Averting The Apocalypse: Foreclosing Lenders Avoid Disaster and Given More Options To Foreclose In *Eaton v. Fannie Mae*

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Score One For Lenders and Mortgage Servicers In Long-Awaited *Eaton v. Fannie Mae* Case

In a case with national implications, the Massachusetts real estate community has been waiting 8 long months for a decision from the Massachusetts Supreme Judicial Court (SJC) in the much anticipated ***Eaton v. Federal National Mortgage Association*** (link) case. The decision came down June 22, and now that the dust has settled, I don't think there is any question that lenders and the title community have been given a judicial Maalox.

The SJC held that lenders must establish they hold both the promissory note (indebtedness) and mortgage – a major problem for securitized or MERS mortgages where the note and mortgage are split between securitized trust and servicer. However, responding to pleas from the real estate bar, the Court declined to apply the new rule retroactively, thereby averting the Apocalyptic scenario where thousands of foreclosure titles would have been called into question. Even better, the Court outlined new sensible procedures, including filing a statutory affidavit, to ensure that foreclosures are compliant going forward. The ruling clearly favors lenders and the foreclosure industry, and will clear the way for foreclosures to accelerate and run their course in Massachusetts and possibly other states if the ruling is followed. Let's break it down.

Background: Borrower Used "Produce the Note" Defense To Stop Foreclosure

As with many sub-prime mortgage borrowers, Henrietta Eaton had defaulted on her mortgage to Green Tree Mortgage. This was a MERS mortgage (Mortgage Electronic Registration System) originally granted to BankUnited then assigned to Green Tree.

Ms. Eaton was able to obtain an injunction from the lower Superior Court halting her eviction on the grounds that Green Tree did not possess the promissory note underlying the mortgage when the foreclosure occurred. This is the "produce the note" defense and has been gaining steam across the country. Superior Court Judge Francis McIntyre bought into that argument, and stopped the foreclosure. Given the importance of the case, the Supreme Judicial Court granted direct appellate review.

FHFA Files Amicus Brief and SJC Asks For More Guidance

This case garnered substantial local and national attention from the lending, title and real estate community on one side, and housing advocates on the other side. Notably, the Obama Administration's Federal Housing Finance Agency filed a rare friend-of-the-court brief in a state court proceeding, arguing for a ruling in favor of lenders. Spirited oral arguments were held back in October which I briefed here.

In January, when a decision was expected, the Court surprisingly asked the parties for additional briefing on whether a decision requiring unity of the promissory note and mortgage would cloud real estate titles. This was the apocalyptic scenario that the real estate bar and title community urged the Court to avoid. (The Court listened, as I'll explained below).

The Opinion: Unity Endorsed, A Foreclosing Lender Must "Hold" Both Note & Mortgage

The first issue considered by the court was the fundamental question of "unity" urged by the Eaton side: whether a foreclosing mortgagee must hold both the promissory note (underlying indebtedness) and the mortgage in order to foreclose. After reviewing Massachusetts common law going back to the 1800′s, the Court answered yes there must be unity, reasoning that a "naked" mortgagee (a holder of a mortgage without any rights to the underlying indebtedness) cannot foreclose because, essentially, there is nothing to foreclose. If the Court stopped there, lenders and MERS would have been in big trouble. But, as outlined below, the Court significantly limited the effect of this decision.

Disaster Averted: Ruling Given Prospective Effect

Swayed by the arguments from the Massachusetts Real Estate Bar Association that retroactive application of a new rule would wreak havoc with existing real estate titles in Massachusetts, the SJC took the rare step of applying its ruling prospectively only. As Professor Adam Levitin (who drafted an amicus brief) noted on his blog, this "means that past foreclosures cannot be reopened because of this case, so the financial services industry just dodged billions in liability for wrongful foreclosures and evictions, and the title insurance industry did as well." So going forward, lenders must establish unity of both note and mortgage, but past foreclosures are immune from challenge.

MERS System Given Blessing?

Ms. Eaton's mortgage was a MERS (Mortgage Electronic Registration System) mortgage. MERS is a private system created by the largest national lenders and title companies to track assignments and ownership of loans as they are bought and sold in the secondary mortgage market. MERS has come under fire from distressed homeowners and registrars of deeds (especially our own Essex County Registrar John O'Brien) for robo-signing and bungled foreclosures. Although the Court did not specifically rule on the validity of the MERS system, the decision cited several new MERS policies and said that lenders who follow these new policies will likely be in compliance with the court's holding. So MERS will continue doing business in Massachusetts for the foreseeable future.

Make Way For the "Eaton" Affidavit

The most important aspects of the *Eaton* ruling, in my opinion, are what came after the two "headline" rulings above. First, the Court made the explicit point that lenders do not have to *physically* possess both note and mortgage to be deemed a "holder" able to foreclose. This is huge given the pandemic paperwork deficiencies common with securitized mortgage trusts.

Second, the court also stated in a very important footnote that it will "permit one who, although not the note holder himself, acts as the authorized agent of the note holder, to stand "in the shoes" of the "mortgagee" as the term is used in these [foreclosure statute] provisions." This footnote opens the door wide open for servicers and MERS to establish that they are authorized to foreclose, and acting on behalf of, the securitized trusts who hold legal title to the mortgages.

Lastly, the court approved the use of a statutory affidavit filed at the county registry of deeds in which the note holder or mortgage servicer confirms that it either holds the promissory note or is acting on behalf of the note-holder. We will surely be seeing these "Eaton" affidavits being prepared and recorded in connection with foreclosures.

What's Next?

As a real estate and title attorney, what I appreciate about this decision is that the SJC took into account the disastrous effect a retroactive rule would have on past titles (now held by innocent third party purchasers) and came up with new ground rules for foreclosing lenders to follow going forward. It's like the court said "what's done is done, now let's move forward doing it the 'right' way." We will definitely see foreclosures that were in a holding pattern resume again. On the closing side, when I am reviewing a title with a past foreclosure, my client and I can sleep better knowing that the risk of a defective title just got a reduced substantially. This is good for the housing market and it makes more properties marketable.

However, this is not the end of foreclosure litigation in Massachusetts. As with most landmark cases pronouncing a new rule of law, subsequent litigation to clarify what the court meant is likely to follow in this case. Some remaining unanswered questions include:

- Is the produce the note defense truly dead for previously completed foreclosures–even where promissory notes are lost and not produced?
- If challenged, what further documentation, if any, will suffice to establish agency for MERS and mortgage servicers of mortgages held in securitized trusts.
- Will borrowers be able to challenge new "Eaton" affidavits which appear to be fraudulent or robo-signed?

All things considered, I will agree with Prof. Levitin who opined: "In the immediate term, I'd score the case as a major victory for the financial services industry, which avoided liability for its failure to comply with state law foreclosure requirements. Going forward, however, things are more complicated."

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