A MAJOR DEFENSE TO FORECLOSURES:
LACK OF INTEREST IN PROPERTY/ LACK OF STANDING BY MERS[1]
AND OTHER MORTGAGE "SERVICING AGENTS/NOMINEES"

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I. OVERVIEW - "FROM A SYNTACTICAL FOG INTO AN IMPASSIBLE SWAMP"

Those are words of the federal judge in the case of In Re Jacobson, 402 BR 359 (BK W.D. Wash. 2009) in which it was held that MERS lacked standing for its lack of interest in the subject property. See also, In Re Wilhelm, 407 BR 392 (BK D. Idaho 2009) (same result). In these cases those entities which claim standing with respect to a mortgage[3] file a claim in the Bankruptcy Court or in some cases bring foreclosure action. See also, Landmark National Bank v. Kessler, 2009 Kan. LEXIS 834 (Kan. 2009) (MERS loses) and cases cited therein. No doubt a problem for the lender/agents is the bundling problem, or by other means situations in which lender A conveys to B which conveys to C which conveys to D, a mere servicing agent of the loan, hired by the lender to bring the action. But this much is clear: homeowners are defeating lenders/agents in a "David and Goliath" battle. Any professional should seriously consider whether he wants to add this area to a practice of loan modification, bankruptcy, or otherwise, and, of course, state law controls. Thus, the results will vary as to the jurisdiction.

II. THE CASES

The cases cited above are but a few examples of the legion of cases being decided in this area. What is clear is that the courts, especially the bankruptcy judges, not only have no sympathy for the lender and agent/nominee, but go to some length to make clear how ludicrous is the position claimed by the lender and agent/nominee. The attitude is best illustrated by Judge Philip H. Brandt in Jacobson, supra, in which he chastised the counsel and the bankruptcy specialist declarant of Swiss Bank UBS for the boilerplate, nonsensical declaration:

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[3] I use the term loosely. In Western states such as California and Arizona, typically, it is not a mortgage but a note and deed of trust.

> One hopes the declarant is not as unsure of his own identity as this imprecision suggests: is he employed as a bankruptcy specialist by UBS AG only in its capacity as servicing agent for ACT Properties? Or for his successor or assignee of ACT? Or, is he is a bankruptcy specialist for UBS AG and its successors and/or assigns? ... how does declarant know he will be employed by whomever it is, or have access to its records?

Id. at 368-9.

III. "SHOW ME THE NOTE!"

No note, no standing. Remember "holder in due course"? And, "assignment of the note equals assignment of the mortgage"? You get the picture.

According to one plaintiff,[4] "MERS members decided it was too costly to pay recordation fees on loans that might be flipped numerous times, so according to MERS, MERS was chosen as nominee for the lender and its assigns in these deeds of trust, for the purpose of 'immobilizing the mortgage lien while transfers of the promissory notes and servicing rights could continue to occur without the expense of recordation.'"

So how does the borrower know who holds the note or deed of trust/mortgage? He doesn't. And he should demand production of the note and any assignments. "No tickie, no laundry." See, e.g., Saxon v. Hillery, 208 WL 5170180 (N.D. Cal. 2008) (complaint by lender dismissed without prejudice; allegations required: holder of note and deed of trust plus supporting evidence). Compare: In re Hill, 2009 WL 1956174 (Bk. D.Ariz. 09) (Chase Finance produced original note; MERS transferred deed of trust to Chase which deed was recorded).

IV. A NEW COTTAGE INDUSTRY?

Presently attorneys are engaged in providing loan modification services. A defense to foreclosure is, of course, a close cousin.

In fact, consider the obvious: are loan modification providers subject to a suit for malpractice/negligence, where, for example, a loan has been modified from one million dollars to $750,000 but under the facts of the case the million dollars in mortgage/lien

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[4] Complaint, at p.6, para.31 in Mills v. First Horizon, No. CH-09-0662-2, Shelby County, TN, quoting MERS v. Nebraska, 704 NW 2d 884, 786 (Neb. 2005). See also, MERS v. Southwest Homes (Ark. S.Ct. 2009).

could have been eliminated through knowledge of the standing problem for the lender? To put a point on it, is the professional subject to a possible suit for $750,000 in damages?

V. MERS: "WHO ARE THOSE GUYS?"

Recall that in the movie "Butch Cassidy and the Sundance Kid," as the two outlaws were fleeing remote Southern Utah, they were closely followed and the question was raised by Sundance, "Who are those guys?" Butch and the Sundance Kid escaped by jumping off a cliff into a raging river. The same question arises as to MERS, and I leave it to the web surfers to provide information on MERS and other "servicing agents."

No doubt, however, MERS is behemoth, which means it is also a huge bureaucracy, which means that it cannot react quickly, and in any event, may not have its act together with respect to the minutia of detail required in a claim to property, especially in a bankruptcy setting. Simply put, the problem is caused, no doubt, by the sale of loans from one entity to another and down, in some cases, a lengthy chain, and probably in the vast majority of cases resulting in "bundling," about which we heard so much regarding the recent fall of the global economy.[5]

If, in fact, the major problem is bundling, then how is the problem resolved, given a fact scenario of A to B to C and finally to D as servicing agent. Query: (1) How does D unravel the paperwork, given its need for the cooperation of A, B, and C, but especially A and B? (2) Why should A and B invest any time in assisting D, and therefore, C, given that A and B have already been paid and the mortgage and note have changed hands?

VI. STATE LAW CONTROLS

It is likely that we will see many decisions of this type, but they will vary depending on the jurisdiction. As an example is an Arizona federal district court case, Blau v. American Servicing Co., U.S., 2009 WL 3174823 (D. Ariz.) In which the homeowner lost on this standing issue, but the court skirted the major issue of standing to enforce the instrument as required by the UCC. Id. at p.6. Even a general reading of this case will lead many readers to conclude, no doubt, that the decision is a political one,[6] and not

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[5] In fact, an attorney in Germany reports that his firm represents German state governments rescuing German state banks which are going under as a result of their investment in, you got it, the U.S. sub-prime (bundled) loan market.

[6] Protect the banks/Goliath, as against David.

one made on the face of the law at hand. The court deferred to the state court[7] to resolve the question of whether the UCC applies to holders of deeds of trust in Arizona, choosing to disregard the Kansas and bankruptcy cases, supra.

I presently have a client in Nevada who visited with a Nevada attorney who informed her that there is a new law in Nevada which gives the homeowner greater rights if the notice of default is filed after July 1, 2009, in which case the bank has to negotiate with the homeowner if requested, and resolve the issue in a reasonable manner. This points out the obvious: at the very least, knowledge of the standing issue can provide leverage for the homeowner which may lead, at the very least, to delay in the foreclosure, and may well result in either (a) a total win and elimination of the debt, or (b) a favorable modification given the lender's hesitancy to proceed to litigation.

VII. CHOICE OF FORUM: BANKRUPTCY, STATE COURT, OR DISTRICT COURT

It is up to the practitioner to research the issues and decide the best forum. Often these cases are in bankruptcy because at the eleventh hour/fall of the gavel at the public auction/foreclosure; the homeowner files a bankruptcy and obtains an automatic stay. Thus, as the bankruptcy cases illustrate, the case becomes one of the lender's attempt to lift the automatic stay, but this attempt is denied due to the lender's lack of standing. It is reported by the Bankruptcy Bar that recently a judge in a New York case held that the debt of over $500,000 was totally eliminated for lack of standing.

VIII. THE GLOBAL VIEW, OR AS CHICKEN LITTLE WOULD SAY, "THE SKY IS FALLING"

At the risk of sounding like Chicken Little, I would be remiss to not point out what should be the obvious to even the most uninitiated: the possibility of global repercussions if the foreclosure defense/lack of standing offense spreads like wildfire. Assume, for example, that the global recession was caused in major part because the value of properties was reduced in half from the top of the market (say July, 05) to today. Then assume that, with hundreds of thousands of foreclosure defenses the lenders conclude that the value of the property is brought to zero because of the lender's inability to foreclose as a result of the standing issue. What is the economic fall out? National? Global? What about availability/unavailability of new loans?

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[7] Rather than refuse to decide the UCC issue, why not send it to the Arizona Supreme Court on a certified question?

IX. HOW CAN THE LENDER FIX THE PROBLEM?

I suggest: with great difficulty and at great cost. Put another way: it is not likely to be fixed.

X. THE TAX QUESTION: FORGIVENESS OF DEBT INCOME TO THE HOMEOWNER?

Doubtful, but I leave it to learned counsel to research how can court-ordered "elimination" of debt be characterized as forgiveness, especially if the order is by a bankruptcy judge? Probably best to make sure that the bankruptcy judge enters the debt as "discharged" in the bankruptcy, given that under §108 of the Internal Revenue Code (IRC; Title 26), bankruptcy discharge is one of the exceptions to forgiveness of debt income aka discharge of indebtedness (DOI) income.

In a nutshell, in 2007 the new act[8] made substantial changes to the law in this area. Simply put, §108(a)(1) provides for situations where DOI income is not taxed: (1) bankruptcy discharge; (2) insolvency; (3) qualified farm indebtedness; and (4) qualified real property business indebtedness. Section 108 also provides two additional circumstances for DOI income as not taxed: forgiveness of student loans and business loans. See IRS Publication 4681 (2007) "Cancelled Debts - Foreclosures, Repossessions and Abandonment."

Another defense to potential DOI income is that the debt must be enforceable under state law, which in the case of a foreclosure where the borrower wins under circumstances described in the cases, supra, it appears there is a strong argument that the debt was not enforceable under state law; after all, as the cases, supra, illustrate, that is the basis for the court's holding. See, e.g., Zarin v. CIR, 916 F.2d 110 (3rd Cir. 1990). Moreover, "disputed amounts" are not considered DOI income. See, e.g., Zarin supra (debtor must contest charges); Earnshaw v. CIR, TC Memo 2002-191 (same); Preslar v. CIR, 167 F.3d 1323 (10th Cir. 1999) (difference between original debt and settlement amount is disregarded); N. Sobel, Inc. v. CIR, 40 BTA 1263 (1939) (origins of doctrine - negotiated settlements not DOI income).

XI. SUMMARY AND CONCLUSION

I tag off to others, learned counsel and otherwise, to more fully investigate this issue, including web surfing for news articles, professional publications, etc., and put their own gloss on this state of affairs. In fact, another question arises: why has this topic not yet been met with national media attention? Or,

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[8] The Mortgage Debt Relief Act of 2007.

perhaps it was, and was missed by this writer. Or, perhaps the "establishment media" does not want to "let the cat out of the bag." "Let the games begin!"