meet the requirements of the PSA. Further, during deposition testimony given by a former bank employee, the court noted that the testimony showed a failure to properly transfer physical possession of the note to the trustee. The testimony established that the allonge was not prepared until the plaintiff's attorney requested it for the court and that it was never properly attached or affixed to the original note.[137] Additionally, during the same case, a Lost Note Certification was filed around the same time, purporting that the original note could not be found, in direct contradiction with testimony in the case and with previous representations made to the court and opposing counsel. When caught red-handed with inconsistent documents, the plaintiff

133. Coughlin, *supra* n. 125, at 3–4.
134. 440 B.R. 624.
135. *Id.* at 625 (explaining that the debtor was challenging the creditor's enforcement of the obligation due to improper endorsement).
136. *Id.* at 627.
137. *Id.* at 628.

requested that the court ignore the certification.[138] Applying state law, the bankruptcy court held that because the trustee never had possession of the note, it could not sue to enforce its obligations as the owner and holder in due course.[139] Furthermore, because the note was not properly endorsed under the guidelines set forth in the PSA, and the allonge never properly attached to the note, all requirements for a proper transfer had failed.[140] After addressing and pointing out the failure of plaintiff's argument under any of the three possible ways[141] to establish proper standing to foreclose under the New Jersey UCC provisions, the judge dismissed the claim.[142]

C. Keeping Your Eye on the Queen: State Courts Have Finally Started to Pay Attention to the Sleight of Hand Tricks of the Banks

One of the first states to recognize the securitization problems presented by bad documents was Massachusetts, in the case *United States National Bank v. Ibanez*.[143] Unusually, the securitization problem reared its head not in a foreclosure action, but in a quiet title action brought by a lender to ensure that it had clear title to properties that it had foreclosed upon.[144] In rejecting the quiet title claim, Judge Gants writing on behalf of the Massachusetts Supreme Judicial Court wrote:

> [w]here a pool of mortgages is assigned to a securitized trust, the executed agreement that assigns the pool of mortgages, with a schedule of the pooled mortgage loans that clearly and specifically identifies the mortgages at issue as among those assigned, may suffice to establish the trustee as the mortgage holder. However, there must be proof that the

138. *Id.* at n. 7.
139. *Id.* at 634.
140. *Id.* at 633–634.
141. Under New Jersey law, a foreclosing lender can sue as a holder (the person in possession if the instrument is payable to bearer or, in the case of an instrument payable to an identified person, if the identified person is in possession), a non-holder in possession (a person in possession of the note through subrogation or some other similar means), or a non-holder not in possession (due to lost, destroyed or stolen instruments). *Id.* at 630.
142. *Id.* at 634.
143. 941 N.E.2d 40 (Mass. 2011).
144. *Id.* at 44.

> assignment was made by a party that itself held the mortgage.[145]

In concluding that again the bank had failed to show that it was entitled to relief, the court stated:

> [t]he type of sophisticated transactions leading up to the accumulation of the notes and mortgages in question in these cases and their securitization, and, ultimately the sale of mortgage-backed securities, are not barred nor even burdened by the requirements of Massachusetts law. The plaintiff banks, who brought these cases to clear the titles that they acquired at their own foreclosure sales, have simply failed to prove that the underlying assignments of the mortgages that they allege (and would have) entitled them to foreclose ever existed in any legally cognizable form before they exercised the power of sale that accompanies those assignments.[146]

An Alabama state court has also seen the light and in the process, gave a dressing-down to the banks in *Horace v. LaSalle Bank National Association*.[147] In that case, the borrower brought suit before the initiation of a foreclosure action by the bank upon her receipt of a Notice of Acceleration. In seeking summary judgment in her suit for an injunction preventing the subject lender from foreclosing on her, the plaintiff argued that the trust failed to properly establish standing to enforce the mortgage and note against her, and prevailed in her argument.[148] The court, in granting summary judgment in favor of the borrower, admonished the plaintiff for its failure to comply with its own internal documents:

> First, the Court is surprised to the point of astonishment that the defendant trust . . . did not comply with the terms of its own Pooling and Servicing Agreement and further did not comply with New York Law in attempting to obtain assignment of [plaintiff's] note and mortgage. Second, plaintiff . . . is a third party beneficiary of the Pooling and Servicing

145. *Id.* at 53.
146. *Id.* at 56.
147. No. 57-cv-2008-000362.00 (Ala. Cir. Mar. 25, 2011).
148. Memo. of L. in Support of Pl. Mot. for S.J. and in Response to Def. Mot. for S.J., *Horace v. LaSalle Bank Nat'l Ass'n*, 57-cv-2008-000362.00 at 1–2 (Ala. Cir. Jan. 13, 2011).

> Agreement created by the defendant trust . . . [i]ndeed without such Pooling and Servicing Agreements, plaintiff . . . and other such mortgagors similarly situated would never have been able to obtain financing.[149]

The court then entered an order permanently enjoining the defendant trust from foreclosing on the subject property and borrower.[150]

In a recent decision by a Florida state court, the Fourth District Court of Appeal for the State of Florida wrote an opinion that will perhaps prevent summary judgment in the favor of any securitized trust in the future. In *Glarum v. LaSalle Bank National*,[151] it was not the documents purportedly transferring the note and mortgage that were at issue for once, but the affidavit of indebtedness filed by the lender based on alleged "personal knowledge" of a bank employee.[152]

For years, lenders have been filing similar affidavits of indebtedness such as the type seen in *Glarum* while failing to attach any business records and failing to establish that the employee signing them had any idea who entered the data, how it was computed, or even which lender or servicer was doing the record keeping. In a win for foreclosure defense attorneys and homeowners everywhere, the court finally held that such affidavits were inadmissible hearsay,[153] validating the argument that borrowers and their counsel had been making for years. So what does this mean in Florida? It means that a trust, or its servicer, would have to establish *actual personal knowledge* of the person who entered payments made by the borrower into the computer system, how the system works, who was responsible for maintaining the records, and whether the records were correct.[154] *And, most importantly*, it would have to establish the same founda-

149. *Horace*, 57-cv-2008-000362.00.

150. *Id.* at 1–2.

151. 83 So. 3d 780 (Fla. 4th Dist. App. 2011).

152. *Id*. at 782.

153. *Id.*

154. *Id.* In fact, some counsel for the major banks have sounded the alarm to their clients as to the potential repercussions this decision could have on their ability to bring and prevail on motions for summary judgment. Greenberg Traurig, *The Changing Landscape of the Business Records Exception under Florida Law and its Impact on Florida Foreclosures*, http://www.gtlaw.com/newsEvents/Publications/Alerts?find=152634 (accessed July 22, 2012).

tional requirements in the affidavit for every lender or servicer who collected the payments on behalf of the trust. With the poor state of recordkeeping by the banks, as evidenced throughout the entire Article, such a task is tantamount to climbing Mount Everest for the foreclosing banks.

Finally, in a decision by the Fifth District Court of Appeals on September 30, 2011, in the case of *Gee v. United States National Association*,[155] the court reversed a summary judgment that was entered on grounds not even raised in the summary judgment motion.[156] In doing so, the court found that the bank lacked the documentation to properly establish standing and noted that "[i]ncredibly, U.S. Bank argues that '[i]t would be inequitable for [borrower] to avoid foreclosure based on the absence of an endorsement.'"[157] In reversing summary judgment, the Fifth District established that the traditional argument made by banks that "the borrower defaulted so who cares if we have the right documents" will no longer prevail in foreclosure actions.[158] Moreover, the issue of standing, particularly in securitized trusts, will now be front and center stage in foreclosure defense.[159]

VIII. YOU CAN FOOL ALL OF THE PEOPLE SOME OF THE TIME, AND SOME OF THE PEOPLE ALL OF THE TIME, BUT YOU CANNOT FOOL ALL OF THE PEOPLE ALL OF THE TIME

The goal of this Article is not to deny, by any means, the right of a mortgage lender to foreclose on borrowers who have failed to meet their financial obligations. It is intended, however, to elucidate for fellow attorneys and members of the judiciary that while these financial obligations exist, so do the legal protections of our judicial system that were instituted to protect the property rights of Americans that are rooted in the United States and Florida

155. 72 So. 3d 211 (Fla. 5th Dist. App. Sept. 30, 2011).
156. *Id.* at 212.
157. *Id.* at 213.
158. *Id.*
159. *See* Tamara R. Parker, *Foreclosure Defense: Where Do We Stand on Standing?* Columbus Bar Laws. Q. (Winter 2011) (available at http://www.cbalaw.org/_files/publications/lawyers-quarterly/Foreclosure%20Defense%20-%20Where%20Do%20We%20Stand%20on%20Standing.pdf) (noting "real party standing" is a prominent standing defense for foreclosure litigation).

State Constitutions. The judicial system was never meant to be evaluated by how swift justice could be dispensed or by how quickly a particular judge could dispose of cases on his or her docket. As officers of the court, both judges and attorneys are responsible for protecting the integrity of the system, ensuring that the system is never compromised solely for financial expediency.

Unfortunately, for the past several years, it is as if the Florida judicial system had adapted a set of "lore" that was not rooted in any legal construct. The standing issue concerning securitized trusts is particularly glaring since it has been argued tens of thousands of times in judicial chambers throughout the state with courts, for whatever reason, turning a deaf ear and a blind eye on these fundamental issues.[160] We will not attempt to address the conflicting motivations that allowed this unfortunate set of events to have occurred, but it is clearly one of Florida's judicial branch's darkest hours. We are encouraged, as a profession, by the new caselaw developing in Florida that would suggest the judiciary has finally seen the light and that homeowners may finally see foreclosure by the proper lender, in compliance with their due process and constitutional rights. In the long run, ensuring the integrity of the system will preserve the judiciary and will re-establish respect for the judicial system.

160. In 2008, one of the Authors appeared before a particular court in defending a foreclosure, at which time the judge was rubber stamping a large stack of uncontested summary judgments. Counsel remarked to the judge that in many of those cases, the bank did not establish the necessary predicate for filing foreclosures based on issues of standing and other legally required foundations. The court asked if the Author was representing the defendants in those files, and the Author said he was not. The Author then suggested to the court that his honor had sworn the judicial oath of office, including to uphold the Code of Judicial Conduct, which in relevant part requires a judge to "respect and comply with the law and shall act at all times in a manner that promotes public confidence in the integrity and impartiality of the judiciary." FL ST CJC Canon 2(A). The court then said to counsel that if he continued in that line of discussion that he would be held in contempt of court. Interestingly enough, this judge has recently stepped down to accept a position at a Florida foreclosure mill.