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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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INTRODUCTION 2
SETTING THE STAGE: A BRIEF HISTORY OF SUB-PRIME MORTGAGE LENDING AND THE BEGINNING OF THE SECURITIZATION CRISIS 4
Bait and Switch: The Rise of Sub-Prime Lending 4
That Old Black Magic: Traditional Mortgage Loans Before the Subprime Lending Crisis, and the Securitization Takeover 7
SELLING THE AUDIENCE: SO WHAT IS "SECURITIZATION?" 8
Credit Rating-Agencies: Making a Silk Purse Out of a Sow's Ear 10
THE SHELL GAME: THE POOLING AND SERVICING AGREEMENT ANDWHAT THE BIG BANKS DON'T WANT THE JUDICIAL SYSTEM TO KNOW 12
Assistant's Revenge: Liability of the Trustee and Servicer Under the PSA 12
PULLING A RABBIT OUT OF A HAT: THE FUNDAMENTAL CONCEPT OF STANDING AND HOW SECURITIZATION HAS RUN AMUCK WITH A BASIC LEGAL REQUIREMENT 14
THE TRICK IS NOT A TRICK: WITH SECURITIZATION, SUBSTANCE IS THE FORM AND THE FORM IS THE SUBSTANCE 16
Handcuff Secrets: Lenders Recognize their Own Illusion, So Why Is the Judiciary Still Being Taken In? 18
The Prestige: The American Securitization Forum and Private Sector Experts Disagree on the Basics 21
"ABRACADABRA" JUST ISN'T CUTTING IT IN SOME COURTS 23

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Judge Boyko Not Fooled by the Illusion, Tells Lender "This Court Possess the Independent Obligations to Preserve the Judicial Integrity of the Federal Court" *23*
The Wise Man Does At Once What the Fool Does Finally: Magic Tricks No Longer Fool Bankruptcy Courts *25*
Keeping Your Eye on the Queen: State Courts Have Finally Started to Pay Attention to the Sleight of Hand Tricks of the Banks *27*
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 30

INTRODUCTION

From 2003 to 2007, Florida saw the largest real estate boom in its history. Real estate sold at astonishing prices as people were sold a bill of goods known as the "American Dream." But for many, that American Dream turned out to be the American Nightmare. From sub-prime mortgage lending and predatory practices by mortgage brokers, lenders and improper securitization of mortgages, this era of economic boom led to the largest crash in the history of the real estate market[2], a crash from which Florida has yet to recover, and to which we have not yet seen the end. 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. And what is worse yet is that the systemic fraud and illegal conduct of the banks has continued to pervasively infect court systems throughout the nation; further, the Florida court system has suffered from extreme abuse at the hands of the banks that have high jacked it and effectively turned it into a private collection agency for the banking industry.[3]

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2. Roy D. Oppenheim, *Florida Housing Crisis Worse than Great Depression?*, South Florida Law Blog, June 16, 2011, http://southfloridalawblog.com/2011/06/16/from-bad-to-worse-securitized-trusts-face-scrutiny-and-housing-crisis-now-worse-than-the-great-depression/ (last visited Sept. 30, 2011). As of June 2011 home prices had fallen more than 33%, 2% lower than the hit the market received in the 1930s. *Id.* In addition, prices in South Florida have likely not hit their low, as thousands of foreclosures continue to occur, home prices could decrease an additional 10-15%. *Id.*

3. Roy D. Oppenheim, *Roy Oppenheim to the Wall Street Journal: "Your Editorial will make future investors think twice about entire system,"* South Florida Law Blog, Oct. 19, 2010, [hereinafter *Roy Oppenheim to the Wall Street Journal*] 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-

Mortgage securitization is perhaps one of the least understood areas of the real estate industry, and for good reason. With phrases such as mortgage bundling, securitized trusts, and tax-exempt structures known as Real Estate Mortgage Investment Conduits ("REMICS"), there are many terms employed to describe massive collections of bundled mortgages which were broken up and sold off in pieces. While this method of bundling mortgages was once looked at as perhaps the best thing to ever happen to the mortgage industry, allowing large scale investors such as pensions and retirement funds to own interests in mortgages in a way that was deemed "safe,"[4] the securitization process has become a nightmare for the American homeowner fighting foreclosure. In fact, the securitization process has made it impossible in many, if not all cases where a mortgage is held in a securitized trust, to determine who actually owns a mortgage and note, a fact which until recently has done little to slow down the foreclosure rocket-docket.[5]

However, there is a great deal which should be understood about securitized trusts 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.[6] This article will review 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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system%E2%80%9D/ (last visited Sept. 30, 2011); Roy D. Oppenheim, *Foreclosure Jurisprudence*, THE FLORIDA BAR NEWS, July 1, 2011; Jose Pagliery, *Canady Returns to Well to Replenish State Courts*, DAILY BUSINESS REVIEW, A1, Sept. 30, 2011.

4. Ironically, these securities were deemed safe because they had Triple-A ratings (similarly to U.S. Treasury bills). Now, neither 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.

5. This failure prevented homeowners and the government from creating a true solution to the crisis through mortgage modifications by making it so unclear as to who owned the mortgages that investor approval could never be obtained. 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.

6. 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.

SETTING THE STAGE: A BRIEF HISTORY OF SUB-PRIME MORTGAGE LENDING AND THE BEGINNING OF THE SECURITIZATION CRISIS

Sub-prime lending is "a fancy financial term for high-interest loans to people who would otherwise be considered too risky for a conventional loan."[7] 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.[8] With short-sightedness, borrowers often were lured with these attractive rates, only to be shocked by "exploding adjustable rates" that they couldn't possibly afford on their low salaries, and especially couldn't afford once many homeowners in lower and middle class families became unemployed.[9]

Bait and Switch: The Rise of Sub-Prime Lending

Although the subprime mortgage lending practices developed gradually over time, the start of the industry was paved by three major events.[10] In the 1980s several key pieces of legislation were passed by Congress.[11] These various Acts created deregulation of the mortgage industry in an effort to encourage homeownership by the American public.[12] First, The Depository Institutions Deregulation and Money Control Act of 1980[13] (DIDMCA) was passed allowing the subprime mortgage industry to flourish by charging rates that had previous been illegal practices.[14] Further, although the current Con-

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7. John Atlas and Peter Drier, *The Conservative Origins of the Sub-Prime Mortgage Crisis*, The American Prospect, December 18, 2007, http://prospect.org/cs/articles?article=the_conservative_origins_of_the_subprime_mortgage_crisis (last visited Sept. 30, 2011).

8. *Id.*

9. *Id.* The borrower 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 life. What they failed to realize is that these parties had such a vested interest in selling high priced loans with exploding rates and getting inflated appraisals that they were putting their interests before those of the borrower, to the borrower's ultimate detriment. Further, since the lenders were no longer holding and servicing their own loans, the high-risk of default no longer discouraged them from such practices.

10. BITNER, CONFESSIONS OF A SUBPRIME LENDER: AN INSIDER'S TALE OF GREED, FRAUD AND IGNORANCE 23 (2008).

11. *Id.*

12. *Id.*

13. 12 U.S.C. §1821(2011).

14. BITNER, *supra* note 10, at 23; Federal Reserve Bank of Boston, *Depository Institutions Deregulation and Monetary Control Act of 1980*, April 1980, available at http://www.bos.frb.org/about/pubs/deposito.pdf; John Birger, *How Congress Helped Create the Subprime Mess*, CNNMoney.com, January 31, 2008,

gress has been quick to point out that the predatory lending practice by banks are responsible for the current housing slump, they have failed to place some of the blame in their own lap for the legislation that contributed to the problem.[15] Patricia McCoy, a Professor of Law at the University of Connecticut pointed out in a CNN Money article published towards 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."[16] 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)[17] was passed, making adjustable rate mortgages (ARMs) and balloon payments legal for the first time.[18] Finally, the Tax Reform Act (TRA) of 1986[19] encouraged more homeownership by making the deduction more prevalent, "increasing the demand for mortgage debt."[20] Further, the Job Growth Tax Relief and Reconciliation Act of 2003[21] cut the tax rate on capital gains to 15%, adding fuel to the fire

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http://money.cnn.com/2008/01/30/real_estate/congress_subprime.fortune/ (last visited Sept. 30, 2011). Further, 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. *Id.*

15. Birger, *supra* note 14.

16. *Id.*

17. 12 U.S.C. §39 (2011).

18. BITNER, *supra* note 10, at 23. Prior to 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 traditional mortgage. Birger, *supra* note 14. 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.*

19. Roger Lowenstein, *Who Needs the Mortgage-Interest Deduction*, N.Y. TIMES, March 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 Regan in his address the National Association of Realtors in 1984 made clear that the goal of the Act plan 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.* However, as noted by Roger Lowenstein, "[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.*

20. Birger, *supra* note 14.

21. The Jobs and Growth Tax Relief Reconciliation Act of 2003, Pub. L. 108-27 (May 28, 2003).

by encouraging speculative investment in real estate due to the disparity in tax rates on regular income versus capital gains from real estate investment.[22]

Further, significant changes within the mortgage industry itself were creating a system ripe for making high-risk loans because the potential pay-off to the bank justified the high rate of default for such loans.[23] First, interest rates began climbing, making it more difficult for people to get traditional mortgage loans.[24] 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 the up-front fee they charged to borrowers.[27]

There are several players within the subprime mortgage industry that contributed to the current crisis.[28] In *Confessions of a Subprime Lender*, 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 are involved in creating, packaging, and selling subprime mortgages as mortgage-backed securities.[29] The base of the food chain, like all good food chains, begins with the small animals that are building blocks for the larger predatory animals. In this food chain, the small animals include borrowers, mortgage brokers, and small time lenders.[30] 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 chain, gouges itself on the largess from these institutions that lavish significant

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22. *Id.*; Tax Foundation, *History of the Income Tax in the United States*. Further, since the tax on capital gains made from buying and selling real estate was capped at 15%, it encouraged investment in real estate as income tax rates on regular income were capped at 30%, twice the rate of capital gains. 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.

23. BITNER, *supra* note 10, at 23–24.

24. *Id.*

25. *Id.*

26. *Id.*

27. *Id.*

28. *Id.*

29. *Id.*

30. *Id.*

31. *Id.*

campaign contributions on individual congressional members.[32] It is all of these players working together that created the "gunslinging process of subprime lending" and as a by-product, mortgage-backed securities.[33]

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.[34] 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.[35] These lenders are called portfolio lenders and are now a dying breed.[36] However, after subprime lending took over, 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.[37] As Professor Adam 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 credit risk, interest-rate risk, and liquidity risk associated with holding the mortgages on their own books.[38]

It is of course the very nature of securitization that made it so appealing to mortgage lenders.[39] 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 sub-prime loans from small mortgage lenders.[40] Mortgage brokers, "the street hustlers of the lending world" would find borrowers and get paid a

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32. *See* GRETCHEN MORGENSON AND JOSHUA ROSNER, RECKLESS ENDANGERMENT (2011).
33. BITNER, *supra* note 10, at 23–24.
34. *Id.*; Adam Levitin and Tara Twomey, *Mortgage Servicing*, YALE J. ON REG. 11 (2011).
35. *Id.*; Levitin and Twomey, *supra* note 34, at 11.
36. *Id.*; Levitin and Twomey, *supra* note 34, at 11.
37. *Id.*; Levitin and Twomey, *supra* note 34, at 11.
38. *Id.*
39. Atlas and Drier, *supra* note 7; Levitin and Twomey, *supra* note 34, at 11.
40. Atlas and Drier, *supra* note 7.

premium for creating sub-prime loans, "seduc[ing] millions of people into signing on the dotted line."[41] Then, instead of holding onto the loans as traditional lending practices had called for before, sub-prime 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.[42] As noted by John Atlas and Peter Drier in their article *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 ownership has become a nightmare.[43]

SELLING THE AUDIENCE: SO WHAT IS "SECURITIZATION?"

Perhaps the most confusing issue when dealing with securitized trusts and what those trusts mean with regards to foreclosure standing is understanding what "securitization" is.[44] While there are many explanations, some lengthy while others brief, understanding the process of securitization and the repercussions from a defensive perspective can truly allow for a crucial offensive strategy. Further, it is essential for any lawyer or judge involved in the foreclosures to understand the process of securitization, the key components, deadlines, 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 get out of a financial nightmare.

A simple definition of securitization is "a process where thousands of mortgage loans are bundled together into financial products called mortgage-backed securities."[45] However, this is an over-simplified definition that does not give true credit to the structural complexities of MBS.

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41. *Id.*
42. *Id.*
43. *Id.*
44. Although 'securitization" is one process, the ramifications and intricacies are different depending on whether you are addressing it from a foreclosure defense standpoint, tax standpoint, or seeking loss mitigation alternatives as a borrower. For a detailed explanation of securitization as it relates to problems with loss mitigation, *see* Adam Levitin, *Mortgage Servicing*, *supra* note 34.
45. BITNER, *supra* note 10, at 107.

The complex definition of the securitization process requires an explanation of the key steps, and how they interact with one another. The first stage occurs when a "sponsor" financial institution bundles mortgage loans together.[46] This bundle is created from loans either originated by the sponsor, or purchased from third party originators such as small lenders or mortgage brokers.[47] The next step involves a sale of the bundled mortgages to a subsidiary created specifically for this purpose, known as a "depositor."[48] 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.[49] The third step occurs when the intermediary depositor sells the loans to a passive entity[50], in the case of residential mortgages a "trust" which is designed to hold the mortgages and to issue securities which are repaid from the mortgage payments made on the loans.[51] The initial purchase of securities provides the capital to pay the depositor and sponsor for the loans.[52] The trust can issue securities one of two ways, either 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.[53] The Congressional Oversight Report published in November 2010 notes that for proper securitization, "[t]here are at least three points at which the mortgage

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46. Levitin and Twomey, *supra* note 34, at 11.

47. *Id.*

48. *Id.*

49. *See* Levitin and Twomey, *supra* note 34, at 11 n.34 for an explanation as to why bankruptcy remoteness is a key component to this process; Adam Levitin, *Written Testimony Before the House Financial Services Committee Subcommittee on Housing and Community Opportunity*, at 3, November 18, 2010 [hereinafter *Written Testimony*].

50. 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 referred to a Real Estate Mortgage Investment Conduit ("REMIC") pursuant to I.R.C. §§860A-G. 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 real estate mortgage investment conduit ("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, *Mortgage Servicing*, *supra* note 34, at 15. In fact the IRS has taken notice and already initiated an investigation into the "active" activities of these trusts and the tax implications from them. Scot J. Paltrow, *Exclusive: IRS Weighs tax penalties on mortgage securities*, REUTERS, April 27, 2011.

51. Levitin and Twomey, *supra* note 34, at 11.

52. *Id.*

53. *Id.*

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."[54]

Credit Rating-Agencies: Making a Silk Purse Out of a Sow's Ear

The final stage of securitization involves the sale of the mortgage-backed securities based on the risks they presented.[55] 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.[56] Tranches are then assigned a different credit rating by a credit rating agency.[57] Each tranche is a portion of the risk on the loan.[58] Therefore, the higher rated portion, those given a Triple-A rating, down to an Equity rating.[59] Those who receive a portion with the triple-A rating are repaid first, have the least risk of loss, but also the lowest possible return on their investment.[60] The lower you go down in the ratings, the higher the rate of possible return, but the greater the risk.[61]

Once the securities are broken down into tranches, the rating agency has to try and judge the quality and value of the assets in each tranche.[62] Bitner uses the following analogy:

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54. November Oversight Report, *Examining the Consequences of Mortgage Irregularities for Financial Stability and Foreclosure Mitigation*, Congressional Oversight Panel, November 16, 2010.

55. Levitin and Twomey, *supra* note 34, at 11.

56. Federal Reserve Bank of New York Staff Reports, *Understanding the Securitization of Subprime Mortgage Credit*, March 2008. Of course, the credit-rating agencies had their own vested interest in giving securities an inflated credit rating, considering that they were paid by large lenders to rate these securities. Roger Lowenstein, *Triple-A Failure*, NEW YORK TIMES, April 27, 2008. Simply put, if they did not give high enough ratings to sell the securities, they would not be hired to rate more. *Id.* 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. *Id.* In 1996 Thomas Friedman, a New York Times columnist, stated, "[t]here 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." *Id.*

57. BITNER, *supra* note 10, at 108–10 (2008); Lowenstein, *Triple-A Failure*, *supra* note 56.

58. BITNER, *supra* note 10, at 108–10 (2008).

59. *Id.*

60. *Id.*

61. *Id.*

62. *Id.*

> [t]hink of it this way: Imagine taking 10 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.[63]

As noted in the New York Times article *Triple-A Failure* published back 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 mortgages 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.[64]

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 they had been artificially inflated from the beginning.[65] 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.[66] Of course, long after the damage was done the SEC began investigating whether the ratings agencies were guilty of fraud by failing to meet their due diligence requirements, which would have allowed them to adequately rate the mortgage-backed securities.[67] All in all it just goes to show that numerous institutions on Wall Street and the United States government

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63. *Id.*
64. Lowenstein, *Triple-A Failure*, *supra* note 56.
65. Roy D. Oppenheim, *Meet the Wall Street Enablers: Credit Rating Companies*, South Florida Law Blog, June 21, 2011, http://southfloridalawblog.com/2011/06/21/meet-the-wall-street-enablers-credit-rating-companies/ (last visited Sept. 30, 2011).
66. *Id.*
67. *Id.*

through its various agencies all contributed to this mass crisis, a crisis for which the American public is paying the price.[68]

THE SHELL GAME: THE POOLING AND SERVICING AGREEMENT ANDWHAT 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") which sets forth the exact steps necessary for a trust to be created, for the bundled mortgages to be transferred into the trust, for the issuance of securities by the trust to the depositor or on the open market, generally to institutional investors, and for the maintenance of the trust once created in order to maintain favorable tax status.[69]

In a foreclosure filed by a trustee on behalf of a securitized trust, the Pooling and Servicing Agreement 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.[70] In general, the Pooling and Servicing Agreement is a public record and can be found through the SEC website as an Exhibit to SEC filings made by each individual trust. However, the true essential component of the PSA is not a public record, but rather a document attached to the PSA 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, making the transfer to the trust defective, the Master Loan Schedule establishes whether the subject mortgage *was ever transferred to that particular trust*. 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.

Assistant's Revenge: Liability of the Trustee and Servicer Under the PSA

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 I.R.S. tax code provisions[71] require that the mortgages be trans-

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68. *Id.*
69. Levitin and Twomey, *supra* note 34, at 23.
70. *Id.*
71. I.R.C. §§860A-860G.

ferred to the trust within a certain time frame, usually 90 days from the date the trust is created.[72] After such time, the trust closes and any subsequent transfers are invalid.[73] The reason for this is purely economic for the trust.[74] If the mortgages are properly transferred within the 90 day open period, and then the trust properly closes, the trust is allowed to maintain REMIC tax status.[75] 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.[76] However, the largest key to REMICS is that they are required to be passive vehicles, meaning that mortgages cannot be transferred in and out of the trust once the closing date has occurred, unless the trust can meet very limited exceptions under the Internal Revenue Code.[77] 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 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 real estate mortgage investment conduit ("REMIC") tax trust 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.[78]

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

72. I.R.C. §860G. The 90 day requirement is imposed by the I.R.C. to ensure that the trust remains a static entity. *Id.* However, since the PSA requires that the trustee and servicer not do anything to jeopardize the tax-exempt status, PSAs generally state that any transfer after the closing date of the trust is invalid. *Id.*

73. *Id.*

74. *Id.*

75. *Id.*

76. *Id.*

77. Levitin and Twomey, *supra* note 34, at 15 n.35.

78. *Id.*

> 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.[79]

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.[80] As a recent Reuters Exclusive article on how the IRS is investigating these lapses noted "[i]f 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."[81]

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

Standing is one of five traditional legal requirements that a person must meet in order to bring suit in a court of law.[82] Of the five requirements, standing is perhaps the most crucial requirement because it requires the aggrieved party to prove that they have the *right* to seek redress.[83] 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 and controversy," and there are three requirements one must prove.[84] First, they must prove a legally cognizable injury; second, that the injury is concrete and par-

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79. *Id.*

80. Paltrow, *supra* note 50. 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. In the matter of the application of The Bank of New York Mellon*, 2011-651786, Supreme Court of the State of New York. Over 90 lawsuits have already been filed against servicers and trustees for improper practices in violation of the PSAs which governed their conduct, with claims totaling over $197 billion as of August 2011. Louise Story and Gretchen Morgenson, *A.I.G. Sues Bank of America Over Mortgage Bonds*, NEW YORK TIMES, August 8, 2011.

81. Paltrow, *supra* note 50.

82. *See generally* U.S. V. SCRAP, 412 U.S. 669 (1973); The 'Lectric Law Library's Lexicon.

83. *See generally SCRAP*, 412 U.S. 669.

84. *See generally id.*

ticularized; and third, a causal relationship between the injury and the conduct of the defending party.[85]

During the robo-signing crisis where 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.[86] On October 9, 2010 the Wall Street Journal published an editorial titled "The Politics of Foreclosure."[87] 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.[88]

The South Florida Law Blog published a response to this outlandish opinion, pointing out the extreme disregard this editorial gives to the legal requirement of standing, and the consequences that such blatant disregard for our constitutional protections could have.[89]

> 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 bank 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 tranches [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

85. *See generally id.*
86. Editorial, *The Politics of Foreclosure*, WALL STREET JOURNAL, Oct. 9, 2010.
87. *Id.*
88. *Id.*
89. Oppenheim, *Roy Oppenheim to the Wall Street Journal*, *supra* note 3.

> protected property right owners from the day our great nation was founded.[90]

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[91] would provide an effective chain of title.[92] By creating new bogus assignments dated years after the trusts were created and closed, the banking industry created a smoking gun and literally got their hands caught in a larger and messier cookie jar than the one they were trying to avoid, providing undeniable evidence that the transfers into the trust were invalid or had never occurred.[93]

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*.[94] 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. The same argument is then made for a trust that missed the closing deadline, but got the assignment done eventually. 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 doesn't 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

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90. *Id.*

91. 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.

92. Citi, *Foreclosures Gone Wild*, October 12, 2010. *See also* Milton A. Vescovacci on behalf of Akerman Senterfitt, *Servicing Real Estate Mortgage Investment Conduits in U.S. Mortgage Securitizations*, Akerman Senterfitt (2006)) [hereinafter Akerman Senterfitt].

93. Citi, *supra* note 92. *See also* Akerman Senterfitt, *supra* note 92; *supra* note 69.

94. Levitin, *Written Testimony*, *supra* note 49, at 3.

> form punctiliously. The rules of the game with securitization, as with real property law and secured credit 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 confusion 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.[95]

On September 15, 2011 the Florida Bar News published an article titled *Who Owns the Note? Paperwork problems still plague foreclosure actions*.[96] 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 McCullogh. 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 Baintree" . . . 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.[97]

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 400,000 foreclosures still pending in the courts.[98] In addition, the author noted that the courts have become dependent on the filing fees for foreclosure, strengthening the belief that the court system has become dependent rather than independent, thus potentially clouding

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95. *Id.*

96. Gary Blankenship, *Who Owns the Note? Paperwork problems still plague foreclosure actions*, THE FLORIDA BAR NEWS, September 15, 2011.

97. *Id.*

98. *Id.*

the unbiased judgment of the judiciary.[99] In addition, 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.[100] 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."[101] In addition, the failure of the judiciary 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.

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 assignments of mortgage could have.[102] In October 2010 Citi published an internal document called *Foreclosures Gone Wild*.[103] Summarizing a conference call, Citi stated, "[i]t 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 questions as to the validity and tax exempt status of the trusts in which the mortgages reside."[104] 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

99. *Id.*
100. *Id.*
101. *Id.*
102. Citi, *supra* note 92. *See also* Akerman Senterfitt, *supra* note 92.
103. Citi, *supra* note 92.
104. *Id.*

> 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.[105]

To test the theory that the securitization failure was systemic, Abigail Field with Fortune Magazine did a field study on hundreds of foreclosure documents.[106] This study of course confirmed what securitization experts and foreclosure defense attorneys have been saying for years, that this is a system-wide failure.[107] The article was instigated by the publication of testimony by a former Countrywide employee, Linda DeMartini.[108] During her hearing testimony, DeMartini stated on the record that the trustee at the time of the foreclosure, and in fact since the origination of the loan, had never had possession of the note for a particular mortgage.[109] 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 foreclosure action so that the trustee would have proper standing.[110] In light of this testimony, the Judge threw out the case on the grounds that the trustee did not have proper standing to foreclose.[111]

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.[112] Bank of America issued the following in response to DeMartini's testimony:

> "Bank of America's policy is to conduct foreclosure 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

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105. *Id.*

106. Abigail Field, *At Bank of America, More Incomplete Mortgage Docs Raise More Questions*, CNNMoney.com, June 3, 2011.

107. *Id.*

108. *Id.*

109. *In Re Kemp*, Transcript of Hearing before the Honorable Judith H. Wizmur; Field, *supra* note 106.

110. *In Re Kemp*, Transcript of Hearing before the Honorable Judith H. Wizmur; Field, *supra* note 106.

111. Field, *supra* note 106; *In re Kemp*, 08-18700-JHW, United States Bankruptcy Court, Dist. N.J., Nov. 16, 2010.

112. Field, *supra* note 106.

> appropriate documentation. We offer home retention options and foreclosure avoidance programs to our distress customers. Foreclosure is our last resort."[113]

The funny thing is no one really expected them to say anything different. It's not as if one of the largest banks in the country is actually going to own up to their mistakes, 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 they took through each public failure, including robo-signing, the 'we did nothing wrong" stance. But the fact that they continue to represent that *nothing* went wrong, that "reviews" show they have followed all proper procedures is also just ludicrous. 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.[114] Both of the steps which DeMartini states did not occur are essential to proper securitization, and Fortune notes that "[b]oth steps are required, in one form or another, under all securitization contracts."[115] The continued denial by Bank of America of any failure or wrongdoing certainly makes it clear that it will continue to try and 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.

Fortune examined 130 cases where Bank of America was foreclosing on Countrywide mortgage-backed securities allegedly held by securitized trusts.[116] Of the original 130 cases, in 104 Countrywide was the originator.[117] The findings of course 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,

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113. *Id.*
114. *Id.*
115. *Id.*
116. *Id.*
117. *Id.*

> 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.[118]

Foreclosure defense attorneys were less than shocked by the results of the investigation by Fortune.[119] Fortune quoted one such attorney: "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."[120] Another Florida foreclosure defense attorney stated that in numerous cases the same phenomenon had been noted, and ignored by the judiciary who were more interested in moving cases along on their dockets than in protecting the property rights of the homeowners before them, "'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.'"[121]

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 ("ASF") published an article in the ASF White Paper Series titled "Transfer and Assignment of Residential Mortgage Loans in the Secondary Mortgage Market.[122] In an effort to repair the damage being inflicted by foreclosure defense attorneys and secu-

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118. *Id.*
119. *Id.*
120. *Id.*
121. *Id.*
122. 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 earlier 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.

ritization 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.[123] The ASF cited alternative rules such as the Uniform Commercial Code ("UCC") and common contract law, under which they argued their methods were more than sufficient.[124]

The largest problem with these arguments is of course the PSA, which governs and supersedes both the UCC and common law.[125] 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.[126] 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 where the parties intended the UCC to govern.[127] Further, even if this argument were valid, the Banks did not follow the fundamental concepts of the UCC either.[128]

Another interesting point to note 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 parties to the contract, which in this case intended very specific rules of transfer.[129] Combined, trust law and contract law set forth extremely rigid principals for the transfer of interests, requirements that are significantly relaxed under the UCC and other types of law which the ASF is claiming control.[130] Besides the general understanding that both types of law apply, PSAs contain *very specific* language called a recital of the transfer which outlines step-by-step the process of transferring the mortgage to the trustee of a trust.[131]

While the American Securitization Forum 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

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123. ASF White Paper Series, *Transfer and Assignment of Residential Mortgage Loans in the Secondary Mortgage Market*, Nov. 16, 2010.
124. *Id.*
125. Levitin, *supra* note 49, at 23.
126. *Id.*
127. *Id.*
128. *Id.*
129. *Id.*
130. *Id.*
131. *Id.*

even in some court decisions.[132] Legal bloggers have been especially receptive of arguments made by Levitin, Ira Markbloom[133], another law professor specializing in trust law, and Thomas J. Adams[134], 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.[135]

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."[136] In fact, it is tantamount to the biblical story of David versus Goliath in that the ASF is backed by thirteen major U.S. law firms and represents the interests of all major lenders who securitized mortgages.[137] Billions of dollars in lobbying and research capabilities against underfunded law professors, with the law professors winning.[138] Such bloggers then mock statements made by Executive Director Deustch of the ASF, including those which 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.[139]

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

Judge Boyko Not Fooled by the Illusion, Tells Lender "This Court Possess the Independent Obligations to Preserve the Judicial Integrity of the Federal Court"

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

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132. John Leamons, *Adam Levitin Replies to ASF: What is the Meaning of "Showing a Complete Chain of Endorsement?"*, LoanQualityMatters.com, December 7, 2010.

133. Ira Markbloom 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.

134. Thomas Adams is a partner with the firm of Paykin, Krieg and Adams in New York specializing in securitization. He too has opined via affidavit in numerous cases involving securitization that the lender attempting to foreclose lacks proper standing due to improper chain of title transfers as part of the securitization process.

135. Horace v. LaSalle Bank, cv-2008-362, Russell Co. Cir. Ct., Affidavit and Testimony of Thomas J. Adams.

136. Leamons, *supra* note 132.

137. *Id.*

138. *Id.*

139. *Id.*

trict of Ohio Eastern Division in the case *In Re Foreclosure Cases*.[140] At the time of the decision in 2007 securitization and the debate being raged between experts on both sides of the fence had not even reached the public forum.[141] The case consisted of fourteen foreclosure actions brought in federal court by a securitized trustee.[142] In his Order finding that the bank lacked proper standing, Judge Boyko sets forth the traditional legal principal of standing and explains its relationship to the federal court jurisdiction concept of diversity jurisdiction.[143] Because the bank could not prove who owned the mortgage and note, they could not establish the diversity jurisdiction of the court.[144]

Notably, it is clear that the decision was unexpected in light of the previous decisions from state courts in that jurisdiction who had turned a blind eye to the documentation problems that were already plaguing the court system even before the robosigning crisis.[145] 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 Plaintiff 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 Plaintiff 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 belie Plaintiffs' assertion they own the Note and Mortgage by means of a purchase which pre-dated the Complaint by days, months or years.[146]

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

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140. *In Re Foreclosure Cases*, 1:07-cv-2282 et al., U.S. Dist. Ct. Dist. Of Ohio, E.D., Opinion and Order, October 31, 2007.
141. *Id.*
142. *Id.* at 1.
143. *Id.*
144. *Id.* at 5–6.
145. Robert J. Coughlin, *Caught in the Cross-fire: Securitization Trustees and Litigation During the Subprime Crisis*, Nixon Peabody LLP, September 18, 2009.
146. *In Re Foreclosure Cases*, 1:07-cv-2282 et al., at 3.

> 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 – seeing foreclosure on the property securing the notes. Yet, this Court possess the independent obligations to preserve the judicial integrity of the federal court and to jealously guard federal jurisdiction . . . [n]either the fluidity of the secondary mortgage market, nor monetary or economic consideration of the parties, nor the convenience of the litigants supersede those obligations . . . [u]nlike . . . [s]tate law and procedure, as Plaintiffs perceive it, the federal judicial system need not, and will not, be "forgiving in this regard."[147]

On that note, all fourteen actions were properly dismissed for failure to prove standing by the Plaintiff banks.[148]

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 where it did not exist. In one such case, *In re Kemp*[149], the court considered whether or not the proper steps were taken in securitizing the underlying mortgage for purposes of expunging the trustee's proof of claim.[150] Quoting the PSA for the underlying securitized trust, the opinion entered by the court notes that the PSA recital of the transfer required:

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147. *Id.* at 4. Judge Koyko includes a footnote concerning his decision which notes the condescending manner in which 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 n.3.

148. *Id.* at 6.

149. 08-18700-JHW, United States Bankruptcy Court, Dist. N.J., Nov. 16, 2010.

150. *Id.* at 1.

> "the 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 indorsed in blank or delivered to the Bank of New York, as required by the Pooling and Servicing Agreement.[151]

At the trial, a new undated allonge was produced purporting to meet the requirements of the PSA.[152] 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.[153] Further, the testimony established that the allonge was not prepared until requested by Plaintiff's attorney for the court, and that it was never properly attached or affixed to the original note.[154] Further, 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.[155] When caught red-handed with inconsistent documents, the Plaintiff requested that the court ignore the certification.[156] Applying state law, the bankruptcy court held that because the trustee never had possession of the note, they could not sue to enforce its obligations as the owner and holder in due course.[157] Further, 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.[158] After addressing and pointing out the failure of Plaintiff's argument under any of the three possible ways[159] to establish proper standing to foreclose under the New Jersey U.C.C. provisions, the Judge dismissed the claim.[160]

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151. *Id.* at 5.
152. *Id.* at 6–7.
153. *Id.* at 7–8.
154. *Id.*
155. *Id.* at 8 n. 7.
156. *Id.*
157. *Id.* at 22.
158. *Id.* at 21.
159. 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 indentified 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 12–17.
160. *Id.* at 22.

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 *U.S. National Bank v. Ibanez*.[161] 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.[162] 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 assignment was made by a party that itself held that mortgage.[163]

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 or 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.[164]

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*.[165] In that case, the borrower brought suit prior to the initiation of a foreclosure action by the bank upon her receipt of a Notice of Accelera-

161. 941 N.E. 2d 40 (Mass. 2011).
162. *Id.* at 44.
163. *Id.* at 53.
164. *Id.* at 56.
165. Horace v. LaSalle Bank Nat'l Ass'n, 57-cv-2008-000362.00 at *1, (Russell Co. cir. Ct., March 25, 2011).

tion.[166] 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.[167] The court, in granting summary judgment in favor of the borrower, admonished the Plaintiff for their failure to comply with their 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[168] in attempting to obtain assignment of [plaintiff's] note and mortgage. Second, plaintiff . . . is a third party beneficiary of the Pooling and Servicing 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.[169]

The Court then entered an order permanently enjoining the defendant trust from foreclosing on the subject property and borrower.[170]

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.[171] In *Glarum v. LaSalle Bank National Association as trustee for Merill Lynch Mortgage Investors Trust, Mortgage Loan Asset-Backed Certificates, Series 2006-FFI*, it was not the documents purportedly transferring the note and mortgage which were at issue for once, but the affidavit of indebtedness filed by the lender based on alleged "personal knowledge" of a bank employee.[172]

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

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166. *Id.*

167. Horace v. LaSalle Bank Nat'l Ass'n, 57-cv-2008-000362.00, Memorandum in Support of Motion for Summary Judgment, at *2 (Jan. 13, 2011).

168. Horace v. LaSalle Bank Nat'l Ass'n, 57-cv-2008-000362.00 at *1, (Russell Co. Cir. Ct., March 25, 2011).

169. *Id.*

170. *Id.* at *2.

171. Glarum v. LaSalle Bank National Association as trustee for Merill Lynch Mortgage Investors Trust, Mortgage Loan Asset-Backed Certificates, Series 2006-FFI, No. 4D10-1372, slip op. at 1 (Fla. 4th Dist. Ct. App. Sept. 7, 2011).

172. *Id.*

doing the record keeping.[173] In a win for foreclosure defense attorneys and homeowners everywhere, the court finally held that such affidavits were inadmissible hearsay, validating the argument that borrowers and their counsel had been making for years.[174] 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.[175] *And, most importantly*, would have to establish the same foundational requirements in the affidavit for every lender or servicer who collected the payments on behalf of the trust.[176] 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. U.S. National Association, as trustee*, the court reversed a summary judgment which was entered on grounds not even raised in the summary judgment motion.[177] In doing so, the court found that the bank lacked the documentation to properly establish standing, finding that "incredibly, U.S. Bank argues that '[i]t would be inequitable for [borrower] to avoid foreclosure based on the absence of an endorsement . . . .'"[178] 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.[179] Moreover, the issue of standing, particularly in securitized trusts, will now be front and center stage in foreclosure defense.

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173. *Id.*

174. Oppenheim, *Foreclosure Jurisprudence*, *supra* note 3.

175. *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, *Client Alert: The Changing Landscape of the Business Record Exception under Florida Law and its Impact on Florida Foreclosures*, Sept. 14, 2011.

176. *Glarum*, No. 4D10-1372, slip op. at 3.

177. Gee v. U.S. Nat'l Bank Ass'n as trustee, No. 5D10-1687, slip op. at 1 (Fla. 5th Dist. Ct. App. Sept. 30, 2011).

178. *Id.* at 4.

179. *Id.* at 8.

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 a borrower who has failed to meet their financial obligations. However, it is intended 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 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.[180] 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 case law developing in Florida which would suggest that the judiciary has finally seen the light, and that homeowner's 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.

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180. In 2008, the author 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 act at all times in a manner that promotes public confidence in the integrity and impartiality of the judiciary." The court then said to counsel that if he continued in that line of discussion that he would be held in contempt in his court. Interestingly enough, this judge has recently stepped down to accept a position at a Florida foreclosure mill.