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A National Mortgage Notes Registry: America's Immense Need for Transparency and Certainty in Mortgage Ownership and the Right to Foreclose

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A NATIONAL MORTGAGE NOTES REGISTRY: AMERICA'S IMMENSE NEED FOR TRANSPARENCY AND CERTAINTY IN MORTGAGE OWNERSHIP AND THE RIGHT TO FORECLOSE

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ABSTRACT:

The most recent mortgage foreclosure crisis has left American law awash in uncertainty and confusion. There were an infinity of instances of borrowers whose mortgage documents had been sold, but the borrowers never learned the identity of the new owner of their note and mortgage. Other homeowners had foreclosures initiated by financial institutions with whom they had no contact, financial institutions which could not demonstrate they were legally the party entitled to enforce the mortgage note by foreclosure or otherwise. The crisis of 2008 was accentuated by courts that struggled to find solutions to the numerous problems arising from fatal legal uncertainties as to the party entitled to enforce mortgage notes that were in default. Experience demonstrates that the existing processes—applicable in each of the 50 states and their 3,007 counties, plus 137 county equivalents—for the tracking of transfers of ownership of promissory notes and their accompanying mortgages in the secondary market are inadequate. These are all unwieldy, unreliable, and unfit for a modern marketplace. Since the mortgage foreclosure crisis is no longer making headlines, calls for change to prevent a recurrence have subsided despite the fact there have been no significant changes to a system that precipitated the crisis initially.

The American Land Title Recording System that has endured for more than two centuries at the individual county level clearly remains the appropriate structure for settling the priority of easements, leaseholds, probate, marital questions, and similar garden variety interests that can be determined by each counties' land title records. But, just as NASA would not attempt to land the space shuttle at a commercial airport used for passenger aviation, the land title and mortgage lending industries require an electronic system for tracking ownership of mortgage notes in the modern marketplace of mortgage securitization.

Why? Simply put, the transfer of ownership of mortgage notes now occurs more rapidly and in vastly greater numbers than just a couple decades ago. Yet, all those counting on the safe and secure transfer of

mortgage notes—America's lenders and borrowers—risk relying on unrefined and outdated systems and processes. To date, the only serious attempt at modernizing mortgage note recordkeeping was the privately owned and operated, and legally insufficient, Mortgage Electronic Registration System ("MERS"). MERS, by all accounts, proved to be a resounding failure.

Failure to properly utilize county land title recording procedures and the use of the failed MERS system sprang from attempts to circumvent the slow, traditional procedures at the county level and resulted in uncertainty of the identity of the party entitled to enforce the mortgage note through foreclosure. In fact, most critical legal issues of the recent foreclosure crisis arose from uncertainty of ownership of the mortgage note, not the garden variety land title issues answered by the counties' land title records. Going forward, mortgage foreclosure crises can be avoided by adoption of a national mortgage notes registry. This article will propose such a national notes registry that, if adopted, would effectively complement the land title records system currently in use in each state and county in the United States.

I. INTRODUCTION

Some have blamed the land title recording system for the foreclosure crisis that helped cause the bottom to drop out of the real estate market beginning in 2006.[1] This foreclosure tragedy that played out on America's stage precipitated the Great Recession that proved so harmful to our country and the financial industry worldwide. Tragedy has been described as pitting right versus right.[2] In this regard, the legitimate owners of differing, yet related, interests in property are pitted against one another. One, the owner of real property, which may be the family home. The other, perhaps an individual whose retirement funds or children's college education funds have been invested in mortgage backed securities ("MBS").[3]

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[1] Elizabeth Renuart, *Uneasy Intersections: The Right to Foreclose and the U.C.C.,* 48 WAKE FOREST L. REV. 1205 (2013).

[2] M. Mark Heekin, *Modernizing Mortgage Foreclosure Law: A Call for Transparency and an End to the Payment Rule,* 33 QUINNIPIAC L. REV. 165, 167 (2014).

[3] Adam J. Levitin, *The Paper Chase: Securitization, Foreclosure, and the Uncertainty of Mortgage Title*, 63 DUKE L.J. 637, 671-72 (2013-2014) ("Although residential-mortgage securitization transactions are complex and vary somewhat depending on the type of entity undertaking the securitization,

While the local, traditional land title recording system would make a convenient scapegoat, it actually performed as it was designed to perform. It has performed well for more than two centuries prior to the development of mortgage securitization. There may be plenty of scapegoats to share the blame for the foreclosure tragedy that played out on America's stage, but the land title system is hardly one of them.

Under current institutional mortgage lending practice, a loan secured by real property as collateral utilizes two key instruments: an instrument containing the borrower's promise to repay the loan with interest and a security instrument granting a lender a security interest in the real property securing the debt.[4] The first instrument is typically called a promissory note, while the security instrument is commonly called a mortgage.[5]

Traditionally, mortgage loans were underwritten, originated, funded and thereafter held in the portfolio of that originating lender.[6]

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there is still a core standard transaction. First, a financial institution (the 'sponsor' or 'seller') assembles a pool of mortgage loans either made ('originated') by an affiliate of the financial institution or purchased from unaffiliated third-party originators. Second, the pool of loans is sold by the sponsor to a special-purpose subsidiary (the 'depositor') that has no other assets or liabilities and is little more than a legal entity with a mailbox. This is done to segregate the loans from the sponsor's assets and liabilities. Third, the depositor sells the loans to a passive, specially created, single-purpose vehicle (SPV), typically a trust in the case of residential-mortgage securitization. The trustee will then typically convey the mortgage notes and security instruments to a document custodian for safekeeping. The SPV issues certificated debt securities to raise the funds to pay for the loans. As these debt securities are backed by the cash flow from the mortgages, they are called mortgage-backed securities (MBS).").

[4] GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW, 1 (5th ed. Thomson/West 2007) ("As the term is used in its modern context, a real estate mortgage involves a transfer by a debtor-mortgagor to a creditor-mortgagee of a real estate interest, to be held as security for the performance of an obligation, normally the payment of a debt evidenced by the mortgagor's promissory note.").

[5] *Id.* at 11. The mortgage is the predominant form of real property security instrument utilized throughout the United States. *Id.* Although many jurisdictions utilize the deed of trust, some utilize the trust deed, or security deed, this paper will use the term "mortgage" and "mortgage note" (or "note") when referring to a security instrument for real property and its accompanying note. *Id.*

[6] Fred H. Miller, *Promissory Notes, Mortgages, Assignments, Foreclosure, and Related UCC Issues*, 65 CONSUMER FIN. L. Q. REP. 406, 407 (2011).

This practice of portfolio lending meant the lender and the borrower developed and maintained an ongoing relationship that started with the lender's underwriting of the loan and continued through the life of the loan.[7] They knew each other's identity and could be in contact with one another when the need arose.[8] Normally, the lender kept physical possession of the mortgage note until the loan was paid in full, whereupon the lender delivered the original promissory note to the borrower.[9] In that scenario, the parties could talk to each other at any time to work out any issues that might have arisen during the life of the mortgage.[10] One set of local laws applied to that mortgage transaction.

Although the secondary mortgage market had existed since the 1960's, the advent of securitization caused a change in traditional institutional mortgage lending practice.[11] This change infused much needed capital into the mortgage market.[12] Mortgage lenders shifted from

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[7] *Id.*
[8] *Id.*
[9] *Id.*
[10] *Id.*
[11] Julia Patterson Forrester, *Fannie Mae/Freddie Mac Uniform Mortgage Instruments: The Forgotten Benefit to Homeowners*, 72 MO. L. REV. 1077, 1081-82 (2007) ("In 1970 the Emergency Home Finance Act authorized Fannie Mae to purchase conventional mortgages for the first time and also created the Federal Home Loan Mortgage Corporation (Freddie Mac) to purchase conventional mortgages. Freddie Mac was initially under the supervision of the Federal Home Loan Bank Board, and its stock was owned by the twelve Federal Home Loan Banks. Freddie Mac was expected to purchase mortgages from savings and loan associations, while Fannie Mae was expected to purchase primarily from commercial banks and mortgage banks. In addition to issuing bonds and using the proceeds to purchase loans, in 1971 Freddie Mac began selling pass-through mortgage backed securities (MBS) backed by conventional mortgage loans. With pass-through MBS, "the investor purchases a fractional undivided interest in a pool of mortgage loans, and is entitled to share in the interest income and principal payments generated by the underlying mortgages." In 1983 Freddie Mac issued the first Collateralized Mortgage Obligation (CMO), which created multiple classes of bonds all backed by the same mortgage pool but with each class paid sequentially as principal payments were received from the underlying mortgages. Fannie Mae began securitizing mortgage loans in the 1980s. When the GSEs issue MBS they "guarantee that investors will receive timely principal and interest payments regardless of what happens to the underlying mortgages." Today, Fannie Mae and Freddie Mac are almost identical in their charters and functions. They both purchase home loans to hold in their portfolios but securitize even more loans.").
[12] *Id.* at 1082 ("Through their purchases and securitization of residential

a portfolio model to one which entails a lender to underwriting and originating the loan, then selling it on the secondary market.[13] Mortgage securitization generally involved several transfers of the promissory note and its underlying mortgage: from the originating lender to an investment bank subsidiary known as a sponsor, then from the sponsor to another subsidiary known as the depositor, and then from the depositor to the trustee of a trust charged with holding the mortgages on behalf of investors.[14] In this model, the originating lender might be engaged to service the loan.[15] The servicer would serve as an agent of the owner of

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mortgage loans, Fannie Mae and Freddie Mac together provide the largest source of home mortgage financing in the nation. In 2004 nearly thirty-five percent of outstanding home mortgage debt was in the GSEs' MBS, and they held over twenty percent of home mortgage debt in their combined portfolios. At the end of 2005, they had securitized or were holding in their portfolios forty-four percent of outstanding home mortgage debt. More recently, they own in portfolio or guarantee through their MBS programs about forty percent of all residential mortgage debt in the nation.").

[13] Miller, *supra* note 6, at 407-08.

[14] Roy D. Oppenheim & Jacquelyn K. Trask-Rahn, *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*, 41 STETSON L. REV. 745, 754 (2012).

[15] GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW §11.1 917 (5th ed. 2007) ("An important feature of a mortgage banker's activity (as well as that of any other financial institution that happens to be acting in a mortgage banking capacity) is the 'servicing' of the loan. Most investors that purchase mortgage loans on the secondary market do not have the necessary staff to receive and maintain records of mortgage payments. Consequently they usually contract with the originating lender for (or some other mortgage banker) to provide servicing. Servicing includes collecting the regular payments of principal and interest, maintaining any necessary escrow account for taxes and insurance, following up on any delinquency, and if necessary, arranging for foreclosure. The servicer maintains proper records, remits the loan payments to the investor which holds the loan, and communicates with the investor if problems arise. For performing this work the servicer receives a fee from the investor. For first mortgages on residential property, the fee is commonly an annual amount of about 25/100 of 1% (or 25 "basis points") on the average outstanding balance of the loan—for example, $250 per year on a $100,000 home loan. Servicing was historically considered a profitable and attractive activity by mortgage bankers, and they are usually eager to retain servicing when a loan is sold.

. . . .

An active market in the "sale" of servicing rights exists; hence, the borrower who originally dealt with a local mortgage banker may be notified to send future the individual note and mortgage.[16] While the servicer may be the originating lender, it is not uncommon for the servicer to be an entity that specifically provides this function for hundreds, if not thousands, of owners of mortgages and who may be a stranger to the transaction that was originated between the borrower and originating lender.[17] The servicer is not an entity the borrower selected and may be located far away from the location of the borrower and the mortgaged property.[18]

The mortgage securitization process involves multiple transfers of ownership of each mortgage; therefore, it requires an expedient and efficient method of transferring the mortgage. Although, as we have seen from the entangled MERS experiment, a method of transferring mortgages that is too abstract may serve the financial industry, its borrowers, and the country poorly.[19] Some have stated there is benefit to having some friction to slow down the transfer of mortgage ownership on the secondary market, comparing the rapid transfer of mortgages on the secondary market to driving on icy roads.[20] While decelerating the transfer of mortgage ownership simply to impede commerce would be feckless, there clearly is a benefit to be derived from a system that heightens transparency, certainty of ownership, and rights to enforce mortgage notes. Ensuring that borrowers know to whom they owe an obligation and who is entitled to enforce that obligation seems to be

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payments to different company, perhaps many miles away. There has been a good deal of consumer dissatisfaction in such cases, and Congress addressed the problem in 1990 by requiring at least a minimal degree of borrower notification concerning transfers of servicing.”).

[16] *Id.*

[17] Miller, *supra* note 6, at 407; John P. Hunt, et al., *All in One Basket: The Bankruptcy Risk of a National Agent-Based Mortgage Recording System*, 46 U.C. DAVIS L. REV. 1 (2012).

[18] Miller, *supra* note 6, at 407.

[19] *See* Hunt, *supra* note 17, at 3-5.

[20] Elizabeth Renuart & Kathleen Keest, *Transcript: Integrity and Accountability in the Secondary Mortgage Market*, 35 HAMLINE L. REV. 487, 488 (2012) (“We’re talking about ethics and standards here, but the overarching thing that I think we saw for the last-well, actually it’s been a gradual process for the last 30 years-but was really heightened in the last decade-was an effort to eliminate friction from the market. We’re in Minnesota. We know that friction actually has a function. For those of you who ever tried to drive on bare ice, friction serves a purpose. But for a great deal of the last few years, the mantra has been to try to get rid of friction in the market. The policy was to put a primary emphasis on trying to get rid of everything that we thought was a speed bump [to a well-oiled market], irrespective of what value that speed bump brought.”).

fundamentally fair. Certain and transparent ownership of mortgages is a necessary component of the foreclosure process.[21] The foreclosing party must determine whether and when it is appropriate to exercise foreclosure rights.

At the mortgage loan closing, customarily the originating lender will ensure the mortgage is properly recorded in the land title records of the county that is the situs of the real property.[22] However, common law holds that when the mortgage loan is sold, the transfer of the note and the accompanying right to enforce the loan through foreclosure typically does not require each transfer of the note and mortgage to be recorded in the land title records where the mortgage was initially recorded.[23] Institutional lenders claim that if such recording were required, it would add a substantial delay and expense to the securitization process.[24] From a process perspective, the massive number of assignments to be recorded could also deluge the land title recording office, resulting in recording delays.[25] As a result, many lenders opted to sell the loan, transfer the note, and register the mortgage information with MERS.

This article will briefly review state property law and the legal status of mortgages and their underlying promissory notes under state recording acts. Then, this article will discuss the immense mortgage foreclosure problems created by U.C.C. Article 3 and the utter inadequacy of the private MERS system to meet the legal challenge to post-foreclosure land titles in the era of mortgage securitization. Finally, this article will propose a remedy in the form of a national mortgage note registry that will meet this legal challenge. A national notes registry would correct the very problem that caused much of the confusion in foreclosure proceedings and uncertainty in land title records of properties whose mortgages had been foreclosed with surgical precision. There is no need for wholesale reform of the mortgage lending industry, a national recording system for mortgages, a national foreclosure statute, or similar broad-sweeping reforms. Those proposals would likely be much more costly to implement and, for good reason, fail to achieve the support of constituents who work in these industries.

The proposal in this article for a national mortgage note registry is designed to bolster post-foreclosure land title issues. The reliability of land title information has been the key hallmark of American real

[21] Miller, *supra* note 6, at 407.
[22] *Id.*
[23] *Id.*
[24] *Id.*
[25] *Id.*

property transactions for more than two centuries. The very technology that helped foster a terrain rife with wild records of mortgage note ownership can, and should, be harnessed to tame that bewildering terrain.

The practices of a number of shortsighted, rapacious mortgage originators,[26] marketers, underwriters,[27] securitizers,[28] and rating

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[26] Terry Carter, *Will those who led the financial system into crisis ever face charges?,* ABA JOURNAL, (Feb. 1, 2016), https://perma.cc/CBK4-QFCN. ("The Financial Crisis Inquiry Report, released in 2011, was particularly pointed in its criticism of Wall Street, which it found had taken advantage of unprepared regulatory agencies that had been methodically defanged through deregulation over several years. The report noted a term coined on Wall Street that captured the carefree wheeling and dealing in the run-up to the meltdown: "IBGYBG"—"I'll be gone, you'll be gone." The term, the report states, "referred to deals that brought in big fees up front while risking much larger losses in the future."").

[27] Alex M. Johnson, Jr., *Preventing a Return Engagement: Eliminating the Mortgage Purchasers' Status as a Holder-In-Due-Course: Properly Aligning Incentives Among the Parties*, 37 PEPP. L. REV. 529, 547-51 (2009-2010) ("Who in their right mind would assist someone in obtaining two mortgages totaling $615,000 (Aviles took out two mortgages--one for $492,000 at 8.5% and a second mortgage for $123,000 at 11.1%) when the primary borrower/mortgagor makes $9 an hour? More importantly, why would someone process and help the mortgagor obtain such a mortgage when it is obvious to everyone (except the mortgagor--of which more anon) that the mortgagor will not be able to make the payments on the mortgage, either presently or in the future, unless some fortuitous event occurred, like a rapid increase in the home's valuation that would allow for refinancing at lower, more affordable rates? The answer, of course, lies with the fees extracted by the originator and folded into the mortgage that are paid to the originator at the time the mortgage is funded by the lender. But why would the lender, in this case the now-defunct WaMu, make such a loan knowing well that the odds the mortgagor would default on the mortgage were very high? The answer is twofold: First, as noted above, the fees that the originator receives upon the execution and completion of a mortgage are powerful inducements for the originator to make the loan, irrespective of the long-term viability of the mortgage. Second, and most importantly for the thesis of this Article, these original lender originators were able to take advantage of the explosion of the use of CDOs as securities to transfer the mortgage and the debt securing same, including the risk of default on the mortgage, to investors purchasing the CDOs. CDOs were first sold in the 1980s, part of a revolution in corporate finance called "securitization" that fueled the unprecedented boom in available credit. Lenders [originators] could package their mortgages, credit card loans, equipment leases, even corporate debt, and sell securities backed by the interest payments. This maneuver transferred the risk of not getting paid to the investors who bought the securities. The deals returned cash to lenders, which they could plow into new loans. This efficient machine pushed borrowing rates

services[29] that led to the market crash of 2007 relied in large measure on the misplaced confidence that the privately-owned MERS would be able to maintain information on ownership of mortgages that were being transferred several times in rapid succession. The end result was to destabilize local mortgage foreclosures and throw the post-foreclosure land title records into chaos. The proposal in this article is targeted to remedy this narrow—but absolutely vital—problem.

The reform proposals in this article are not meant to replace all other necessary mortgage industry reforms, but to supply the pivotal link to prevent a recurrence of chaos in American land title records and allow for a more reliable mechanism upon which the mortgage securitization industry can proceed. A transparent, functional system needs to be

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lower, creating a win-win-win for consumers, lenders and investors.").

[28] THE FINANCIAL CRISIS INQUIRY REPORT 43 (last updated Feb. 25, 2011), https://perma.cc/KG4R-2VBG ("Securitization was designed to benefit lenders, investment bankers, and investors. Lenders earned fees for originating and selling loans. Investment banks earned fees for issuing mortgage-backed securities. These securities fetched a higher price than if the underlying loans were sold individually, because the securities were customized to investors' needs, were more diversified, and could be easily traded. Purchasers of the safer tranches got a higher rate of return than ultra-safe Treasury notes without much extra risk—at least in theory. However, the financial engineering behind these investments made them harder to understand and to price than individual loans. To determine likely returns, investors had to calculate the statistical probabilities that certain kinds of mortgages might default, and to estimate the revenues that would be lost because of those defaults. Then, investors had to determine the effect of the losses on the payments to different tranches.").

[29] *Id.* at 43-44 ("This complexity transformed the three leading credit rating agencies—Moody's, Standard & Poor's (S&P), and Fitch—into key players in the process, positioned between the issuers and the investors of securities. Before securitization became common, the credit rating agencies had mainly helped investors evaluate the safety of municipal and corporate bonds and commercial paper. Although evaluating probabilities was their stock-in-trade, they found that rating these securities required a new type of analysis.
Participants in the securitization industry realized that they needed to secure favorable credit ratings in order to sell structured products to investors. Investment banks, therefore, paid handsome fees to the rating agencies to obtain the desired ratings. "The rating agencies were important tools to do that because you know the people that we were selling these bonds to had never really had any history in the mortgage business. . . . They were looking for an independent party to develop an opinion," Jim Callahan told the FCIC; Callahan is CEO of PentAlpha, which services the securitization industry, and years ago he worked on some of the earliest securitizations.").

implemented that will accommodate the needs of the land title industry, the mortgage lending industry, and those who transfer mortgages on the secondary market.

II. REAL PROPERTY LAW IS AND SHOULD REMAIN STATE LAW

Practically every lawyer who thinks back on his or her first year law school Property class is likely to recall property ownership being described as a bundle of rights or, perhaps, as a bundle of sticks.[30] Indeed, even Supreme Court Justices utilize the "sticks in the bundle of rights" analogy.[31]

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[30] *Id.* The bundle of sticks metaphor derives from the field of economics. Economics scholars have long viewed property rights as assets that can be partioned and aggregated into bundles of rights, with each bundle assigned to the party who will use those rights in the most efficient manner (in economic terms) for production. *See, e.g.,* Armen A. Alchian & Harold Demsetz, *The Property Right Paradigm*, 33 J. ECON. HIST. 16 (1973); Armen A. Alchian, *Some Economics of Property Rights*, in IL POLITICO 816, 817 (1965) (describing property as "[t]he rights of individuals to the use of resources . . . supported by the force of etiquette, social custom, ostracism, and formal legally enacted laws supported by the states' power of violence or punishment."); GRANT S. NELSON ET. AL., CONTEMPORARY PROPERTY, 19 (LEG, Inc. d/b/a West Academic Publishing, 4th ed. 2013). Under this definition, property is a concept that consists of a bundle of rights or expectations. These rights with respect to property are enforceable against third parties, including the government. An individual's property may consist of some or all of the following rights:
(1) the right to possession;
(2) the right to use;
(3) the right to exclude possession or use by others;
(4) the ability to alienate (transfer) the property rights to others; and
(5) the right to destroy."

[31] Aetna v. United States, 444 U.S. 164, 176 (1979) ("But this is not a case in which the Government recognizes any obligation whatever to condemn "fast lands" and pay just compensation under the Eminent Domain Clause of the Fifth Amendment to the United States Constitution. It is instead a case in which the owner of what was once a private pond, separated from concededly navigable water by a barrier beach and used for aquatic agriculture, has invested substantial amounts of money in making improvements. The Government contends that as a result of one of these improvements, the pond's connection to the navigable water in a manner approved by the Corps of Engineers, the owner has somehow lost one of the most essential sticks in the bundle of rights that are commonly characterized as property-the right to exclude others.").

The bundle of sticks analogy is employed to show that property is an aggregation of complex legal rights, the prioritized relationships among a wide range of parties, and is not merely ownership of property itself or the relationships between owners and things. In Anglo-American law, the word "property" is an umbrella construct that includes real property, personal property, and intangibles.[32] Generally, real property includes land and anything that is affixed to that land, making real property not moveable.[33] Personal property, or chattels, is comprised of goods, wares, and belongings such as watches, furniture, automobiles, animals and similar things that are moveable.[34] Intangibles are things that include promissory notes, stocks and bonds, insurance policies, bank accounts, a business's goodwill, as well as intellectual property such as patents, trademarks and copyrights.[35]

Because the bundle of rights metaphor contemplates multiple diverse parties, those parties may have simultaneously existing, legally recognized claims to property and, because of their different characteristics, real property, personal property, and intangibles are subject to different rules and laws regarding ownership and transfer of ownership.

There are a number of areas of property law clearly specific to individual states. Among those state-specific areas are theories of the effect of a conveyance of a mortgage on title to real property,[36] the

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[32] *See generally*, WILLIAM B. STOEBUCK & DALE A. WHITMAN, THE LAW OF PROPERTY §§1.1-1.5, at 1-14 (Hornbook Series, 3rd ed. 2000).
[33] *Id.*
[34] *Id.*
[35] *Id.*
[36] NELSON & WHITMAN, *supra* note 4, at 10 ("Three ''theories'' of mortgage law exist today in the United States. One of these, the title theory, has its roots in the English common law mortgage discussed earlier. Under this theory, legal ''title'' is in the mortgagee until the mortgage has been satisfied or foreclosed. While the states that recognize this theory have for the most purposes treated the mortgagee as simply holding a security interest, the mortgagee's ''title'' does appear to give him the right to possession. Under the more predominant lien theory, however, the mortgagee holds no ''title'' but has security only. The mortgagor, accordingly, has the right to possession until there has been a valid foreclosure. The so-called intermediate theory gives the right to possession to the mortgagor at least until default, and generally to the mortgagee after default. The lien theory states, with such exceptions as New York and South Carolina, tend to be west of the Mississippi, and the title and intermediate theory states in the east. Lien theory states have rejected the mortgagee's possessory rights, either by judicial decision or by statute.").

method of foreclosure of a mortgage,[37] and recording acts. Recording acts control the process for recording an instrument of conveyance of an interest in real estate, including mortgages, along with priority given to such recorded instruments, which will be discussed in greater detail below.

Well-settled property law has already given us the rules necessary to resolve the issues raised by mortgage securitization and the ensuing foreclosure crisis. It is the paramount job of interested parties in America, including the land title insurance industry, mortgage lending industry, as well as federal, state, and local governments, to utilize property law for the implementation of measures that prevent a repeat of the foreclosure crisis that caused such loss, measured both in monetary terms and in non-monetary terms. Uncertainty in ownership of mortgage notes caused an unprecedented amount of fraud on the courts, which significantly tarnished the image of the mortgage lending industry and many in the legal profession who represented them, and resulted in unprecedented enforcement action for such transgressions.[38] It may be

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[37] NELSON & WHITMAN, *supra* note 4, at 9("While strict foreclosure is theoretically available in a few states and in some relatively special situations in others, the major method of foreclosure in the United States involves a public sale of the premises. There are two main types of sale foreclosure used in the United States today. The most common type is judicial foreclosure where a public sale results after a full judicial proceeding in which all interested persons must be made parties. In many states this is the sole method of foreclosure. It is time-consuming and costly. The other method of foreclosure is by power of sale. Under this method, after varying types and degrees of notice to the parties, the property is sold at a public sale, either by some public official such as a sheriff, by the mortgagee, or by some other third party. No judicial proceeding is required in a power of sale foreclosure. It is generally available only where the mortgage instrument authorizes it.").

[38] Alan M. White, *Losing the Paper - Mortgage Assignments, Note Transfers and Consumer Protection*, 24 LOY. CONSUMER L. REV. 468, 469-70 (2012) ("Five years into the subprime mortgage crisis, the foreclosure machinery has slowed to a crawl. Historically high levels of mortgage defaults continue to overwhelm the foreclosure system. At the same time, 2010 and 2011 saw a second wave of the foreclosure crisis, brought on in part by relatively obscure legal rules that govern the transfer of mortgage loans from one lender to another and the shortcuts to circumvent those rules. Those shortcuts have come to be known as the 'robo-signing' scandal. Robo-signing describes mortgage servicers' response to the tremendous volume of mortgage defaults and foreclosures after 2007: assembly-line signing and notarizing of affidavits for foreclosure cases, mortgage assignments, note allonges and related documents, all filed in courts and deed recorders in counties across the United States. In

tempting for legal scholars, legislators, and the judiciary to design and implement changes to the system based purely on property law. This temptation to implement change was addressed by the providence of Justice Livingston in his dissent from the opinion in the timeless fox hunting case, *Pierson v. Post*.[39] Justice Livingston called for advice from those sportsmen who had knowledge of the customs involved in fox hunting.[40] Legitimate goals of the mortgage lending industry and industry custom that are, to the extent possible, congruent with rules that must be developed are much more likely to be enforceable and acceptable to solve the problem. Those framing much needed reform to mortgage lending laws and practices should seek and measure input from interested parties within the mortgage lending industry.

A. State Law's Role in Claims Against Real Property

Absent compelling circumstances, real property law has historically evolved in America as a function of state law and conveyances of interests in real property are controlled by state law.[41] Thus, we have the present reality of fifty separate states in the United States, each with its own laws regarding real property. Generally speaking, property lawyers find each state works in harmony with the other states to provide an orderly system of real property law across the United States. Even with the diversity of real property law among the fifty jurisdictions, the United States legal system demands certainty,

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early 2012, the state attorneys general, together with the Federal Department of Housing and Urban Development and other agencies, announced a settlement with five major banks and mortgage servicers of robo-signing related claims. Many hope that this settlement would not only resolve some of the liabilities arising from robo-signing but also somehow resolve legal questions about a variety of mortgage industry practices, allowing the foreclosure process and housing markets to return to normal.").

[39] Pierson v. Post, 3 Cai. R. 175 (N.Y.S. 1805).

[40] *Id.* at 180. ("This is a knotty point, and should have been submitted to the arbitration of sportsmen, without poring over Justinian, Fleta, Bracton, Puffendorf, Locke, Barbeyrac, or Blackstone, all of whom have been cited; they would have had no difficulty in coming to a prompt and correct conclusion. In a court thus constituted, the skin and carcass of poor reynard would have been properly disposed of, and a precedent set, interfering with no usage or custom which the experience of ages has sanctioned, and which must be so well known to every votary of Diana.")

[41] Bd. of Regents v. Roth, 408 U.S. 564, 577 (1972); *See* Philips v. W.A. Legal Found., 524 U.S. 156 (1989).

consistency, and predictability in all land transactions. Another critical feature of the United States' common law system is its adherence to precedent, while also allowing for legislative modification of laws when called for. While no jurisdiction's law is binding on any other jurisdiction, it is not uncommon for state courts to look to other state's laws as persuasive authority.

Basically, the near infinite number of local title details create the private citizens' property rights protected by the Constitution.[42] Moreover, each state has developed its own system of recording, registering, and searching of mortgages and other instruments of conveyance. Although some have advocated for a national mortgage registration system, there is considerable benefit to be gained by continuing to utilize this infrastructure and system within each state, not the least of which is the familiarity of that system by lawyers, judges, title insurers, those in the mortgage lending industry, and the citizens of that state. Each state has a system for registering records of land title conveyances at the local level. These local recording offices are well-established for recording and indexing real estate instruments. In addition to the infrastructure, states have laws that give certainty to the effect of recording. These recording statutes control how disputes are resolved if there is a conflict between the sequence of conveyances and the order in which instruments are recorded. Recording acts will seek to resolve conflicts by determining priority, which may take into account both the order of recording and any notice a claimant may have had about a prior, competing conveyance. Recording acts will also control which instruments may be recorded and which instruments should be recorded. The recording acts in most jurisdictions provide that mortgage assignments may be recorded. Despite this, mortgage securitizers largely elected not to record mortgage assignments in the years leading up to the foreclosure crisis for a variety of reasons. While properly recording mortgage assignments may have slowed down the process, anyone who has stepped onto black ice in the winter knows how beneficial some friction can be to slow down forward progress.

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[42] U.S. CONST. amend. V; *see also* JOHN E. CRIBBETT & CORWIN W. JOHNSON, PRINCIPLES OF THE LAW OF PROPERTY, 2 (3rd ed. 1989) ("Property consists, in fact, of the legal relationships among people in regard to a thing."); *see also* WILLIAM B. STOEBUCK & DALE A. WHITMAN, THE LAW PROPERTY, 1-4 (Hornbook Series, 3rd ed. 2000).

B. Recording Acts

Real property recording acts are designed to protect the orderly ownership and transfer of interests in real property. Recording acts have several objectives, but two of the fundamental objectives are to give parties who acquire interests in real property a means of protecting against otherwise undetectable competing claims to the real property and to provide anyone interested in acquiring an interest in real property, either by purchase or as security for a loan, a way to assess the validity of the rights claimed by those with whom they are dealing.[43] Recording acts accomplish these objectives by requiring real estate instruments to be properly recorded and giving priority to interests that are promptly and properly recorded in the land title records. Recording acts must settle adverse claims against the same parcel of land predictably and fairly in order to accomplish these goals. However, once a mortgage is properly recorded in the land title records, the practice of recording subsequent assignments of mortgages whose notes have been sold on the secondary markets have less to do with priority than it does with giving notice of the new owner of the mortgage note and whoever is entitled to enforce the note through foreclosure. While ownership and right to enforce mortgage notes are gravely important information, this information can be provided more effectively through a separate registry of mortgage notes without cluttering the county land title records with a myriad of mortgage assignments for the very same mortgage securing the very same parcel of land.

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[43] 1 JOYCE PALOMAR, PATTON AND PALOMAR ON LAND TITLES § 4 (3d ed. 2003) ("Recording acts are now in force in all the states and also in the District of Columbia. Their object has been variously stated as being the original one of securing a prompt recordation of all conveyances by according priority of right to the purchaser who is first to record her conveyance, the equitable one of protecting subsequent purchasers against unknown conveyances and agreements regarding the land, and the constructive one of preserving an accessible history of each title, so that anyone needing the information may reliably ascertain in whom the title is vested and any encumbrances against it. In other words, these acts establish a statutory rule of priority among conveyances, extend the doctrine of notice to the instruments recorded, and provide a system of semi-public records that have the same dignity and evidentiary value that attaches to public records. As a result, the modern American recording system includes both those portions of the strictly public records that relate to land titles—such as the legislative and departmental records of public grants and the judicial records of both official grants and transfers by decree, devise or descent—and the quasi public records established by the states' recording acts.").

There are three basic types of recording acts. Each state will have enacted either a race, notice, or race-notice statute.[44] Regardless of which type a state has enacted, an unrecorded interest in real property is generally deemed to not be protected. A detailed examination of these is not relevant to the core problem considered in this article. Suffice it to say that so long as the mortgage has been properly recorded, the proposed national notes registry will solve the core problem regardless of the type of recording statute any state has enacted.

C. Enforceable Claims Against Real Property That Fall Outside the Scope of Recording Acts

Despite the well-established property law principle that unrecorded interests in real property are not protected, there are numerous examples to the contrary. Any real estate attorney who has represented the borrower or the lender in a mortgage loan closing on a commercial revenue producing property has likely experienced the aggravation of tracking the execution and delivery of subordination and non-disturbance agreements for each tenant.[45] Even those tenants whose

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[44] THOMAS E. ATKINSON ET AL., 4 AMERICAN LAW OF PROPERTY § 17.5, at 545 n.63 (A. James Casner ed. 1952). Two states have adopted race statutes for deeds: Louisiana and North Carolina. *Id.* The remaining states are somewhat equally divided between their adoption of 'notice' and 'race-notice' statutes. *Id.* Notice states include: Alabama, Arizona, Arkansas (except mortgages), Colorado, Connecticut, Delaware, Florida, Illinois, Indiana, Oklahoma, Iowa, Kansas, Maine, Massachusetts, Missouri, New Hampshire, New Mexico, Ohio (except mortgages and oil and gas leases), Rhode Island, South Carolina, Tennessee, Texas, Vermont, Virginia, West Virginia. *Id*. Race-notice states include: Alaska, California, District of Columbia, Georgia, Hawaii, Idaho, Indiana, Maryland, Michigan, Minnesota, Mississippi, Montana, Nebraska, Nevada, New Jersey, New York, North Dakota, Oregon, Pennsylvania (except mortgages), Utah, Washington, Wisconsin, Wyoming. *Id.*; 1 JOYCE PALOMAR, PATTON AND PALOMAR ON LAND TITLES § 17 (3d ed. 2003)

[45] David P. Kassoy, *The Tension Between Lenders and Credit Tenants Over SNDAs,* 23 L.A. L. 16, 17 (2001) ("The primary purpose of SNDAs is to secure the agreement of the tenant to subordinate the priority of its lease to the lender's loan. The tenant also agrees that in the event of a foreclosure by the lender, it will attorney to the foreclosure purchaser (the new landlord), which means that the tenant will become contractually bound to the foreclosure purchaser under all terms of the lease. Moreover, and most important, the tenant agrees to continue satisfying all the tenant's financial obligations under the lease. In exchange, the lender agrees that the foreclosure purchaser will not disturb the

unrecorded leases may have an interest in its leasehold estate that receives priority to the new mortgage that is recorded upon the loan closing have experienced this aggravation. Additionally, adverse possession, prescriptive easements, claims of lien, and rights of trust beneficiaries all are claims to real property that may not be found in land title records. The owner of a promissory note secured by a mortgage or those with the right to enforce the note likewise have property rights notwithstanding the lack of notice in land title records.

The holders of rights in real property whose claims are unrecorded may find it necessary to resort to judicial action, possibly a declaratory judgment or quiet title action, as a remedy to prove their rights in real property. Accordingly, property law already provides a legal framework to enforce claims to real property when conclusive ownership cannot be established through the county land title records.

III. Sale and Transfer of Mortgages on Secondary Markets

Prior to the advent of MBS securitization, assignments of mortgages were typically recorded in the land title records of the county that is the situs of the property encumbered by the mortgage when the mortgage originator sold the mortgage and each time thereafter.[46] The requirement that mortgage assignments be recorded, usually in the land title records of the county, which is the situs of the property encumbered by the mortgage, has little to do with the real property, but rather with who is entitled to enforce the note through foreclosure. Although mortgage foreclosure law and process vary from state to state, one common requirement is evidence the foreclosing party is entitled to foreclose.[47] The rights under the mortgage are rights involving real property, whereas the rights under the mortgage note are intangibles. One of the recurring challenges to foreclosure has been the foreclosing lender's ability to produce documentation showing the right to enforce the mortgage note and, therefore, the right to proceed with the foreclosure.[48]

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tenant's right to possession of the premises—even if, by virtue of the SNDA, the lease has been rendered junior to the loan—so long as the tenant is not in default under the terms of the lease.")

[46] *See* Miller, *supra* note 6, at 407.

[47] Heekin, *supra* note 2, at 193.

[48] *Id.* at 179-81.

Until the mortgage foreclosure crisis brought possession of the note into the spotlight, distinctions between Article 3 and Article 9 of the Uniform Commercial Code ("U.C.C.") as they relate to transfer of mortgage notes were largely discussed by academics, if at all. In the years since, differences in the two articles of the U.C.C. have been examined more closely. There are several informative articles that have been written on the topic, so we will not undertake an exhaustive examination here, but rather focus on characteristics relating to the focus of this article.

Mortgage law has been and remains state law, but since portions of the U.C.C., including Article 3 and Article 9, have been codified statutorily by all states, we will examine these pertinent parts. Since most mortgage notes sold on the secondary market are deemed to be negotiable instruments,[49] Article 3 of the U.C.C. provides the structure within which to examine their sale and transfer. Article 3, which only applies to promissory notes that qualify as negotiable instruments, has been enacted in every state and has unambiguous, orderly rules for the transfer and enforcement of notes.[50] Article 9, which applies to both negotiable and non-negotiable notes,[51] has also been adopted in all states, although Article 9 does not address the party entitled to enforce notes, making it less clear for those mortgage servicers tasked with the job of foreclosing mortgages in default. However, it would seem that Article 9 is better suited to the modern transfer of mortgage notes than Article 3, given that the provisions of Article 9 do not mandate the actual transfer of the original "wet" note. In either case, though, the party with rights to the payment of money evidenced by the note is entitled to enforce the rights to the real property granted under the mortgage.

A. Article 3

To qualify as a negotiable instrument, and thus fall within the scope of Article 3, the note must contain an unconditional written promise to pay a fixed amount of money to the bearer of the note or to the order of a specific payee on demand or at a definite time.[52] A review of the formal provisions of the note will identify whether it meets the foregoing requirements and thus qualifies as a negotiable instrument subject to Article 3. Most residential and commercial mortgage notes are

[49] Levitin, *supra* note 3, at 656.
[50] U.C.C. § 3-104 (AM. LAW INST. & UNIF. LAW COMM'N 2002).
[51] U.C.C. § 9 (AM. LAW INST. & UNIF. LAW COMM'N 2000).
[52] U.C.C. § 3-104 (AM. LAW INST. & UNIF. LAW COMM'N 2002).

deemed to qualify as negotiable instruments, although there is considerable debate as to whether those notes are truly negotiable instruments.[53] Most institutional lenders originating residential mortgages utilize the Fannie Mae/Freddie Mac Uniform Instruments, which allows the mortgage originator to more easily sell the mortgages on the secondary market after origination, often to mortgage securitizers.[54]

i. Negotiation and Enforcement of the Note

The transfer of ownership of negotiable instruments generally occurs through negotiation. Negotiation requires the physical delivery of possession of the note by the owner to the transferee to enable the party receiving possession the right to enforce the note.[55] Notes that are bearer

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[53] Ronald J. Mann, *Searching for Negotiability in Payment and Credit Systems*, 44 UCLA L. REV. 951, 971 (1997) ("The irrelevance of negotiability to home-mortgage note transactions is best demonstrated by the fact that the standard form of promissory note used for those transactions fails to satisfy the requirements of negotiability. Because of the strong interest in uniformity in the large securitized home-mortgage note transactions, Fannie Mae and Freddie Mac have promulgated a number of standard forms for use in those transactions. Transactions that do not use those forms are not eligible for repurchase by Fannie Mae or Freddie Mac. Accordingly, although a significant number of home-mortgage notes are not securitized for various reasons, the Fannie Mae/Freddie Mac forms dominate the market, even for transactions in which the lender does not contemplate an immediate sale to Fannie Mae or Freddie Mac.").

[54] Forrester, *supra* note 11, at 1086-87 ("Fannie Mae and Freddie Mac have purchased or securitized subprime loans to a limited extent. Their purchases of subprime loans have been restricted primarily to purchasing loans made to A-borrowers. Therefore, most of the secondary market for subprime loans involves non-GSE securitizations. Nevertheless, a surprising number of subprime loans are made using Fannie Mae/Freddie Mac form documents. Of course, the documents can be modified to be less consumer-friendly when Fannie Mae and Freddie Mac are not the anticipated purchasers of the loans. But even with modifications, many of the standard terms remain in place. The use of Fannie Mae/Freddie Mac uniform mortgage instruments is, therefore, widespread in the prime mortgage market for both conforming and non-conforming loans and even in the subprime market to some extent. By some estimates, more than ninety percent of residential mortgage loans are documented on Fannie Mae/Freddie Mac uniform mortgage instruments, although this percentage may have decreased as the size of the subprime mortgage market has increased.").

[55] U.C.C. § 3-202 (Am. Law Inst. & Unif. Law Comm'n 2002).

notes require physical possession alone for proper negotiation.[56] If the note is payable to order and not simply to bearer, the transferor must also endorse the note in addition to transferring physical possession of the note.[57]

Proper negotiation of a mortgage note will vest in the transferee all the rights of the transferor, including potential rights of a holder-in-due-course.[58] When dealing with mortgages held in securitization trusts, the foreclosing party may face the burden of proving it is a "person entitled to enforce" the mortgage note, commonly known as the PETE.[59] A party can become a PETE by showing it is the "holder" of the promissory note,[60] a non-holder in possession with the rights of a holder, or an owner of a "lost note."[61] The first two possibilities require possession of the promissory note. Similarly, Article 3 provides that the obligation of a maker of a note is discharged by paying the PETE. Therefore, the PETE can enforce the note, whether or not the PETE is the owner of the note. A non-possessor can be the PETE if the person was in possession of it when loss of possession (other than by transfer or lawful seizure) occurred and the person cannot reasonably obtain possession because the instrument was destroyed, its whereabouts are unknown, or it is in possession of a person who cannot be found or is not amenable to service of process. Mortgage servicers are frequently the PETEs under securitization pooling and servicing agreements. According to Article 3, mortgage servicers who are non-possessors seeking PETE status for a lost mortgage note should not be able to obtain a judgment unless the court finds that the borrower is adequately protected against the risk of double payment, a risk which is the root source of the payment rule discussed below.

ii. Holder-in-Due-Course Doctrine

One of the problematic areas of mortgage securitization is the *holder-in-due-course* doctrine. The *holder-in-due-course* doctrine originates in negotiable instruments law and protects the purchaser of a negotiable instrument if the transferee meets certain criteria. U.C.C. Article 3 requires that the transferee must take the negotiable instrument

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[56] *Id.*
[57] *Id.*
[58] U.C.C. § 3-302 (Am. Law Inst. & Unif. Law Comm'n 2002).
[59] Heekin, *supra* note 2, at 175.
[60] U.C.C. §3-302 (Am. Law Inst. & Unif. Law Comm'n 2002).
[61] U.C.C. § 3-309 (Am. Law Inst. & Unif. Law Comm'n 2002).

for value, in good faith, without notice.[62] A holder-in-due-course can hold better title to the mortgage note than the party from whom it obtains the note. So, for example, a holder-in-due-course may have superior rights to collect from the borrower than the mortgage originator or some prior holder had.[63] The rights to payment do not rely on the validity of the underlying transaction giving rise to the debt and the holder-in-due-course's rights are not subject to set-off.

The rights of a holder-in-due-course of a negotiable instrument are qualitatively, as matters of law, superior to those provided by ordinary species of contracts. The obligation to make mortgage payments, which must be made by the mortgagor regardless of the diligence the originator applied to underwriting the loan, the circumstances surrounding the origination of the mortgage, and the property's value, is virtually absolute if the holder is a holder-in-due-course.[64] No notice need be given to any party liable on the instrument for transfer of the rights under the instrument by negotiation. Under the current version of U.C.C. § 3-602, payment by the party liable to the person previously entitled to enforce the instrument "counts" as payment on the note until adequate notice has been received by the liable party that a different party is to receive payments from then on.[65] However, only eleven states and the District of Columbia have adopted the 2003 revisions to U.C.C. §3-602.[66]

When a mortgage lender originates a mortgage and sells that mortgage and its underlying note on the secondary market, the buyer

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[62] U.C.C. § 3-302 ("(1) the instrument when issued or negotiated to the holder does not bear such apparent evidence of forgery or alteration or is not otherwise so irregular or incomplete as to call into question its authenticity; and (2) the holder took the instrument (i) for value, (ii) in good faith, (iii) without notice that the instrument is overdue or has been dishonored or that there is an uncured default with respect to payment of another instrument issued as part of the same series, (iv) without notice that the instrument contains an unauthorized signature or has been altered, (v) without notice of any claim to the instrument described in Section 3-306, and (vi) without notice that any party has a defense or claim in recoupment described in Section 3-305(a).").
[63] U.C.C. § 3-305 (Am. Law Inst. & Unif. Law Comm'n 2002).
[64] *Id.*
[65] U.C.C. § 3-602(b) (Am. Law Inst. & Unif. Law Comm'n 2002).
[66] *See* Legislative Fact Sheet – U.C.C. Article 3, Negotiable Instruments and Article 4, Bank Deposits (2002), https://perma.cc/BL9N-ZD64 (last visited May 14, 2016). Arkansas, District of Columbia, Indiana, Kentucky, Michigan, Minnesota, Mississippi, Nevada, New Mexico, Oklahoma, South Carolina, Texas.

normally requires that it acquire the status of holder-in-due-course.[67] The mortgage originator knows it will not hold the mortgage long enough for problems with the loan to become apparent. The buyers of the mortgages know that as long as they take the mortgage note for value, in good faith, and without notice of issues governed by U.C.C. § 3-302, they become holders-in-due-course. This process, quite frankly, would embolden some mortgage originators to circumvent many of the protections built into the underwriting process and encourage some buyers on the secondary mortgage market to refrain from conducting any due diligence into the loans they buy.[68] The doctrine of *holder-in-due-course*, while a longstanding foundation of negotiable instruments law, would seem to work in mortgage securitization counter to public policy. By analogy,

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[67] Levitin, *supra* note 3, at 659 ("The ability of a purchaser of a negotiable note to become a holder in due course significantly enhances the liquidity and hence the value of the instrument. Because a holder in due course is immune from some defenses, counterclaims, and competing claims, much less diligence is required of a purchaser of a negotiable note. Holder-in-due-course status is used to shield mortgage investors from assignee liability in the secondary mortgage market, which has encouraged the funding of more aggressive mortgage lending.").

[68] Johnson, *supra* note 27, at 574-75 ("Given the transferee's status as holder-in-due-course, the transferee is unconcerned about any imperfections in the bargaining process that lead to the execution of the note and its security interest, the mortgage. Specifically, the transferee is unconcerned about whether the maker of the note was misled during the negotiation process leading up to the note's execution because the maker/mortgagor may not assert this defense against the transferee. Similarly, the transferee of the note is unconcerned that the mortgagor may have been duped into signing a mortgage that is unconscionable in that it is not capable of performance by the mortgagor. Finally, the fact that the mortgagor was lied to by the originator/lender (i.e., "We will provide refinancing at a lower rate before the first Interest Change Date.") is also not relevant because the holder-in-due-course, assuming there has been a valid negotiation and that the originator is not affiliated with the transferee, cannot be held responsible for the lies and misfeasance of the originator. Thus, the holder-in-due-course is free to enforce the terms of the note irrespective of these bargaining process imperfections and any allegations of unfairness and illegality. The holder-in-due-course status thus insulates the transferee from most claims by the mortgagor and provides no incentive for the transferee to investigate the bona fides of the transaction between the mortgagor and the originator. Indeed, the transferee, in order to protect its status as a good faith holder-in-due-course, may be better off not inquiring about the bargaining process than making inquiries and discovering imperfections in the bargaining process present in the note/mortgage the transferee wishes to purchase.").

insurance law has long recognized the risk of moral hazard[69] and courts actively protect against it. Mortgage law has no such concern when it comes to the practices of mortgage loan originators and subsequent buyers of those loans.

iii. The Payment Rule

Another perplexing characteristic of negotiable instruments law is the *payment* rule.[70] It is perplexing in part because courts within many states around the nation are issuing disparate opinions with regard to the payment rule. The payment rule arises from U.C.C. § 3-302. The homeowner demands that the foreclosing party produce the original note (or prove in some other way that it is the true owner of the note) to demonstrate it has the legal right to foreclose (some courts allow a copy of the note to suffice). When the foreclosure crisis first began, attorneys representing homeowners used this defense to stop some foreclosures.[71]

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[69] 44 AM. JUR. 2D *Insurance* § 1198 ("A "moral hazard" likewise refers to the effect of insurance in causing the insured to relax the care he or she takes to safeguard his or her property because the loss will be borne in whole or part by the insurance company.").

[70] Dale A. Whitman, *Reforming the Law: The Payment Rule as a Paradigm*, 1998 BYU L. REV. 1169, 1171 (1998); M. Mark Heekin *Modernizing Mortgage Foreclosure Law: A Call For Transparency And An End To The Payment Rule*, 33.1 Quinnipiac L. Rev. 165, 175-76 (2014-2015) ("The payment rule has a long history in United States negotiable instruments law. Its origins can be traced to interpretations of the holder in due course doctrine in negotiable instruments law. The payment rule requires that once a negotiable instrument has been transferred to an assignee who then becomes a holder, the maker of the instrument who makes payment on the instrument to anyone other than that assignee does so at his or her own peril. The maker's errant payment is not binding on the assignee unless the party who received the payment forwards it to the assignee. This is so even if the maker of the instrument has no knowledge of its transfer. Therefore, the maker can become liable for double payment after the transfer of the signed note to a new holder.").

[71] Adam Leitman Bailey & Rachel Sigmund, *Using the Judicial System to Abate the Foreclosure Crisis*, 27-FEB PROB. & PROP. 12, 13 (2013) ("Many of today's foreclosure actions are commenced not by the original lenders but instead by parties that received a mortgage after a number of transfers during the last housing boom. Because of lenders' sloppy record-keeping millions of mortgage notes were lost as the mortgage interests were bundled into mortgage-backed securities and, in many cases, tracked only through the Mortgage Electronic Registry System. As a result, borrowers have successfully used the "show me the note" defense to defeat many foreclosures.")

This sometimes worked because producing the note can be difficult.[72] In many cases, the debt is sold among different banks and investors -- sometimes over and over again.[73] Every so often, the new owner of the loan does not get the proper paperwork to show they own the note and mortgage.[74] Even in situations where the original note is available, the endorsements might not be in order.

Revisions to U.C.C. § 3-602 attempts to address the payment rule; however, as of this writing only eight states have adopted the revised § 3-602.[75]

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[72] *Id.*
[73] George M. Cohen, *The Financial Crisis and the Forgotten Law of Contracts*, 87 TUL. L. REV. 1, 11-12 (2012) ("The primary innovation was the extension of "private-label" securitization into the subprime residential mortgage market. Securitization begins with the pooling of mortgages, or the assignment by the originating lenders (commercial banks or specialized monoline lenders) to a trust (special purpose entity or vehicle) created by a sponsor, also known as an arranger or issuer (often originating banks, but also investment banks and monoline lenders). The trust raises money to buy the mortgages by soliciting investors to buy "residential mortgage-backed securities" (RMBSs), which are bonds entitling the investors to a payment stream from the mortgage pool. In subprime mortgage securitizations, investors purchase securities in different "tranches," which correspond to priority levels of payment streams from the aggregated proceeds of all the loans. Investors in the upper-level, highest-rated tranche, which typically represents the vast majority of the investors, get paid first out of the pool and so get the lowest return, corresponding with the lowest level of risk. Investors in the lower-level tranches have a lower priority of payment and so incur a higher level of risk, corresponding with a higher rate of return. Securities from lower-level tranches are themselves often resecuritized by being pooled with similar securities from other mortgage pools. In these resecuritized pools, termed "collateralized debt obligations" (CDOs), investors are also grouped into tranches, again with the vast majority of the highest tranche receiving the highest credit rating. Finally, the trust hires servicers, often affiliated with large commercial banks, to manage the collection and distribution of mortgage payments and to deal with the borrowers in the event of difficulties. Thus, in the world of securitization, it is no longer sufficient to talk about "the lender"; instead, we must distinguish (at the very least) four different parties: the originator, the sponsor (arranger), the investor, and the servicer.").
[74] *See* Bailey & Sigmund, *supra* note 71, at 14.
[75] Heekin, *supra* note 2, at 197; Levitin, *supra* note 3, at 659.

B. Article 9

While Article 3 applies exclusively to mortgage notes that qualify as negotiable instruments, Article 9 applies to all notes. Initially, Article 9 was utilized in secured transactions. However, the reach of Article 9 applies to notes in a variety of capacities, including the transfer of notes and the transfer of ownership in the general intangible and the mortgaged real property that serves as security for the note. To fully understand the relation of Article 9 to the sale of notes, one must discard the more commonly understood definitions in Article 9, used in connection with the pledge of collateral for an obligation. For example, in the context of a note sale, Article 9 uses the term "security interest" to mean "any interest of . . . a buyer . . . of a promissory note in a transaction that is subject to article 9." Similarly, the term "debtor" means the seller of the note, "secured party" means buyer of the note, and "collateral" means the payment right sold.

i. Transfer and Enforcement of the Note

For the originating mortgage lender to effectively sell its ownership rights in a mortgage note on the secondary mortgage market, Article 9 requires that value be given by the buyer, that the seller have rights in the note or the power to transfer rights in the note to the buyer, and either the seller authenticate a "security agreement" describing the note to the buyer or deliver the note to the buyer pursuant to a security agreement. Upon the occurrence of these necessary elements, the buyer's security interest, or ownership interest, in the note attaches and the sale transaction is effectuated. The term "security agreement," as described in Article 9, is a document that provides for the transfer of the note to the buyer.[76] One of the benefits of Article 9 as it relates to the transfer of mortgage notes is that it requires broader, less restrictive methods of transferring notes when they are sold. Rather than the actual, physical transfer from assignor to assignee, a purchaser can perfect its security

[76] U.C.C. § 9-102 Official Comment 3(b) (Am. Law Inst. & Unif. Law Comm'n 2002)("Whether an agreement creates a security interest depends not on whether the parties intend that the law characterize the transaction as a security interest but rather on whether the transaction falls within the definition of "security interest" in Section 1-201. Thus, an agreement that the parties characterize as a "lease" of goods may be a "security agreement," notwithstanding the parties' stated intention that the law treat the transaction as a lease and not as a secured transaction.").

interest in the note by filing a financing statement.[77] The filing office is not described with specificity,[78] thereby, leaving an avenue for the filing office to be a national notes registry. This greater flexibility in the transfer of notes provided by Article 9 reflects the needs and realities of a more modernized society and a more modernized mortgage lending industry.

While Article 9 provides greater flexibility on acceptable methods of the transfer of mortgage notes, it does not have any provisions that correspond to Article 3's PETE and is less clear on who has the power to release the mortgage. Determining the PETE status is critically important to standing in foreclosure proceedings. Article 9 does not address PETE status or the right to enforce the note. While Article 9 does address transfer of ownership, it is not fathomable that the vast number of investors in mortgage backed securities whose fractional share of ownership of a note would attempt to enforce the note. That is why identifying the PETE for each note is so utterly important in foreclosure proceedings and to provide borrowers certainty with regard to the party with whom they should deal with on matters relating to their mortgage loan.

The terminology used in Article 9 to discuss the transfer of ownership in a note is not clearly expressed since the terms used in Article 9 also apply, more commonly, to secured transactions and not to the outright sale and transfer of ownership of notes. The sale of the ownership rights in the note under Article 9 does not require transfer of physical possession of the note. The buyer of the note can obtain ownership of the note from a seller merely through a signed security agreement granting rights to the note. If possession of the note does not transfer, the provisions of Article 3 and Article 9 specifically interact to determine where rights lie.

C. The Mortgage Follows the Note

It is a longstanding principle in American law that the security follows the obligation, or expressed another way, the mortgage follows the note.[79] The import of this is that the obligation, usually debt

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[77] U.C.C. § 9-312(a) (Am. Law Inst. & Unif. Law Comm'n 2002).
[78] U.C.C. § 9-501(a)(2) (Am. Law Inst. & Unif. Law Comm'n 2002).
[79]Carpenter v. Longan, 83 U.S. 271, 274-75 (1872) ("The note and mortgage are inseparable; the former as essential, the latter as an incident. An assignment of the note carries the mortgage with it, while an assignment of the latter alone is a nullity . . . The transfer of the note carries with it the security, without any

evidenced by the promissory note, is the paramount instrument, not the mortgage itself.[80] The party with certain rights in the promissory note is the party with standing to enforce the note and thereby reach the property secured by the mortgage to foreclose.[81] Article 9's § 9-203(g) explicitly provides that when a note is transferred, the transfer of the interest of the seller in the note automatically transfers a corresponding interest in the mortgage to the assignee. The upshot of this is that when a note is transferred, the right to the proceeds resulting from tender of a payoff or the proceeds from a foreclosure accompany the transfer.

Since the practice of transferring ownership of mortgages multiple times in the securitization process involves transfer of a negotiable instrument requiring the physical transfer of the note, there

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formal assignment or delivery, or even mention of the latter. If not assignable at law, it is clearly so in equity. When the amount due on the note is ascertained in the foreclosure proceeding, equity recognizes it as conclusive, and decrees accordingly. Whether the title of the assignee is legal or equitable is immaterial. The result follows irrespective of that question. The process is only a mode of enforcing a lien.").

[80] GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW §5.27, 387-88 (5th ed. Thompson/West 2007) ("The security is virtually inseparable from the obligation unless the parties to the transfer agree to separate them. The reason is that the security is worthless in the hands of anyone except a person who has the right to enforce the obligation; it cannot be foreclosed or otherwise enforced. Hence, separating the security and the obligation is ordinarily foolish, since it will leave one person with an unsecured debt and the other with a security instrument that cannot be enforced."); *accord* RESTATEMENT (THIRD) OF PROP. MORTGS. § 5.4 cmt. a (Am. Law Inst. 1996) ("The essential premise of this section is that it is nearly always sensible to keep the mortgage and the right of enforcement of the obligation it secures in the hands of the same person. This is so because separating the obligation from the mortgage results in a practical loss of efficacy of the mortgage.").

[81] Elizabeth L. McKeen, et. al., *The Latest Standing-To-Foreclose Challenges at Odds with UCC Article III*, 45 No. 4 UCC L. J. ART. 2 ("The promissory note is a negotiable instrument governed by Article III of the Uniform Commercial Code ("UCC"). Article III of the UCC details the obligations of parties with respect to negotiable instruments, such as promissory notes, including to whom those obligations are owed and by whom they may be enforced. A person need not be the owner of a note to be entitled to enforce it (and not all owners will qualify as persons entitled to enforce the note). U.C.C. Section 3-301 identifies three categories of persons entitled to enforce a note: "(i) the holder of the instrument, (ii) a nonholder in possession of the instrument who has the rights of a holder, or (iii) a person not in possession of the instrument who is entitled to enforce the instrument pursuant to Section 3-309 or 3-418(d).'"").

should be less concern for tracking assignments of mortgages and much more concern for tracking ownership of the note. We know that the real property is not capable of being moved and, more importantly, the mortgage is recorded in the land title records of the county where the property is located. On the other hand, the note, another form of property, is capable of being moved. Indeed, if one follows the requirements of Article 3, the note must be moved to be physically transferred in the securitization process. Therefore, the longstanding principle that the mortgage follows the note shows that so long as there is a transparent, certain method of identifying where in the stream of commerce the note is, the mortgage has followed along. As we have seen in the foreclosure crisis, keeping accurate track of these instruments can be far more demanding than it would seem.

D. The Unholy Mess: Applying Article 3, Article 9, and State Recording Laws to Bundled MBS

A multitude of mortgage industry originators and servicers positively ignored both the fifty states' versions of Article 3 and their recording statutes when transferring mortgage notes after origination. Because of Article 9's less restrictive transfer requirements, compliance or lack thereof with the fifty states' version of Article 9 is more difficult to determine. Whether these failures to comply were willful or negligent remains a topic of speculation. However, it is possible that mortgage securitizers—operating in the nation's financial centers bundling mortgages from a variety of states—could not or would not keep track of the laws affecting mortgages they were transferring secured by real property in all fifty states. Perhaps it was a lack of clear understanding of which laws applied and which laws to follow.

Additionally, confusion by the legal profession between Article 3, Article 9, and the varying state law interpretations of both articles, has generally spawned inconsistent treatment of foreclosures by state courts.[82] There seems to be considerable turmoil in the court opinions, much of which is due to the uncertainty of who is entitled to foreclose and the evidentiary standard by which that party is required to prove they are the party entitled to proceed.

The mismarriage of the core legal principles flowing from U.C.C. Articles 3, 9, and state recording laws has frozen the gears of the mortgage marketplace. Such incoherence can be expected whenever the

[82] Heekin, *supra* note 2.

enforcement of legal remedies for borrower default is defeated by an unintended consequence of these three legal principles.[83]

As explained above,[84] Article 3 requires proof of, and often actual production of, the original signed promissory note that represents the debt. A demand for such proof or presentation by a borrower defending against most foreclosures can be successful.[85]

Also noted above,[86] Article 9 produces the principle that the ownership of the mortgage follows with ownership of the mortgage debt as represented by the promissory note, the reasons for this principle being self-evident.

This Article 9 principle trumps the general legal thrust of state recording acts that provide for recording in the county land records of documents that assign the mortgage interest from the original lender to subsequent investor-lenders. Thus, the state recording acts fail to account for note ownership under U.C.C. law of financial instruments. If those who claim a failure of the American land title system because some in the mortgage lending industry chose not to record a transfer of ownership of mortgage notes,[87] that surely champions the call for a Torrens-like registration system to conclusively determine note ownership.

This doctrinal mismarriage presents a legal roadblock in the path of providing effective legal remedies to lenders involved in modern MBS land financing. The proposal of this article, for a national electronic mortgage note registry dissolves such roadblocks.

IV. PRACTICAL SOLUTIONS

"Sunlight is said to be the best of disinfectants; electric light the most efficient policeman."[88] In that statement, Justice Louis Brandeis espoused transparency and openness. One has to wonder if sunlight shining on an accurate, current database of mortgage note ownership records would have provided transparency enough to prevent the murky confusion of mortgage ownership and the right to enforce mortgages created by MERS, the failed private registry of vital mortgage

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[83] Heekin, *supra* note 2, at 179-87.
[84] *See supra* note 50- 71 and accompanying text.
[85] *Id.*
[86] *See* Bailey & Sigmund*, supra* note 71.
[87] *See* Marsh, *infra* note 91, which proposes that state recording acts are inadequate and often not complied with by modern mortgage lenders. *Id.*
[88] LOUIS D. BRANDEIS, OTHER PEOPLE'S MONEY: AND HOW THE BANKERS USE IT 92 (McClure Publ'ns 1913-14, N.Y. Frederick A. Stokes Co., 1914).

information. Instead of continuing to dwell on MERS and the legal entanglements it created, it would be helpful to take the central concept from the private MERS and the legal problems exposed by the foreclosure crisis to design a system to preclude a repeat performance.

Some have recommended a national mortgage registry somewhat similar to MERS, only operated by the federal government.[89] While an electronic registry for mortgages that is of public record would seem to be a solution, there are very important concerns that such a preemptive federal registry would inevitably lead to one national set of mortgage laws, making such a system politically unattainable. A national electronic registry of mortgage documents would require, or be the first step, in a national recording law, which would unify determination of priority and lead to control of real property law by the federal government. While this might appear on its surface desirable to some, building a consensus of those willing to hand over the familiarity and certainty of their state's law would likely be difficult, if not nigh impossible. The land title insurance industry, real estate attorneys, and other ancillary interests for each of the fifty states are not likely to be willing to give up their individual state laws and centuries of judicial precedent that guides them in favor of unified federal law. Lobbyists for these interests would surely target legislation aimed at forcing a unified system. Others have called for a national foreclosure law.[90] This too would likely be fought vigorously by interests unwilling to jettison their state law in favor of a unified set of laws. Additionally, such a move would be antithetical to notions of the federal system our nation was founded upon.

A. National Notes Registry

There has been little change to the venerable land title records system used in America since colonial times.[91] At that time, a paper

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[89] Dale A. Whiteman, *A Proposal for a National Mortgage Registry: MERS Done Right*, 78 MO. L. REV. 1 (2013); *see also* Hunt, *supra* note 17.
[90] Grant S. Nelson, *Confronting the Mortgage Meltdown: A Brief for the Federalization of State Mortgage Foreclosure Law*, 37 PEPP. L. REV. 583, 620 (2010).
[91] Tanya Marsh, *Foreclosures and the Failure of the American Land Title Recording System*, 111 COLUM. L. REV. SIDEBAR 19, 20 (2011) ("Little has changed since colonial days in the process by which title is recorded. There are over 3,000 local recording systems where holders of an interest in real estate can register that interest. For centuries, deeds, mortgages, easements, and leases

recording and indexing system was Eighteenth Century state of the art. That system has largely gone unchanged even though technology for the transmission and storage of information has improved exponentially. Existing property law, coupled with increased technology, already provides a solution to prevent a recurrence of the foreclosure crisis that plagued our nation and helped usher in a worldwide recession and brought unprecedented uncertainty to America's land title records. U.C.C. Article 3, as noted above, legally forces a burden not met by the fifty states' land title recording systems (nor the failed privately supported MERS system). The task of an effective land title records system should be to review instruments that grant an interest in land for compliance with formal requirements, record those instruments, index the recorded instruments in a logical manner, and make the indexes and recorded instruments available and searchable to the public to ensure transparency in land title records. This system was sufficient in America from colonial times up until the advent of securitization. However, with growth in population, along with the number of mortgage loans originated and the complexity of those transactions, our country has outgrown this system as a mechanism for tracking transfers of mortgage notes.[92] The land title records system was not designed to track PETE

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were hand-transcribed into books. Indexes were created as finding guides to locate the transcriptions. Some counties used multiple index books--one for deeds, one for mortgages, and one for miscellaneous records. In most American recording offices, computers are now used to digitize new records and maintain the indexes, although some smaller and more rural counties continue to use physical books for indexing. Still, many counties that digitize their records and index on a computer maintain the fiction of a paper-based system by referring to the location of a document by "book" and "page" numbers. There are two methods of indexing land title records: the tract index and the grantor/grantee index. The tract index uses a legal description of the relevant land as its organizing principal. The grantor/grantee index uses the names of the parties to a conveyance as its organizing principal. Indexes normally include the following fields of information: names of the parties, type of conveyance, recording date, short legal description, and reference to the location of the document.").

[92] Dean Arthur R. Gaudio, *Electronic Real Estate Records: A Model for Action*, 24 W. NEW ENG. L. REV. 271, 272 (2002) ("For that era of history, paper technology was more than adequate. But as years unfolded, the document records multiplied. At first they increased as a simple result of the accumulation of time and the resulting accumulation of transfers. In the period of a hundred or more years, many transfers of real estate, accompanied by various liens and probates of estates, would be recorded. This growth began to increase because conveyances became more frequent, financing became more common and parcels were being subdivided, resulting in even more conveyances. As a

status since, traditionally the originator of the loan maintained ownership until it was paid off at its maturity or sooner. Therefore, the owner and the PETE were one in the same. Securitization and its multiple transfers of the note necessitates transparency, certainty, and up-to-date records of not only the note owner, but also the PETE for each note. These records must be accessible not only by mortgage industry insiders, but by anyone who seeks this information. Just as the public's unfettered access to land title records has been a staple of American society, so should be access to records of ownership and the right to enforce mortgage notes.

Sunlight in the form of transparency and certainty with regard to all aspects of ownership of mortgage notes, servicing rights, and the rights to enforce the debt or other obligation evidenced by each mortgage note is vitally needed. Only serious reform, such as that proposed here, will allow the nation's mortgage and land title industries to return to normalcy. Transparency and certainty beginning with the origination of each mortgage loan that follows each mortgage throughout its life to maturity would help provide certainty. Mortgage note ownership records must be transparent and certain. Mortgage notes and all the rights and duties that flow from them are far too important to the borrower, lender or assignee, and America as a whole to entrust custodial duty of those records to a private entity, as was done in the MERS experiment. Of all the issues that emanated from the foreclosure crisis, few, if any, involved the validity, priority or enforceability of the mortgage instrument itself. Most were issues relating to the underlying obligation evidenced by the mortgage notes, such as the identity of the owner of the note, the identity of the PETE, the identity of the servicer of the mortgage, and whether the borrower was in default of its obligations under the note.[93] Issues such as these are not relating to the land title records, but rather to keeping a transparent, certain, and accurate database of mortgage note ownership and identity of the party entitled to enforce the note that is easily accessible by homeowners, land title searchers, mortgage lenders, and anyone else interested in a mortgage affecting land. All land title lawyers know that a mortgage is the conveyance of an interest in real property that serves as security for an obligation, not the instrument that evidences the obligation. A change in the terms of the obligation by reduction in the

consequence, the first innovation in the recording system became necessary--the index. The index served as a starting point for a title examiner to begin his or her search. Earlier index systems were based on the names of the grantor and grantee. Later systems were based on the individual parcels of land and became more prevalent as history progressed.").

[93] Miller, *supra* note 6; Heekin, *supra* note 2.

principal amount, amending the interest rate, or granting an extension of the term of the loan, by and large, do not affect the real property interest conveyed under the mortgage. The most common exception to this occurs when a senior mortgagee modifies the obligation and thereby can affect the priority of its mortgage with respect to junior encumbrances.[94] Even so, such involuntary loss of priority is not automatic, but must be decreed by a court.

There needs to be a bifurcated system of registration and recording of (1) interests in land title such as the security interests of perfected mortgage liens or deeds of trust, and (2) ownership of the debt as evidenced by the mortgage notes.

By common law and state statutory law, the ownership of the mortgage follows the ownership of the note. However, sending the note and mortgage in different directions for filing purposes is not the anathema some envision. This bifurcated system could be accomplished by continuing to employ the established county land title recording

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[94] RESTATEMENT (THIRD) OF PROP.: MORTGS. § 7.3 (Am. Law Inst. 1996) ("(a) If a senior mortgage is released of record and, as part of the same transaction, is replaced with a new mortgage, the latter mortgage retains the same priority as its predecessor, except

(1) to the extent that any change in the terms of the mortgage or the obligation it secures is materially prejudicial to the holder of a junior interest in the real estate, or

(2) to the extent that one who is protected by the recording act acquires an interest in the real estate at a time that the senior mortgage is not of record.

(b) If a senior mortgage or the obligation it secures is modified by the parties, the mortgage as modified retains priority as against junior interests in the real estate, except to the extent that the modification is materially prejudicial to the holders of such interests and is not within the scope of a reservation of right to modify as provided in Subsection (c).

(c) If the mortgagor and mortgagee reserve the right in a mortgage to modify the mortgage or the obligation it secures, the mortgage as modified retains priority even if the modification is materially prejudicial to the holders of junior interests in the real estate, except as provided in Subsection (d).

(d) If a mortgage contains a reservation of the right to modify the mortgage or the obligation as described in Subsection (c), the mortgagor may issue a notice to the mortgagee terminating that right. Upon receipt of the notice by the mortgagee, the right to modify with retention of priority under Subsection (c) becomes ineffective against persons taking any subsequent interests in the mortgaged real estate, and any subsequent modifications are governed by Subsection (b). Upon receipt of the notice, the mortgagee must provide the mortgagor with a certificate in recordable form stating that the notice has been received.")

systems, the systems that have endured for nearly two centuries, for the recording of the mortgage documents. But, this should be supplemented by the creation of a nationwide, federally operated National Notes Registry ("NNR") that could operate on a computerized, Torrens-like system. In essence, this system would create a publicly operated, publicly transparent, MERS-like system.

Thus, all existing county land title recording systems, their records, and their offices will be left as they are to record any conveyance of an interest in the land itself, including mortgage and deed of trust security instruments. Priority, as it relates to the mortgage or deed of trust and any prior or subsequent encumbrances in the chain of title of the real property, will continue to be determined in the same fashion that all such land titles are currently determined in each state according to established state land title law. Title searchers would continue to search land title records in each state and county as they have for decades to establish priorities among deeds of conveyance, easements, restrictive covenants, probate claims, and other similar garden variety encumbrances. Legal precedent as it relates to real property matters—including mortgage or deed of trust foreclosures—would continue to operate as it has historically operated in each state. There is no need to reinvent the fifty states' land title recording system or the myriad of established institutions that rely upon these recording systems.

The note would be sent to the newly developed NNR. Then, when a mortgage originator or subsequent owner or holder has transferred ownership of a mortgage note, or any modification of a mortgage note has been agreed upon, and any subsequent transfer of ownership of a mortgage note, or the servicing rights thereto have been transferred, that would be registered in the NNR. The NNR must be created as an openly public, not private, recordkeeping entity (unlike the murkiness and obfuscation of the ineffective MERS private system).

i. Federal Preemption of State Mortgage Law

The reform proposals herein are not meant to replace all the other needed reforms, but to supply the pivotal legal link to prevent post-foreclosure chaos in America's land title system and ensure certainty, transparency, and orderly transfer of mortgage ownership. Although there has been a call by some scholars for a solution on a national level through one uniform mortgage registry or uniform national recording or foreclosure laws, an effectuation of such a system would be a herculean undertaking that would likely be opposed by any organization that has an interest in land title law.

In order for the federal government to require a national registry of mortgage notes, an examination of federal preemption is unavoidable. This portion of the article will examine the general background of preemption, coupled with the state police power of property law, and a comparable regulatory scheme as it relates to securities law that allowed for existing state law and enactment of federal law to supplement some areas of the regulation scheme and preempt other portions of it.

The Supremacy Clause of the United States Constitution provides that regulations, laws, and treaties made pursuant to the authority of the Constitution are the supreme law of the nation.[95] Based upon this power, the doctrine of federal preemption was created to help clarify conflicts arising between federal and state law. In preemption matters, courts initially look to the legislative intent of Congress when the law or regulation in question was enacted.[96]

Based on the legislative intent, preemption is either express or implied, and the language of the regulation determines intent.[97] Express preemption occurs when Congress specifically states that the regulation preempts any existing state law.[98] A clear statement should be crafted that the legislation is intended as a prevention of another national mortgage foreclosure crisis. Further, there are two forms of implied preemption, conflict and field preemption. Under conflict preemption, if the state regulation makes it impossible to comply with the federal regulation, or creates an obstacle to compliance with the federal regulation, the state law will be held unconstitutional.[99] Under field preemption, if the regulation is "so pervasive as to make reasonable the

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[95] U.S. CONST. Art. VI, cl. 2 ("The Constitution, and the Laws of the United States… which shall be bound thereby, any Thing in the Constitution or Laws of any state to the Contrary notwithstanding.").
[96] Gade v. Nat'l Solid Wastes Mgmt. Ass'n, 505 U.S. 88, 96 (1992), (quoting Allis-Chalmers Corp. v. Lueck, 471 U.S. 202, 208 (1904) (quoting Malone v. White Motor Corp., 435 U.S. 497, 504 (1978) (quoting Retail Clerks v. Schermerhorn, 375 U.S. 96, 103 (1963)))) ("[T]he question whether a certain state action is pre-empted by federal law is one of congressional intent. 'The purpose of Congress is the ultimate touchstone.'").
[97] *Gade*, 505 U.S. at 98.
[98] *Id*. at 98-99.
[99] *See* McDermontt v. Wisc., 228 U.S. 115 (1913); *See* Nash v. FL Industrial Comm'n, 389 U.S. 235 (1967).

inference that Congress left no room for the States to supplement it," then the federal legislation will preempt state law.[100]

If the federal regulation preempts state law, the state law will be invalidated or deemed unconstitutional because Congress's legitimate Commerce Clause regulations are the supreme law of the land. We must now examine the issue of property law and how it comports with preemption.

When examining state police powers, the Supreme Court stated in *Rice v. Santa Fe Elevator Corp* that "[w]e start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress."[101] In *Rice*, the Court reasoned that the Illinois Commission could act in a way that was "harmonious with the measure of control . . . which the Federal Act imposes."[102] Thus, a federal regulation is able to supplement current state law. Further, the Supreme Court has held that there is no presumption that the regulation preempts existing state law. [103]

Based on case law, regulation of property is deemed to be a state police power.[104] The Court has stated, "[p]roperty interests, of course, are not created by the Constitution. Rather they are created and their dimensions are defined by existing rules or understanding that stem from an independent source such as state law-rules or understandings that secure certain benefits and that support claims of entitlement to those benefits."[105] The upshot of this is that state law creates the property interest and the Constitution protects the interest created through procedural processes.

In order for Congress to preempt state law to create and regulate a national notes registry, Congress would need to justify the regulation through the Commerce Clause. Established in *Gonzales*, Congress has the power to regulate local activity for the purposes of an overarching

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[100] *Gade*, 505 U.S. at 98.
[101] Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 229 (1947).
[102] *Id.* at 231.
[103] *New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.,* 514 U.S. 645, 654 (1995) ("[D]espite the variety of these opportunities for federal preeminence, we have never assumed lightly that Congress has derogated state regulation, but instead have addressed claims of pre-emption with the starting presumption that Congress does not intend to supplant state law.").
[104] Bd. of Regents of State Colleges v. Roth, 408 U.S. 564, 577 (1972); *See* Philips v. Washington Legal Found., 524 U.S. 156 (1999).
[105] *Roth,* 408 U.S. at 577.

regulatory scheme when the local activity, on the aggregate, bears a rational basis for believing there is a substantial effect on interstate commerce.[106] Therefore, Congress would need to pass the NNR through an enumerated power to withstand judicial review.

Congress could establish the NNR under the powers of the Commerce Clause. The Commerce Clause provides authority to "regulate Commerce with foreign Nations, and among the several states, and with Indian Tribes."[107] Generally, Congress has the ability to regulate commerce in three ways: (1) the channels of interstate commerce; (2) the instrumentalities of interstate commerce; and (3) when the activity has a substantial economic effect on interstate commerce. [108] Advanced in *Gonzales*, Congress has the power to regulate local activity for the purposes of a grand regulatory scheme when the local activity, on the aggregate, has a rational basis for believing there is a substantial effect on interstate commerce.[109] The significance of this case is that the Court determined a local non-economic activity could be regulated through the commerce clause. In *Lopez*, the Court did note that if the regulation is dealing with matters of true state concern with no economic impact, the regulation fell outside the commerce clause. [110]

Congress would have the continuing ability to regulate the NNR through the Commerce Clause, as well. Congress would be able to establish that purchasing mortgage notes on the secondary market has a substantial effect on interstate commerce. Further, courts that examine this would likely hold that this regulation is a grand regulatory scheme that would withstand rational basis review due to the government's legitimate interest in avoiding future crashes of the nation's real estate market.

For an examination of a comparable regulatory scheme that allowed for the preemption of existing state laws while simultaneously supplementing others, the Securities Act of 1933 and Securities Exchange Act of 1934 would be a good specimen. The federal government began enacting securities regulations in response to the

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[106] Gonzalez v. Raich, 545 U.S. 1, 2-3 (2005).
[107] U.S. CONST. art. I, § 8, cl. 3.
[108] U.S. v. Lopez, 514 U.S. 549, 558 (1995); *See also* U.S. v. Darby, 312 U.S. 100, 119 (1941) ("Congress may appropriate legislation regulate intrastate activities where they have a substantial effect on interstate commerce." (citing *Santa Cruz Fruit Packing Co. v. NLRB*, 303 U.S. 453, 466 (1938))).
[109] *Gonzalez,* 545 U.S. at 2-3; *See* Wickard v. Filburn, 317 U.S. 111, 124 (1942).
[110] *Lopez,* 514 U.S. at 577.

Great Depression.[111] The states also had their own securities laws, which created conflicts for corporations and exchanges.[112] Due to these conflicts, Congress clearly preempted portions of state law with the revision of the National Securities Markets Improvement Acts of 1996.[113]

ii. Recording the Mortgage upon Origination Serves as a Marker in the Land Title Records

Under the national notes registry system, mortgage instruments would continue to be recorded in the county land title records, but the mortgage notes would be registered with the NNR. After all, longstanding property law recognizes ownership rights affecting real property that are not recorded in the county land title records.[114] At the time of its origination, each mortgage loan would be issued an alpha-numeric mortgage identification number ("MIN") that would be unique to that particular mortgage for the life of the loan. The MIN would be used to reference that mortgage and its note shortly after its origination. The recommended alpha-numeric sequence would begin with (i) the two letter postal abbreviation of the state in which the mortgaged property lies; (ii) a number assigned to each county within that state; (iii) the book and page in that county's land records of the instrument (i.e., its deed) conveying into the mortgagor its interest being mortgaged; (iv) a six digit sequence of numbers unique to the originated loan so that the loan has sufficient internal identification during underwriting by its originator; and (v) finally, the book and page in the county land records where the

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[111] Robert Brown, *The Irrelevance of State Corporate Law in the Governance of Public Companies*, 38 U. RICH L. REV. 317, 336 (2004) ("[I]t was clear that state law did not adequately protect the rights of shareholders in the context of voting or disclosure."); S. Rep. No. 73-792, at 3 (1934) ("There can be little question that stock-market speculation is among the post potent of the factors which have contributed to the prolonged depression . . . uncontrolled speculation on security markets was an important cause of the credit inflation which led to the collapse of 1929 and the subsequent depression.").

[112] Jeffery Chadwick, *Proving Preemption by Proving Exemption: The Quandary of the National Securities Market Improvement Act,* 43 U. RICH. L. REV. 765 (2009).

[113] Manning Gilbert Warren III, *Reflections on Dual Regulation of Securities: A Case for Reallocation of Regulatory Responsibility*, 78 WASH. U. L. REV. 497, 498 (2000); 15 U.S.C. § 77(a) (1916) ("Except as otherwise provided in this section, no law, rule, regulation, or order, or other administrative action of any State or any political subdivision thereof.").

[114] Kassoy, *supra* note 45.

mortgage for this loan can be located. For example, if John and Joan Smith, who own real property located in Duval County, Florida (and whose warranty deed conveying title to that land to them is recorded in Official Records Book 1225, Page 123), were to grant a mortgage on that property and upon closing the mortgage is recorded in Official Records Book 1225, Page 126, the MIN would appear as FL-02-1225-0123-918273-1225-0126. Thus, anyone who needed information on that mortgage would know, based upon that MIN, to search FL (Florida), 02 (Duval County), the vesting instrument recorded at book 1225, page 123, and the mortgage for this loan at book 1225, page 126 of the land records of Duval County.

There would be no need to amend the mortgage instrument in the county land title records or record assignments every time the note is transferred. As at present, the mortgage may of course be amended if some modification affecting the real property, such as releasing a portion of the real property, were to occur.

The mortgage is extinguished by operation of law when the underlying debt has been paid in full or other secured obligation has been satisfied. However, the recorded mortgage continues to appear as a cloud on title to the real property encumbered. Upon satisfaction, the lender is consequently required to execute and deliver a release of mortgage in recordable form that can be recorded in the land title records of the county in which the mortgage was recorded to clear the cloud on title. Lenders who refuse to execute a release are subject to penalty in all fifty states.[115] This obligation to execute a release would continue unchanged under the NNR system working in concert with the fifty states' county land title recording systems. The servicer or PETE identified in the NNR would be the appropriate party bound by this obligation.

iii. Registration of Mortgage Notes in the National Notes Registry

The NNR would be designed as a computerized, Torrens-like registry, somewhat similar to Minnesota's land title registration system. The Torrens system is designed to determinately establish matters of ownership.[116] When established, the NNR note ownership examiner

[115] *See* RESTATEMENT (THIRD) OF PROP. MORTGAGES § 6.4 (AM. LAW INST. 1997).
[116] Anh T. Le, *Property--The Effect of the Hersh Decision on the Torrens Act: Getting to the Root of the Problem*, 26 WM. MITCHELL L. REV. 601, 608 (2000) ("The Torrens system is fundamentally different from the recording system. The

would participate in any proceedings that purport to affect the promissory note and all interested parties, including mortgagees, would be notified of proceedings and allowed to participate. This process ensures compliance with due process and statutory requirements. For instance, Minnesota appellate courts have set aside court orders that concern registered real property not obtained in a proceeding subsequent to initial registration.[117] With very few exceptions, registered real property is subject only to interests shown on the certificate of title.[118] The good-faith holder of a certificate of title will even prevail in the face of a forged deed in his or her chain of title.[119]

The existing well-run Torrens systems show that a simple, one instrument (Certificate of Title in Torrens operations) system is possible. In the NNR that single instrument is the Mortgage Note.

iv. An Examiner of Notes (or Register) of Notes

The NNR Register of Notes would tend to such ministerial things, such as assigning NNR numbers to each note and registering any other note or mortgage identification information. The NNR Register of Notes would register information such as parties; location (state, county, recording number) of the security devices, such as Mortgage and U.C.C. filing numbers; and note transferees. Such ministerial matters as the Register of Notes may be deemed appropriate to fulfill the purposes of the NNR law. The Register of Notes shall be deemed a Necessary Party to be served in any litigation seeking to affect the note ownership, obligation, identification of the PETE, and other such matters.

Any change involving a particular mortgage note would be registered in the NNR accessing that note's records by the MIN, whether it be a transfer of the note, a modification, satisfaction, change of servicer rights, or otherwise. Technology available and currently being employed in the financial industry could assist in registration and data storage for the NNR. Blockchain, a distributed database which utilizes distributed ledger technology, is a relatively cutting edge technology that has the capability to store data or transactions through a secure internet

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recording system "makes no averments to the public about the state of the title to any parcel of land," and requires title searchers to make their own assessments as to the state of title. The Torrens system, on the other hand, conclusively declares the true state of title through the issuance of a certificate of title.").

117 *Id.* at 608.

118 *Id.* at 609.

119 *Id.*

server. [120] At the most basic level, the importance of this server, is that individuals are assured the transaction or the data that they are storing is secure and not fraudulent.[121] Once data is stored within the database, a subset of data, known as a "block," is then created to organize the data.[122] Further, once the data is within the blockchain it cannot be altered or deleted.[123] This new technology has allowed for the execution of smart contract and digital currencies.[124] In addition, due to the nature of the technology, it is decentralized, allowing multiple authorized users to enter data.[125] The Register of Notes would issue secured access to those lenders, servicers, or other eligible authorized mortgage industry participants to make entries in the blockchain. The unique authorization would identify the party making blockchain entries and each of those entries would be examined and approved by the registrar staff. The federal government, through the NNR, would be able to maintain a transparent, certain, and current record of notes, knowing the data is secure within the blockchain. Further, each note would correspond with a smaller "block" to allow for more precise tracking and reliability. The public would be given access to view the NNR once the entries had been verified by the Register of Notes staff but would not be able the affect any entries to the blockchain.

B. Mortgage Servicer Compliance Reform

In the aftermath of the foreclosure crisis, the federal government agency review offered a sobering assessment of the oversight mortgage servicers with respect to the financial industry[126] and the well-being of

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[120] Aaron Wright & Primavera De Filippi*, Decentralized Blockchain Technology & the rise of Lex Crtyographia* (2015), *available at* https://perma.cc/KL66-327U.
[121] *Id.* at 5-6.
[122] *Id*. at 6.
[123] *Id.* at 8.
[124] *Id.* at 8-9.
[125] *Id.* at 15.
[126] FEDERAL RESERVE SYSTEM: OFFICE OF THRIFT SUPERVISION, INTERAGENCY REVIEW OF FORECLOSURE POLICIES AND PRACTICES, (Apr. 2011), 5 https://perma.cc/22G6-HXEH ("Mortgage servicing plays a central role in the management of mortgage loans from origination to final disposition. The mortgage servicer is the intermediary between borrowers and their lenders. When the borrower is paying as agreed, the servicer's duties are ministerial: collecting payments, distributing payments to investors, managing cash and administering funds in escrow, and reporting to investors. When a loan is in

individuals,[127] organizations,[128] and processes[129] in modern American society. Assuring mortgage servicer compliance with any solution is

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default, the demands on the servicer necessarily expand, requiring additional resources and much more sophisticated risk management. A necessary consequence of the growth in foreclosures since 2007 is increased demands on servicers' foreclosure processes. The residential mortgage-servicing market is highly concentrated among a few servicers. The five largest mortgage servicers by activity volume—included among the 14 servicers subject to the reviews addressed in this report—account for 60 percent of the industry's total servicing volume. The 14 servicers included in the interagency review collectively represent more than two-thirds of the servicing industry (see figure 1), or nearly 36.7 million mortgages.").

127 *Id.* ("Weaknesses in foreclosure processes and controls present the risk of foreclosing with inaccurate documentation, or foreclosing when another intervening circumstance should intercede. Even if a foreclosure action can be completed properly, deficiencies can result (and have resulted) in violations of state foreclosure laws designed to protect consumers. Such weaknesses may also result in inaccurate fees and charges assessed against the borrower or property, which may make it more difficult for borrowers to bring their loans current. In addition, borrowers can find their loss-mitigation options curtailed because of dual-track processes that result in foreclosures even when a borrower has been approved for a loan modification. The risks presented by weaknesses in foreclosure processes are more acute when those processes are aimed at speed and quantity instead of quality and accuracy.").

128 *Id.* at 6 ("Weaknesses in foreclosure processes pose a variety of risks to the financial services industry and investors. These risks extend beyond the financial cost of remedying procedural errors and re-filing affidavits and other foreclosure documents. Servicers may also bear legal costs related to disputes over note ownership or authority to foreclose, and to allegations of procedural violations through the use of inaccurate affidavits and improper notarizations. Servicers may be subject to claims by investors as a result of delays or other damages caused by the weaknesses. Furthermore, concerns about the prevalence of irregularities in the documentation of ownership may cause uncertainty for investors of securitized mortgages. Servicers and their affiliates also face significant reputational risk with their borrowers, with the court system, and with regulators.").

129 *Id.* ("Weaknesses in foreclosure processes have resulted in increased demands on judicial resources to resolve a variety of foreclosure-related matters, including note ownership. In addition, courts rely extensively on affidavits (usually affidavits of indebtedness) submitted by servicers to decide foreclosure actions on a summary basis without requiring in-person testimony. If such affidavits were not properly prepared or executed, courts may lose confidence in the reliability of the affidavits as persuasive evidence filed on behalf of servicers.").

critically important in the scheme of restoring certainty to ownership of mortgage notes and integrity to the nation's land title records.

In order to make any mortgage lending system in which the originating lender transfers ownership of the mortgage note on the secondary market a reliable system, clearly defined rules for transfer, tracking, and transparency must be paramount features. If the mortgage lending industry is to continue to function effectively in a system where mortgage ownership is fractionalized, servicers will continue to play an indispensable role. The mortgage lending industry and compliance commentators have examined this aspect, but there is work to be done in this area to help assure a healthy future.[130] Assuring mortgage servicer compliance is essential and will be examined fully in the next article in this series.

V. CONCLUSION

From its inception, a fundamental duty of the United States government has been to protect citizens' property ownership from unreasonable seizure.[131] This duty is as important today as it ever was, extending to real property and personal property, including general intangibles. In the foreclosure crisis, many of our nation's citizens lost real property to foreclosure by parties who were strangers to the owners' mortgage transaction. Mortgages that are rendered unenforceable due to failure of the foreclosing party to produce the original note or otherwise prove it is the party entitled to enforce may cause the actual owners of interests in the note to lose money. It is imperative for the financial, judicial, moral, and general well-being of our country that this dishonorable chapter of United States' history not be repeated.

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[130] Michael Volkov, *Financial Institutions and a Lack of Ethics*, (Jan. 12, 2015) https://perma.cc/RFJ8-JFY3 (last visited May 12, 2016) ("Financial institutions have responded to this mess with technocrat solutions – let's split compliance from legal and lets build up compliance departments. That is a good thing. But financial institutions have not taken much to heart. They are convinced that more compliance resources will do the trick.
What is missing from the financial institution equation is the heart – they are not yet convinced that more is needed. In fact, the solution for financial institutions is right before their eyes – on a silver platter. It is called *ethics*. It is not a hard concept nor is it one they should be afraid of. Ethics is the most effective compliance control that exists in the compliance toolkit.").
[131] U.S. CONST. amend. IV

The seemingly intentional obfuscation of mortgage note ownership records by organizations such as MERS prevented property owners from knowing whether or not the foreclosing party actually had the right to foreclose. These questionable foreclosures, in turn, had a significant impact on the integrity of the American land title record system. In order to restore, maintain, and protect the nation's land title records from another such attack or any other degradation, our society's real property laws as they exist today must be applied to readily available technology and processes to develop the NNR.

There currently exists within each of the fifty states good law, administrative processes, infrastructure, attorneys, judiciary, mortgage lending, and land title insurance personnel to operate the system of recording and interpreting general land title matters relating to mortgages, including priority of competing claims and the processes necessary for foreclosure. Congress must take steps to enact a registry that will track ownership and the right to enforce mortgage notes through a national notes registry. Calls for a federally operated mortgage documents registration system or a national mortgage foreclosure statute, while well-intentioned, may face insurmountable opposition from members of Congress whose constituents do not want to jettison their states' systems of land title records with which they are familiar and have a wealth of land title precedent to guide practitioners and the judiciary alike. Further, concerns with nationalized systems taking control of state real property law would likely come from states' rights advocates who may see a federal mortgage foreclosure system as usurping those powers that have historically been left to the states. The NNR offers a less disruptive alternative.

Longstanding property law, currently existing technology, and administrative oversight are all available to ensure, through the NNR, that America will not experience a return engagement of the uncertainty. Through the NNR, there should be less uncertainty of mortgage note ownership, the ensuing loathsome episode of robo-signing, judicial unpredictability, and devastation to a significant portion of the personal wealth of the nation's homeowners as well as the general economy of the nation and the world that we witnessed with the recent mortgage foreclosure crisis. The NNR would remedy, with surgical precision, the problems arising from the lack of transparency and certainty that brought about confusion in foreclosure proceedings and uncertainty in land title records of properties whose mortgages had been foreclosed.