August 14, 2013

Show Me The Note Q&A

David J Reiss, *Brooklyn Law School*
Bradley T Borden, *Brooklyn Law School*

THE KNOWLEDGE EFFECT

THOMSON REUTERS

Brooklyn Law School professors discuss 'Show me the note!' defense in foreclosures

We spoke with Brooklyn Law School professors Bradley T. Borden and David J. Reiss about their recent commentary "Show me the note!" published in the Westlaw Journal Bank & Lender Liability this summer.

02 AUG 2013
Phyllis Skupien

In their commentary, the attorneys discuss how courts across the country are interpreting homeowner claims that a foreclosing party must produce the mortgage and the associated promissory note as proof of the right to initiate foreclosure. We asked them a few more questions about this so-called "show me the note" defense and when it's applicable.

Westlaw Journals: *Your commentary is about the success of the "show me the note" defense to stop or delay a foreclosure. Can you explain what the "show me the note" defense means during foreclosure proceedings?*

Bradley T. Borden and David J. Reiss: "Show me the note" can mean different things in different jurisdictions. But the bottom line is that the homeowner is typically telling the court that the foreclosure should not proceed unless and until the foreclosing party can prove that it in fact owns or holds (or is the agent of the owner or holder of) the mortgage note that is secured by the mortgage that is being foreclosed upon.

WJ: *What is the difference between a mortgage and a deed of trust, and does this have any bearing on the foreclosure defense?*

Bradley Borden

BTB and DJR: The two documents are very similar in many ways – they both provide a security interest in real property. The mortgage is the simpler of the two, involving just two parties. The two parties are the mortgagor (the borrower) and the mortgagee (the lender). The borrower uses its interest in real property to secure a loan made to it by the lender. If the borrower fails to repay the loan or otherwise violates the terms of the loan transaction, the mortgagee can foreclose upon the real property. The mortgagee forecloses through a judicial proceeding.

The deed of trust adds another party to a secured loan transaction. Here, the borrower delivers a deed of trust to a trustee which states that the borrower's real property is held as security for the loan made by the lender to the borrower. The trustee of a deed of trust has the very limited role of following the provisions of the deed of trust. Most importantly, it can foreclose on the deed of trust on behalf of the beneficiary of the deed of trust, the lender, if the terms of the loan transaction have been violated. Because of the addition of this third party, foreclosure can (but need not) take place in a non-judicial proceeding. The thinking is that the trustee will ensure that there will be some basic procedural protections in place for the foreclosure, obviating the need for judicial oversight. The big advantage of the deed of trust is the ability to foreclose quickly and cheaply by means of a non-judicial proceeding.

WJ: *How do assignments of mortgages contribute to the confusion about what entity has the right to foreclose?*

BTB and DJR: Let us count the ways! On our blog, REFinblog.com, we track the litigation that arises from the foreclosure epidemic. The absence of all of the relevant assignments in a transaction can play out one way in a judicial foreclosure (in mortgage-only jurisdictions), another way in a non-judicial

foreclosure (in jurisdictions that allow for deeds of trust) and another way in a bankruptcy proceeding. It plays out differently in different states. It can play out one way if the mortgagee brings the suit, in another way if the servicer brings the suit and another if MERS (the Mortgage Electronic Recording System) brings the suit. It can play out differently if the note is negotiable or if it is non-negotiable. So to answer your question precisely, assignments of mortgages don't contribute to the confusion – they are the confusion!

WJ: *What is the difference between a judicial and non-judicial foreclosure? Is the "show me the note" defense more successful in states that use a non-judicial foreclosure proceeding or judicial proceeding? What contrasts exists between the cases highlighted in your analysis?*

BTB and DJR: Keep in mind that states typically fall into two categories: those that only allow judicial foreclosures and those that allow either judicial or non-judicial foreclosures. In a judicial foreclosure, foreclosure actions are brought in court. A judicial foreclosure can be brought where the security interest is a mortgage or deed of trust. A non-judicial foreclosure does not – shocker! — involve a court proceeding. Instead it is conducted using the power of sale contained in the deed of trust. With the power of sale, the mortgaged property is sold at a public auction.

David J. Reiss

If we were to generalize, the rule is that state supreme courts do not require the foreclosing party to "show the note" in a non-judicial foreclosure (with Massachusetts one exception). In addition, the general rule in a judicial foreclosure is that the foreclosing party must "show the note," although it need not be the actual mortgage note holder, but merely one who has been assigned an interest in the mortgage note by the mortgage note holder.

We think the most interesting contrast is between the more typical Hogan v. Washington Mutual Bank, 277 P.3d 781 (Ariz. 2012), and the more cutting edge Eaton v. Federal National Mortgage Association, 969 N.E.2d 1118 (Mass. 2012). Hogan strictly construes the state foreclosure law, but leads to some odd results, including the possibility that a borrower can be liable in competing foreclosure proceedings arising from just one deed of trust. Eaton pushes the language of the statute a bit, but seems to ensure that borrowers are protected from inequitable results in foreclosure proceedings. For a more in depth analysis, we would recommend a recent law review article by Dale Whitman and Drew Milner in the most recent issue of the Arkansas Law Review, Foreclosing on Nothing: The Curious Problem of the Deed of Trust Foreclosure Without Entitlement to Enforce the Note.

WJ: How does state law influence the success of the defense? Are there any federal laws applicable to the "show me the note" defense?

BTB and DJR: While "show me the note" does come up in federal cases, federal courts defer to the applicable state law in reaching their results. As our article demonstrates, the courts' holdings tend to flow from a careful reading of the relevant state foreclosure statute, so a particular state's law can have a big effect on the outcome. We would note that many scholars and leaders of the bar are befuddled by courts' failure to do a comprehensive analysis under the UCC as part of their reasoning in mortgage enforcement cases, but judges make the law, not scholars and members of the bar. *See* Report of The Permanent Editorial Board for The Uniform Commercial Code Application of The Uniform Commercial Code to Selected Issues Relating to Mortgage Notes at 1 (Nov. 14, 2011) (PDF).

WJ: *What are the main points you want to emphasize for homeowners and their attorneys challenging a foreclosure action?*

BTB and DJR: The main point is – the law matters and the jurisdiction matters. Whether you are a homeowner trying to stave off foreclosure or a real estate finance lawyer structuring a securitization, you should expect that courts will enforce statutes as they are written in an adversarial proceeding. What works in one jurisdiction may not work in another because the laws of the jurisdictions may vary. Plan accordingly.

CATEGORIES
Legal, Westlaw Journals

TAGS
Bradley T. Borden, Brooklyn Law School, David J. Reiss, deed of trust, foreclosures, mortgage

SHARE THIS