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SUPREME COURT
OF THE STATE OF WASHINGTON

CERTIFICATION FROM UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF WASHINGTON AT SEATTLE
(CASE NO. C10-05523 JCC)

KEVIN SELKOWITZ,

Plaintiff,

v.

LITTON LOAN SERVICING, L.P., *et al.*,

Defendants.

RESPONSE BRIEF OF DEFENDANT MORTGAGE ELECTRONIC REGISTRATION SYSTEMS, INC.

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TABLE OF CONTENTS

Page(s)

TABLE OF CONTENTS

Page(s)

TABLE OF AUTHORITIES

Page(s)

CASES

TABLE OF AUTHORITIES

Page(s)

TABLE OF AUTHORITIES

Page(s)

TABLE OF AUTHORITIES

Page(s)

TABLE OF AUTHORITIES

Page(s)

I. INTRODUCTION AND RELIEF REQUESTED.

This proceeding is before the Court as the result of an Order Certifying Question to the Washington Supreme Court, issued by the Honorable John C. Coughenour of the United States District Court for the Western District of Washington (the "District Court") on June 24, 2011 (the "Certification Order").[1] The Certification Order was issued in two related cases – *Selkowitz v. Litton Loan Servicing LP, et al.*, Case No. C10-5523 ("*Selkowitz*") and *Bain v. Metropolitan Mort. Group, Inc., et al.*, Case No. C09-0149 ("*Bain*"). On October 7, 2011, this Court consolidated *Bain* and *Selkowitz* for purposes of oral argument and decision, but did not consolidate briefing.[2] Mortgage Electronic Registration Systems, Inc. ("MERS") respectfully submits this Response Brief in *Selkowitz*.

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[1] Case No. C10-5523, Dkt. No. 41. Throughout this brief, references to the record are based upon those documents certified to the Court in the Certification Order, and are cited by Docket Number ("Dkt. No."), with specific references to underlying page numbers.

[2] Although briefing was not consolidated, as the Court has recognized through consolidating argument and decision, the issues in *Bain* and *Selkowitz* are identical. The facts of the two cases vary slightly, but the factual differences are of no consequence. With that said, given both plaintiffs filed an opening brief before consolidation, MERS is filing a separate response brief to each. Although argued slightly differently, both plaintiffs assert essentially the same arguments. As a result, MERS's response briefs, in large part, are similar. In the interests of efficiency, MERS encourages the Court to review its response briefs in both cases (in order to see the similarities and note the differences), then refer to one of the two as it prepares for argument and decision.

Plaintiff Kevin Selkowitz ("Plaintiff" or "Selkowitz") borrowed $309,600 to purchase a home in 2006. In 2009 he defaulted on his loan and has not made a single payment on his home since that time, despite the fact that he continues to occupy the property. Facing foreclosure, instead of curing the default on his loan, in July 2010, Plaintiff sued to stop foreclosure. Plaintiff sued virtually every party that had any involvement in his home loan and the foreclosure process. This included MERS, the party that Plaintiff contractually agreed would be the beneficiary for the lender and its successors and assigns in its capacity as the nominee or agent for the lender under Plaintiff's deed of trust. But Plaintiff now argues that MERS is not a proper beneficiary under his deed of trust, or RCW 61.24, *et seq.*, Washington's Deed of Trust Act (the "Act"). MERS disagrees.

MERS is a Delaware company, headquartered in Reston, Virginia, and a subsidiary of MERSCORP, Inc. ("MERSCORP").[3] The operating company, MERSCORP, also owns the MERS® System, which is a national electronic registry (a database) that tracks beneficial ownership

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[3] Allen H. Jones, *Setting the Record Straight on MERS,* MORTG. BANKING 34, 35 (May 2011).

interests and servicing rights in mortgage loans.[4] The MERS® System is operated as a membership organization and, along with MERS, was formed to eliminate problems of delayed releases, reconveyances, and other related title problems that resulted from the collapse of the savings and loan ("S&L") industry in the 1980s.[5] MERS serves as beneficiary of record (mortgagee in mortgage states) in its capacity as agent for the original lender, its successors and assigns.[6]

Although Selkowitz expressly agreed in his deed of trust that MERS was the beneficiary of record, he now disclaims that contractual agreement and argues MERS is not a proper beneficiary. While many courts, both in Washington and outside of Washington, have simply ruled that MERS is a proper beneficiary and can act on behalf of lenders, through basic agency principles, the District Court here determined that the issue should be certified to this Court for direction.

For the reasons set forth below, MERS respectfully requests that the Court hold that MERS is a lawful "beneficiary" under the Act, even if it never holds the promissory note secured by the deed of trust that it has a legal interest in. In so holding, the Court should further rule that the

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4 *Id.*

5 *Jackson v. Mortg. Elec. Registration Sys., Inc.*, 770 N.W.2d 487, 490 (Minn. 2009).

6 Jones, *supra* note 3, at 35.

District Court's remaining certified questions, both of which are posed in the event the Court holds MERS is not a proper beneficiary, are moot.

II. QUESTIONS CERTIFIED.

The District Court certified the following questions to this Court:[7]

1. Is Mortgage Electronic Registration Systems, Inc., a lawful "beneficiary" within the terms of Washington's Deed of Trust Act, Revised Code of Washington section 61.24.005(2), if it never held the promissory note secured by the deed of trust?

2. If so, what is the legal effect of Mortgage Electronic Registration Systems, Inc., acting as an unlawful beneficiary under the terms of Washington's Deed of Trust Act?

3. Does a homeowner possess a cause of action under Washington's Consumer Protection Act against Mortgage Electronic Registration Systems, Inc., if MERS acts as an unlawful beneficiary under the terms of Washington's Deed of Trust Act?

If the answer to the first question is that MERS is a proper beneficiary under the Act, MERS respectfully submits, there is no need to address the second and third questions. The standard of review on these certified questions is *de novo* review.[8]

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[7] The certified questions are reproduced here as they are framed in the Certification Order. There appears to be a typographical error, however, in the second of the three certified questions. MERS believes that question should begin by reading "If **not**, what is the legal effect …."

[8] *See Post v. City of Tacoma*, 167 Wn.2d 300, 308 (2009) ("Statutory interpretation is a question of law that this court reviews *de novo*.").

III. STATEMENT OF FACTS.

The facts that are relevant to the certified questions before the Court in these proceedings are straight-forward.

A. Selkowitz Is A Borrower In Default Who, Through The Underlying Lawsuit, Challenges The Contractual Right To Foreclose.

Selkowitz borrowed $309,600 from New Century Mortgage Corporation ("New Century") to purchase a home which he promised to repay pursuant to a promissory note dated October 30, 2006 (the "Promissory Note").[9] As part of the transaction, Selkowitz contractually agreed to secure the Promissory Note (*i.e.*, the repayment obligation) with a Deed of Trust also dated October 30, 2006 that was recorded in the appropriate county land records.[10] The Promissory Note and Deed of Trust go hand-in-hand. This fact was clearly reflected in the Deed of Trust and contractually agreed to by Selkowitz.[11] Indeed, it could be no

9 Dkt. No. 9, at 4 of 9. A copy of the Promissory Note at issue in this case was not submitted to the trial court prior to certification, and is, therefore, not a part of the record. This fact, however, should not alter the Court's ruling. Promissory notes contain uniform terms, and there is no reason to think Selkowitz's Promissory Note contains terms that are materially different than the note in *Bain*, which is in the record. Indeed, Selkowitz does not argue that his Note is materially different. Thus, the Court does not need the Selkowitz Promissory Note to rule on the certified issues. The certified issues can be fully resolved through reference to the Bain note and based on the terms of Selkowitz's Deed of Trust and Washington law. But, general reference to the Promissory Note, which the record shows Selkowitz entered into, will be made herein as it reflects further contractual agreement to the loan terms entered into by Selkowitz.

10 Dkt. No. 9, at 4 of 9; Dkt. No. 9-1 at 2 of 34.

11 Dkt. No. 9-1, at 4 of 34 ("This Security Instrument secures to Lender: (i) the repayment of the Loan, and all renewals, extensions and modifications of the Note; and

other way. Lenders must secure their residential loans to ensure repayment. In Washington, the way lenders do that is through promissory notes and accompanying deeds of trust – *i.e.*, the very loan documents that were entered into here.

Here, the Deed of Trust specifically names MERS as the beneficiary acting in its capacity as agent for the lender and the lender's successors and assigns (*i.e.*, New Century and New Century's successors and assigns). Specifically, the Deed of Trust provides: "MERS is a separate corporation that is acting solely as a nominee for Lender and Lender's successors and assigns. *MERS is the beneficiary under this Security Instrument.*"[12]

Selkowitz also granted and conveyed an interest in the property to MERS in that capacity and authorized MERS to act on the lender's behalf with any foreclosure, discharge or release:

> Borrower understands and agrees that MERS holds only legal title to the interests granted by Borrower in this Security Instrument, but, if necessary to comply with law or custom, MERS (as nominee for Lender and Lender's successors and assigns) has the right: to exercise any or all of those interests, including, but not limited to, the right to foreclose and sell the Property; and to take any action required of Lender including,

(ii) the performance of Borrower's covenants and agreements under this Security Instrument and the Note.").

12 Dkt. No. 9-1, at 3 of 34 (emphasis added).

> but not limited to, releasing and canceling this Security Instrument.[13]

Selkowitz also contractually agreed in the Deed of Trust that the lender (New Century) could freely and without notice transfer the Promissory Note to another.[14] Finally, Selkowitz irrevocably granted the trustee (First American Title Insurance Company ("First American")) the power of sale in the event of a default.[15]

The Deed of Trust was signed by Selkowitz and acknowledged by a notary.[16] Further, it was recorded in the appropriate public land records, providing notice that MERS was the contractually agreed to beneficiary under the Deed of Trust, in its capacity as the agent for the lender.[17]

In November 2009, Selkowitz defaulted on his loan.[18] On April 23, 2010, Quality Loan Service Corporation ("Quality") – the

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13 Dkt. No. 9-1, at 4 of 34.

14 *See* Dkt. No. 9-1, at 13 of 34 ("The Note or a partial interest in the Note (together with this Security Instrument) can be sold one or more times without prior notice to the Borrower.").

15 Dkt. No. 9-1, at 3 & 4 of 34 ("Borrower irrevocably grants and conveys to Trustee, in trust, with power of sale, the following described property ...").

16 Dkt. No. 9-1, at 15-16 of 34.

17 Dkt. No. 9, at 4 of 9.

18 Dkt. No. 15, at 3 of 13.

successor trustee to First American[19] – issued a Notice of Default to Selkowitz pursuant to RCW 61.24.030.[20]

On May 27, 2010, Quality executed, and, on June 1, 2010, recorded a Notice of Trustee's Sale pursuant to RCW 61.24, *et seq.*[21] To halt the foreclosure sale, in July 2010, Selkowitz filed an action in the Superior Court for the State of Washington in and for King County, seeking an injunction and asserting various causes of action against a number of defendants.[22] The King County action was removed to the District Court in July 2010 (the "District Court Action").[23]

Through the District Court Action, Selkowitz seeks to avoid foreclosure on his home despite the fact that he remains in default. Furthermore, Selkowitz continues to occupy the property, even though he has not made a payment on the property in over two years. In summary, the incontrovertible material facts are as follows:

- Selkowitz defaulted on his Promissory Note in November 2009 and has not cured the default, yet he continues to occupy the property for free.

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19 On May 20, 2010, MERS recorded an Appointment of Successor Trustee naming Quality the successor trustee to First American under the Deed of Trust. *See* Dkt. No. 15, at 3 of 13; Dkt. No. 9-1, at 28-29 of 34.

20 Dkt. No. 15, at 3 of 13; Dkt. No. 15-1, at 2 of 2.

21 Dkt. No. 9-1, at 31-33 of 34.

22 *See* Opening Brief, at 4.

23 *Id.*

- Selkowitz contractually agreed that the Deed of Trust secures repayment of the Promissory Note and authorizes the foreclosure sale of the property in the event of default.

- Through the Deed of Trust, Selkowitz contractually agreed that MERS was the "beneficiary" acting as the agent for the original lender and its successors and assigns.

- Selkowitz contractually agreed that MERS had the right to foreclose on behalf of the lender as the agent for the lender (and its successors and assigns).

- Quality was appointed successor trustee to First American, and Quality issued a Notice of Default to Selkowitz.

- Thereafter, pursuant to the Deed of Trust Act, Quality issued a Notice of Trustee's Sale in order to proceed with foreclosure.

- To stop foreclosure, Selkowitz filed the underlying lawsuit.

Based upon these incontrovertible facts, there is no basis to further delay foreclosure. The foreclosure avoidance arguments Selkowitz advances are without merit; they are not supported by the facts or the law.

B. MERS And The MERS® System Provide Positive Advantages To Consumers And The Residential Housing Industry.

This section of this brief is identical to Section III.B. of MERS' Brief in *Bain*. In the interest of efficiency and economy, MERS incorporates that briefing here. A copy of the MERS brief in *Bain* is being served on all parties to this case so they are fully apprised of the matters discussed in the referenced section of the *Bain* brief.

IV. AUTHORITY AND ANALYSIS.

A. MERS Is A Proper Beneficiary Under Washington Law.

Selkowitz's argument that MERS is not a proper "beneficiary" under Washington law boils down to the contention that MERS was never the holder of the Promissory Note and, therefore could not be the beneficiary of the Deed of Trust.[24] This argument fails for a number of reasons.

1. MERS Meets The Definition Of "Beneficiary" Under The Deed Of Trust Act.

First and foremost, MERS was a proper "beneficiary" under the Deed of Trust as a matter of law because it meets the statutory definition of "beneficiary" set forth in the Act.

Selkowitz asks the Court to interpret the definition of "beneficiary" under the Act in a manner that is far narrower than it should be interpreted. Selkowitz argues that "beneficiary" *solely* means the holder of the Promissory Note.[25] The Court should reject that strained reading.

"In interpreting a statute, the primary objective of the court is to ascertain and carry out the intent and purpose of the Legislature in creating

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[24] Opening Brief, at 13-14.

[25] *Id.*

it."[26] "To determine legislative intent, this court looks first to the language of the statute."[27] "Legislative definitions provided in a statute are controlling, but in the absence of a statutory definition, courts may give a term its plain and ordinary meaning by reference to a standard dictionary."[28] The Court must "avoid literal reading[s] of a statute which would result in unlikely, absurd, or strained consequences."[29]

The statutory provision at-issue here is found at RCW 61.24.005 – *i.e.*, the definition of "beneficiary" under the Deed of Trust Act. It reads:

> The definitions in this section apply throughout this chapter *unless the context clearly requires otherwise....*
>
> (2) "Beneficiary" means the holder of the *instrument* or *document* evidencing *the obligation* secured by the deed of trust.[30]

MERS meets this definition for, at least, the following reasons:

First, the Washington Legislature specifically indicated that the term "beneficiary" had the meaning provided "*unless the context clearly*

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26 *Fraternal Order of Eagles, Tenino Aerie No. 564 v. Grand Aerie of Fraternal Order of Eagles*, 148 Wn.2d 224, 239 (2002) ("*Tenino Aerie*").

27 *Id.*

28 *Id.*

29 *Id.* ("The spirit or purpose of an enactment should prevail over … express but inept wording.").

30 RCW 61.24.005 (emphasis added).

requires otherwise."[31] The Legislature did not have to include this qualifying language. But it did. And because it did, the Legislature clearly recognized and intended that there may be circumstances where a literal reading of the defined terms in the Act is not appropriate. This is one of those circumstances. The Court must give the Legislature's caveat meaning, and look at the full context here.[32]

The context here *requires* that MERS be recognized as a proper "beneficiary" under the Deed of Trust. The context here is that the Legislature was creating a more efficient default remedy for lenders, not putting up barriers to foreclosure. The Deed of Trust Act was also enacted within the context of Washington law, which specifically permits the use of agents and the right to freely contract.[33] In that context, by including MERS in the transaction, the parties agreed that, instead of a traditional three party deed of trust, it would be a four party deed of trust, wherein MERS would act as the contractually agreed upon beneficiary for the lender and its successors and assigns. Selkowitz has pointed to no statute or public policy that prohibits the parties from so contracting; to the contrary, the parties were legally entitled to do so.[34] *Simply put, the*

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31 *Id.* (emphasis added).

32 *Tenino Aerie*, 148 Wn.2d at 239.

33 *See infra*, Sections IV.A.2. & IV.A.3.

34 *Id.*

parties contractually agreed that the "beneficiary" under the Deed of Trust was "MERS" and it is in that context that the Court should apply the statute.[35]

Second, MERS meets the definition of beneficiary set forth in the Act on its face. The Act does not define "beneficiary" as "the holder of the note," which is the definition Plaintiff asks the Court to adopt. The statutory definition is broader. If the Washington Legislature intended "beneficiary" to solely mean "the holder of the *note*," it would have defined it that way. The fact that it did not evidences the Legislature's intent that "beneficiary" means more than just the holder of the *note*, and the Court should give effect to that Legislative intent.[36]

The Legislature broadly defined "beneficiary" to mean "the holder of the *instrument or document* evidencing the *obligations* secured by the deed of trust."[37] "Instrument," "document" and "obligations" are not defined and should be given their plain and ordinary meaning.[38]

> "Instrument" broadly means: "A written legal document that defines rights, duties, entitlements, or liabilities, such as a contract, will, promissory note, or share certificate."[39]

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35 Dkt. No. 131-2, at 2-3 of 18 ("MERS is the beneficiary under this Security Instrument.").

36 *Tenino Aerie*, 148 Wn.2d at 239.

37 RCW 61.24.005(2).

38 *Tenino Aerie*, 148 Wn.2d at 239.

39 BLACK'S LAW DICTIONARY 801 (7th ed.).

> "Document" is even broader, meaning: "Something tangible on which words, symbols, or marks are recorded." Alternatively, "The deeds, agreements, title papers, letters, receipts, and other written instruments used to prove a fact."[40]

Neither "instrument" nor "document," under any reasonable construction, can be read to solely mean, "promissory note." The Legislature clearly intended more. And in the context of a residential loan, undoubtedly the Legislature was referring to all of the loan documents that make up the loan transaction – *i.e.*, the note, the deed of trust, and any other rider or document that sets forth the rights and obligations of the parties under the loan.

> "Obligations" broadly means: "A legal or moral duty to do or not do something."[41]

Thus, "obligation" means more than just repayment of the debt under the Promissory Note as Plaintiff contends. It includes any and all obligations owed by Plaintiff under the Promissory Note and the Deed of Trust.

The Deed of Trust defines the obligation – the "loan" – as "the debt evidenced by the Note, plus interest, any prejudgment charges and late charges due under the Note, *and all sums due under this Security*

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40 BLACK'S LAW DICTIONARY 498 (7th ed.).

41 BLACK'S LAW DICTIONARY 1102 (7th ed.).

Interest, plus interest."[42] "Obligations" under the Act, therefore, include all "taxes, assessments, charges, fines, and impositions ..., leasehold payments or ground rents ..., Community Association Dues, Fees, and Assessments," insurance costs, costs to maintain the property, and any attorneys' fees and costs incurred in the event of default.[43] These additional loan "*obligations*" are part of and accrue under the Deed of Trust, *not the Promissory Note*.[44] Simply put, the "obligations" owed by Plaintiff arise under *both* the Promissory Note *and* the Deed of Trust (not just the Promissory Note).[45] MERS is indisputably the "holder" of the Deed of Trust. MERS is, therefore, a proper "beneficiary" under the Deed of Trust as that term is defined by the Deed of Trust Act.[46]

This analysis is underscored by logic. The interpretation of "beneficiary" that Plaintiff is asking the Court to adopt is one that is simply not palatable, and certainly not one that the Legislature intended when it enacted the Act. The Promissory Note and the Deed of Trust were entered into contemporaneously as one loan transaction. They set forth all

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42 Dkt. No. 9-1, at 3 of 34 (emphasis added).

43 Dkt. No. 9-1, at 4-9 of 34.

44 Dkt. No. 9-1, at 4 of 34.

45 Plaintiff states in his Opening Brief that, at no time did Plaintiff owe any obligations to MERS. Opening Brief, at 2. As this discussion reveals, that is inaccurate.

46 Plaintiff encourages the Court to define "beneficiary" consistent with the UCC. Opening Brief, at 13-14. Regardless of whether the Act's definition of "beneficiary" is

of the rights and obligations of the parties (in unequivocal terms). The Legislature certainly did not intend to disregard many of those rights and obligations (*i.e.*, the ones that are set forth in the Deed of Trust) through the Act. More to the point, the Legislature certainly did not intend for home loans in the State of Washington to become unsecured, or to allow defaulting home loan borrowers to avoid non-judicial foreclosure, through manipulation of the defined terms in the Act.[47] But that is precisely what Plaintiff is asking this Court to rule.

2. Under Washington Law, The Parties Were Free To Contractually Agree That MERS Is A Proper Beneficiary Under The Deed Of Trust, Which Is Exactly What The Parties Did.

Selkowitz's argument also fails because it is squarely contrary to what Selkowitz legally and contractually agreed to. The Deed of Trust is a contract that Selkowitz entered into to secure repayment under the Promissory Note.[48] It is black letter law that, absent an unlawful purpose, parties in Washington are free to contract as they wish. As this Court has plainly and consistently stated, "[t]he whole panoply of contract law rests on the principle that one is bound by the contract which he voluntarily and

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strictly applied or if it is reframed consistent with the UCC, for the reasons discussed throughout this brief, MERS is a proper beneficiary under the Deed of Trust.

47 *Tenino Aerie*, 148 Wn.2d at 239 (The court must "avoid literal reading[s] of a statute which would result in unlikely, absurd, or strained consequences.").

48 *In re McGrath's Estate*, 191 Wn. 496, 508 (1937) ("trust deeds are contracts").

knowingly signs."[49] Indeed, these bedrock principles of contract law are so firm that this Court has gone even further, ruling: "a party to a contract which he has voluntarily signed *will not be heard* to declare that he did not read it, or was ignorant of its contents."[50]

The Deed of Trust Act itself invokes these fundamental contract principles. Pursuant to the Act, deeds of trust are subject to all laws relating to mortgages on real property.[51] One such law is codified at RCW 61.12.020, which expressly provides, "parties may insert in [a] mortgage *any lawful agreement or condition*."[52] Thus, pursuant to the Deed of Trust Act itself, the parties were free to include any lawful contractual agreement or condition in the Deed of Trust. These contract rules, without more, end the analysis.

In the Deed of Trust, **Selkowitz contractually agreed that MERS was a proper beneficiary under the Deed of Trust, authorized to act as the agent of the lender and the lenders successors and assigns.** Specifically, in the Deed of Trust, Selkowitz unequivocally agreed: "*The*

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49 *Nat'l Bank of Wash. v. Equity Investors*, 81 Wn.2d 886, 912-13 (1973) (en banc); *see also Torgerson v. One Lincoln Tower, LLC*, 166 Wn.2d 510, 517 (2009) ("It is black letter law of contracts that the parties to a contract shall be bound by its terms.").

50 *Michak v. Transnational Title Ins. Co.*, 148 Wn.2d 788, 799 (2003) (en banc) (emphasis added; internal citations omitted); *see also M.A. Mortenson Co., Inc. v. Timberline Software Corp.*, 140 Wn.2d 568, 584 (2000) (en banc) ("it was not necessary for [plaintiff] to actually read the agreement in order to be bound by it").

51 RCW 61.24.040.

52 RCW 61.12.020 (emphasis added).

beneficiary of this Security Instrument is MERS (solely as nominee for Lender and Lender's successors and assigns) and the successors and assigns of MERS. *This Security Instrument secures to Lender*: (i) the repayment of the Loan ...; and (ii) the performance of Borrower's covenants and agreements under this Security Instrument and the Note."[53] Selkowitz further agreed that "*MERS . . . has the right*: to exercise any or all [legal rights of the Lender], including, but not limited to, the right to foreclose and sell the Property; and *to take any action required of Lender* including, but not limited to, releasing and cancelling this Security Instrument."[54]

It is indisputable that Selkowitz contractually agreed that MERS could act on behalf of the lender (New Century) and its successors and assigns as the beneficiary under the Deed of Trust. It is further indisputable that Selkowitz contractually agreed that MERS was a valid beneficiary under the Deed of Trust, with all of the powers bestowed upon it through the Deed of Trust to take action on behalf of New Century (and its successors and assigns). Under this Court's unwavering pronouncements on Washington contract law, Selkowitz should not now be heard to argue that MERS was not a proper beneficiary, with full

[53] Dkt. No. 9-1, at 4 of 34 (emphasis added).

[54] Dkt. No. 9-1, at 4 of 34 (emphasis added).

authority to act on behalf of New Century (and its successors and assigns), under the Deed of Trust.[55]

The Ninth Circuit recently conducted this very same analysis (applying similar Arizona law) and came to the same conclusion.[56] In *Cervantes*, plaintiffs asserted a claim for fraud, among other things, arguing that "MERS is a 'sham' beneficiary without a financial interest in the loan …."[57] While styled as a fraud claim, this is essentially the identical argument Selkowitz makes here – *i.e.*, that MERS is not a proper "beneficiary" because MERS was not entitled to payments under the note. In rejecting the argument, the Ninth Circuit expressly noted:

> [Plaintiffs'] claim is undercut by the terms in [plaintiffs'] standard deed of trust, which describe MERS's role in the home loan…. [T]he disclosures in the deed indicate that MERS is acting 'solely as a nominee for Lender and Lender's successors and assigns' and holds 'only legal title to the interest granted by Borrower in this Security Instrument.' Further, while plaintiffs indicate that MERS was used to hide who owned the loan, the deed states that the loan or a partial interest in it 'can be soled one or more times without prior notice to Borrower,' but that '[i]f there is a change in Loan Servicing, Borrower will be given written notice of the change' as required by consumer protection laws. Finally, the deed indicates that MERS has 'the right to foreclose and sell the property.' *By signing the deeds of trust, the plaintiffs agreed to the terms and were on notice of the contents….* In light of the

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55 *Michak*, 148 Wn.2d at 799; *M.A. Mortenson Co., Inc.*, 140 Wn.2d at 584; *Nat'l Bank of Wash.*, 81 Wn.2d at 912-13.

56 *See Cervantes v. Countrywide Home Loans, Inc.*, --- F.3d ---, 2011 WL 3911031 (9th Cir. Sept. 7, 2011).

57 *Id.* at *5.

> explicit terms of the standard deed signed by [plaintiffs], it does not appear that the plaintiffs were misinformed about MERS's role in their home loans.[58]

The Fourth Circuit also very recently rejected the same arguments Plaintiff makes here. In *Horvath v. Bank of New York, N.A.*,[59] plaintiff sought to quiet title on his property, in part on the theory that his deed of trust was separated from his note and that the parties could not have properly contractually agreed that MERS was a valid beneficiary under the deed of trust.[60] The Fourth Circuit outright rejected the argument:

> [Plaintiff's] argument is seriously flawed. For starters, both the deed of trust and the case law suggest that there is no reason to treat the note and deed of trust as governed by separate forms of law. The text of the deed of trust envisions that it will be conjoined with the note, clarifying that '[t]he Note or a partial interest in the Note (*together with this Security Instrument*) can be sold one or more times without prior notice to Borrower.' ... This provision belies any contention that the note is somehow walled off from the deed of trust. ...
>
> Here, the 'agreement' is that the note and deed of trust form part of one transaction, that the note may be transferred freely with the purchaser or recipient inheriting full rights to enforce, and that the deed of trust follows the note.
>
> Indeed, common sense suggests that things could not be any other way. If [plaintiff] were correct in asserting that the transfer of a note splits it from the deed of trust ..., there would be little reason for notes to exist in the first place. One of the defining features of notes is their transferability, but on [plaintiff's] view, transferring a note would strip it from the

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58 *Id.* (internal citation omitted; emphasis added).

59 641 F.3d 617 (4th Cir. 2011).

60 *Id.* at 623.

> security that gives it value and render the note largely worthless. This cannot be – and is not – the law.[61]

The Ninth and the Fourth Circuits could not have said it more eloquently. Having entered into a lawful contract whereby the parties agreed that MERS would act as an agent for New Century (and its successors and assigns) as the "beneficiary" under the Deed of Trust, Selkowitz cannot now complain that MERS was not a proper beneficiary.[62] To rule otherwise would require the unraveling of decades-old contract law jurisprudence by this Court.

3. What The Parties Contractually Agreed To – *i.e.*, That MERS Is A Proper Beneficiary – Is Consistent With Basic Principles Of Agency.

What Plaintiff appears to be arguing, in addition to his argument that he should not be bound by the terms of his contract, is that New Century (and its successors) could not act through an agent (MERS).[63] This argument plainly fails.

The use of "nominees" or "agents" acting on one's behalf is not against public policy, but instead has long been recognized under Washington law. Indeed, as this Court has instructed, "whatever one may lawfully do for himself, he may lawfully authorize an agent to do for

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61 *Id.* at 623-24 (emphasis in original; citations omitted).

62 *Simonds v. Noland*, 142 Wn. 423, 427 (1927) (en banc) (where agreement is found to be legally valid, contracting party is estopped from denying its terms).

63 *See* Opening Brief, at 14.

him."[64] "[A]n agency relationship results from the manifestation of consent by one person that another shall act on his behalf and subject to his control, with a correlative manifestation of consent by the other party to act on his behalf and subject to his control."[65] Here, the manifestation of consent to an agency relationship between MERS and New Century was not only contractually agreed to by MERS and New Century, but it was contractually agreed to by Selkowitz.[66]

Furthermore, not only are agency principles a long-standing facet of Washington common law, but the Deed of Trust Act itself expressly contemplates the use of agents. For example, RCW 61.24.031 repeatedly recognizes that acts may be performed under the Deed of Trust Act by an "authorized agent."[67] Specifically, without limitation, the Act permits agents to issue notices of default,[68] contact borrowers to assess borrower's financial ability to pay to avoid foreclosure,[69] advise borrowers of their

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64 *Sherman v. Millikin*, 9 Wn.2d 339, 341 (1941).

65 *Moss v. Vadman*, 77 Wn.2d 396, 402-403 (1970) (en banc).

66 *See* Dkt. No. 9-1, at 3-5 of 34.

67 RCW 61.24.031. This Court has previously recognized that the Deed of Trust Act permits the use of agents. *See, e.g.*, *Udall v. T.D. Escrow Services, Inc.*, 159 Wn.2d 903, 914-15 (2007) (en banc) (upholding use of agent in Deed of Trust Act foreclosure); *see also Buse v. First American Title Ins. Co.*, 2009 WL 1543994, *2 (W.D. Wash. 2009) ("The Deed of Trust Act 'explicitly permits trustees to use agents, thereby incorporating agency law principles.'" (citations omitted)).

68 RCW 61.24.031(1)(a).

69 RCW 61.24.031(1)(b).

meeting rights relating to foreclosure,[70] participate in any such meeting,[71] and more.[72] In enacting the Act, the Washington Legislature plainly intended to permit participants in transactions governed by the Act to act through agents.[73] That is all that happened here.

Indeed, the use of a nominee, which simply means "one designated to act for another as his representative in a rather limited sense,"[74] is a common occurrence and "has long been sanctioned as a legitimate practice."[75] Individuals frequently confer rights on a "nominee" or "agent" for a variety of purposes, including executing or holding security instruments.[76] The RESTATEMENT (THIRD) OF PROPERTY (MORTGAGES) confirms that an agent may be used to enforce a deed of trust on behalf of a note owner, even instructing courts to "be vigorous in seeking to find

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70 RCW 61.24.031(1)(c).

71 RCW 61.24.031(3).

72 RCW 61.24.031.

73 When there is no legislative intent to overturn the common law, it is presumed that legislation is consistent with existing common law. *State v. Lively*, 130 Wn.2d 1, 11 (1996) (en banc) ("If the statute ... provides no indication of the Legislature's intent to overrule common law, the statute will be presumed to follow judicial precedent.").

74 *Schuh Trading Co. v. Comm'r*, 95 F.2d 404, 411 (7th Cir. 1938); *see also* BLACK'S LAW DICTIONARY 1072 (7th ed.) (A "nominee" is "[a] person designated to act in place of another, usually in a very limited way.").

75 *In re Cushman Bakery*, 526 F.2d 23, 30 (1st Cir. 1975) (citations omitted); *see also* MILTON R. FRIEDMAN, FRIEDMAN ON CONTRACTS & CONVEYANCES OF REAL PROPERTY, § 6:1:5 *Nominees* ("it is familiar practice in real estate transactions to use a nominee").

76 *In re Cushman Bakery*, 526 F.2d at 30; *In re Childs Co.*, 163 F.2d 379, 382 (2d Cir. 1947); *Barkhausen v. Cont'l Ill. Nat'l Bank Trust Co. of Chicago*, 120 N.E.2d 649, 655 (Ill. 1954).

such [an agency] relationship, since the result is otherwise likely to be a windfall for the mortgagor and the frustration of [the note owner's] expectation of security."[77] Further, there is simply nothing disadvantageous to consumers through the use of agents in mortgage lending practices. To the contrary, it allows for more efficient lending and loan servicing. In short, using a nominee or agent to serve as mortgagee is nothing new, and in fact, was part of the lending system decades before MERS and the MERS® System came into existence.

For example, under the Federal Housing Administration's ("FHA") insured loan program in the 1930s, mortgage lenders originated mortgage loans and sold them to investors, such as life insurance companies.[78] The originating lenders, as independent contractors, serviced the loans as mortgagee of record on behalf of the investors, the beneficial owners whose names did not appear in the county land records. Before securitization in the 1960s, it was also common that two or more thrifts would buy a group of mortgage loans and obtain participation interests in them. These participation loans were often serviced by one lender, as mortgagee of record, that retained no beneficial interest in the

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77 RESTATEMENT (THIRD) OF PROPERTY (MORTGAGES) § 5.4, cmt. e (1997).

78 *See, e.g.,* Angelo R. Mozilo, *A Century's Milestones in Residential Lending,* MORTG. BANKING 13, 13-14 (Jan. 2000) (describing historical context and the creation of the FHA).

participation loan or the underlying loans themselves.[79] Later, with the advent of securitization in the late 1960s and early 1970s,[80] Ginnie Mae, under its guarantee agreement, became the equitable owner of pooled loans while the originator or aggregator of the loans, the "issuer," either remained or became the mortgagee of record and serviced the loan as an independent contractor.[81] Fannie Mae and Freddie Mac soon followed, utilizing the same model.[82] Thus, the use of an agent to hold record title in a mortgage while another holds a beneficial interest in the mortgage loan (*i.e.*, the promissory note) has a long history in the residential housing industry, which the Washington Legislature has endorsed.[83]

As the Deed of Trust here clearly states, MERS was an agent acting on behalf of New Century (and New Century's successors and assigns): "MERS (as nominee for [New Century] and [New Century's] successors and assigns) has the right: to exercise all of [New Century's rights], including, but not limited to, the right to foreclose and sell the

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79 *See, e.g., Jones, supra* note 3, at 36 (noting that the entity servicing the loan was designated the mortgagee of record).

80 Mozilo, *supra* note 78, at 14.

81 *See, e.g., Consol. Mortg. & Fin. Corp. v. Landrieu,* 493 F. Supp. 1284, 1286-87 (D.D.C. 1980) (discussing the Mortgage Backed Securities Program and Ginnie Mae's role).

82 Mozilo, *supra* note 78, at 14.

83 Plaintiff incorrectly claims that land title records are required to identify the holder of the promissory note. Opening Brief, at 30. Promissory notes have never been recorded (certainly with exceptions) in land title records. The security is recorded, not the underlying note.

Property; and to take any action required of [New Century.]"[84] New Century was the holder of the Promissory Note. The fact that MERS is the "beneficiary" under the Deed of Trust ("acting solely as a nominee [or agent] for" New Century[85]) does not eviscerate this agency relationship.[86] To the contrary, the identification of MERS as the acting agent for New Century in the Deed of Trust is squarely consistent with the law of agency and the requirement that, under the Act, the "beneficiary" means "the holder of the instrument or document evidencing the obligations secured by the deed of trust ...."[87] This is because, here, the "holder" of the note was New Century (later its successor), and the agent of that "holder" under the Deed of Trust was MERS. And all of this was plainly know by Plaintiff. *The entire relationship between the parties, and each party's role in the transaction, was fully disclosed to Plaintiff at the very outset of the relationship. Nothing was hidden!*

To find in favor of Selkowitz, the Court would have to overturn decades-old Washington law that permits the use of agents.

84 Dkt. No. 9-1, at 4 of 34.

85 Dkt. No. 9-1, at 3 & 4 of 34.

86 *See Udall*, 159 Wn.2d at 911 (recognizing that the Act cannot be used to avoid foreclosure based on ministerial acts, even if those acts are made by mistake).

87 RCW 61.24.005(2).

4. The Courts Repeatedly Find In Favor Of MERS, Striking Down The Very Arguments Plaintiff Asserts Here.

The United States District Court for the Western District of Washington has recently issued a series of opinions on the very issues before the Court, finding in favor of MERS.[88] In *Daddabbo v. Countrywide Home Loans, Inc.*,[89] plaintiff challenged a non-judicial foreclosure based on MERS' status as beneficiary under the Act because MERS did not hold the promissory note.[90] The court rejected plaintiff's arguments, ruling, "the deed of trust, of which the court takes judicial notice, explicitly names MERS as beneficiary. The deed of trust grants MERS not only legal title to the interests created in the trust, but the authorization of the lender and any of its successors to take any action to protect those interests, including the right to foreclose and sell the Property."[91]

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88 Plaintiff claims that there are no cases addressing the issues before the Court. Opening Brief, at 10. As the cases discussed herein reveal, this is clearly a misstatement.

89 2010 WL 2102485 (W.D. Wash. May 20, 2010).

90 *Id.* at *5.

91 *Id.* (considering documents identifying the trust company as the holder of the note and finding, those documents do not 'remotely support Plaintiffs' assertion that MERS somehow has been stripped of the power that the deed of trust grants." (internal citations omitted)).

More recently, in *St. John v. Northwest Trustee Services, Inc.*,[92] plaintiff similarly argued that a non-judicial foreclosure should be enjoined on the basis that "MERS lacked authority to act as beneficiary under the Deed of Trust and thus could not assign its beneficial interest."[93] The Court rejected the argument, ruling, "This Court has previously and consistently ruled that, when a plaintiff affixes a deed of trust that he/she signed wherein MERS is named as a beneficiary with the right to transfer such rights, the plaintiff's arguments that MERS is not a beneficiary under the security instrument are without merit."[94]

In *Vawter v. Quality Loan Servicing Corp. of Washington*,[95] plaintiff advanced the same argument, challenging a non-judicial foreclosure based, in part, on "MERS' role as beneficiary on the Deed of Trust" where MERS did not hold the note.[96] Again, the *Vawter* court rejected the argument, finding that plaintiff's allegations could not survive Rule 12 dismissal.[97]

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92 Case No. 11-cv-5382 (W.D. Wash. Sept. 29, 2011 Dismissal Order).

93 *Id.* at 5.

94 *Id.*

95 707 F. Supp.2d 1115 (W.D. Wash. 2010).

96 *Id.* at 1125.

97 *Id.* at 1126.

Daddabbo, *St. John*, and *Vawter* are just three of a number of cases that reject the very arguments Plaintiff asserts here.[98] These cases, and other similar cases, must be contrasted with the near non-existence of cases finding against MERS. The cases cited by Plaintiff are inapposite.

Plaintiff discusses *Mortg. Elec. Registration Sys., Inc. v. Nebraska Dep't of Banking & Fin.*[99] at length.[100] The inference Plaintiff attempts to draw is that *Nebraska Dep't of Banking* somehow concluded that MERS conducts unlawful business practices or otherwise cannot be a "beneficiary" under the Act. Any such inference is unfounded. *Nebraska Dep't of Banking*, has nothing to do with whether MERS can act as a

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98 There are a number of similar decisions that find in favor of MERS, all of which cannot be discussed at-length here. *See, e.g.*, *Corales v. Flagstar Bank, FSB*, W.D. Wash. Case No. 10-cv-1922 (Oct. 14, 2011 Order Granting Motion for Summary Judgment) (rejecting argument that MERS is not a valid beneficiary, where plaintiff contractually agreed it was); *Cebrun v. HSBC Bank*, 2011 WL 321992, *3 (W.D. Wash. Feb. 2, 2011) ("courts consistently hold, when evaluating similar deeds, that MERS acted as a beneficiary and possessed the rights set out above"); *Salmon v. Bank of America Corp.*, 2011 WL 2174554, *6 (E.D. Wash. May 25, 2011) (rejecting argument that MERS is a "ghost beneficiary" and not a "beneficiary" as that term is defined by the Act); *Klinger v. Wells Fargo Bank*, 2010 WL 5138478, *7 (W.D. Wash. Dec. 9, 2010) (agreeing with rulings in *Daddabbo* and *Vawter*, thus dismissing plaintiffs' contention that MERS was not a valid beneficiary); *Moon v. GMAC Mortg. Corp.*, 2009 WL 3185596, *6 (W.D. Wash. Oct. 2, 2009) (recognizing MERS as beneficiary under deed of trust); *see also Gomes v. Countrywide Home Loan, Inc.*, 192 Cal. App. 4th 1149 (2011) (holding that plaintiff, by executing the deed of trust, specifically agreed MERS had the authority to act under the deed of trust); *Pantoja v. Countrywide Home Loans, Inc.*, 640 F. Supp.2d 1177, 1189 (N.D. Cal. 2009) ("Plaintiff distinctly granted MERS the right to foreclose through the power of sale provision" and, therefore, "[p]ursuant to the terms of the Deed of Trust [and California's non-judicial foreclosure statute], as a beneficiary, MERS has a right to conduct the foreclosure process."); *Silvas v. GMAC Mortg., LLC*, 2009 WL 4573234, at *8 (D. Ariz. 2009) ("MERS [is] empowered to act on behalf of whoever was the equitable owner of the rights in the Deed of Trust").

99 270 Neb. 529 (2005).

lawful beneficiary. *Nebraska Dep't of Banking* was not even a foreclosure case. It was a case about licensing under Nebraska law – *i.e.*, whether MERS needed to be licensed as a mortgage banker in Nebraska. The answer, although irrelevant to these proceedings, was "No" because MERS is not a loan originator.[101]

Plaintiff also relies on *Landmark Nat'l Bank v. Kesler*[102] and *Mortg. Elec. Registration Sys., Inc. v. Southwest Homes of Arkansas, Inc.*[103] *Landmark* and *Southwest Homes* are equally of no help to Plaintiff. Neither *Landmark* nor *Southwest Homes* involved beneficiary status in a non-judicial foreclosure action. The issue in both *Landmark* and *Southwest Homes* was whether notice of a *judicial* action had to be provided to MERS, the designated beneficiary for the lender, where notice had already been provided to the lender. The cases are factually unique and of no bearing. On the unique facts of the case, *Landmark* concluded notice to MERS was not required, but the Kansas Legislature later overturned that limited holding. Kansas law now requires that any

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100 Opening Brief, at 14-15.

101 *Nebraska Dep't of Banking*, 270 Neb. at 530. MERS's position in *Nebraska Dep't of Banking* is consistent with its position here – *i.e.*, MERS holds legal title to the Deed of Trust as the agent of the lender and is authorized to act on behalf of the lender.

102 289 Kan. 528 (Kan. 2009).

103 301 S.W. 3d 1 (Ark. 2009).

nominee of record be notified, period.[104] Similarly, in *Southwest Homes,* the Arkansas Supreme Court concluded that notice to MERS was unnecessary when the lender had already received notice[105]—not that MERS was prohibited from serving as mortgagee and agent for the lender. In fact, an Arkansas federal district court later distinguished *Southwest Homes* when it held that MERS, as agent for the lender, was authorized as mortgagee of record to assign the mortgage to another lender.[106] Simply put, *Landmark* and *Southwest Homes* have no bearing on the issues before the Court.[107]

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104 Kan. Stat. Ann. § 60-219(e).

105 *Southwest Homes,* 301 S.W. 3d at 1-2, 5.

106 *See, e.g., Coley v. Accredited Home Lenders, Inc.*, 2011 WL 1193072, at *4 (E.D. Ark. Mar. 29, 2011). Notably, if notice to MERS had been required in *Landmark* and *Southwest Homes*, both courts would have had to set aside the sale of property to third parties, something they were not inclined to do.

107 *Mortg. Elec. Registration Sys., Inc. v. Saunders*, 2 A.3d 289 (1st Cir. 2010) is also inapposite. *See* Opening Brief, at 40-41. As Plaintiff acknowledges, *Saunders* did not involve interpretation of a statutory definition of "beneficiary" or whether a lender can use an agent to act on its behalf as a beneficiary under a deed of trust. *Saunders* involved the application of constitutional and prudential standing requirements in *judicial* foreclosure proceedings. No such standing requirements exist in non-judicial foreclosure proceedings.

Fidelity & Deposit Co. of Maryland v. Ticor Title Ins. Co., 88 Wn. App. 64 (1997) and *Walcker v. Benson and McLaughlin*, 79 Wn. App. 739 (1995), are also inapposite. *See* Opening Brief, at 11. *Ticor* involved the assignment of a forged note, and ultimately stands for the non-controversial proposition that to foreclose, a default must occur on the obligation secured. *Ticor*, 88 Wn. App. at 68-70. In *Walcker*, the beneficiary under the deed of trust was also the holder of the note and had to do with whether the limitations period had run. *Walcker*, 79 Wn. App. at 740-41. Neither case addresses whether the parties can contractually agree that a lender can appoint an agent to act on its behalf as a beneficiary under a deed of trust.

Plaintiff also briefly mentions the recent Michigan court of appeals decision in *Residential Funding Co., LLC v. Saurman*,[108] which did call MERS into question. With respect, *Saurman* was wrongly decided, is flatly undermined by a vast array of Michigan state cases that find to the contrary,[109] and is on appeal before the Supreme Court of the State of Michigan. In coming to the wrong ruling, respectfully, the *Saurman* court ignored the fact that, under Michigan law, a mortgagee of record with power of sale is authorized to foreclose, and ignored Michigan's long-standing law on agency.[110] The *Saurman* court also incorrectly found that MERS did not have an interest in the obligations owed through the at-

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108 --- N.W.2d ---, 2011 WL 1516819 (Mich. App. April 21, 2011).

109 *See, e.g., Amera Mortg. Corp. v. Schatz*, LT-05-6565 (Wayne Cnty. Ct. Ct. Feb. 17, 2006); *Murray v. Mortg. Elec. Registration Sys., Inc.*, Civ. No. 06-623719-CH (Wayne Cnty. Cir. Ct. Feb. 6, 2007); *Bank of N.Y. v. Diefenbach*, Civ. No. 07-11691-AV (Kent County Cir. Ct. May 23, 2008); *Wilson v. Mortg. Elec. Registration Sys., Inc.*, Civ. No. 08-090519-CH (Oakland Cnty. Cir. Ct. Aug. 6, 2008); *Aurora Loan Servs., LLC v. Yono*, Civ. No. 2008-DA8884-AV (Oakland Cnty. Cir. Ct. Feb. 25, 2009); *U.S. Bank Nat'l Ass'n v. Ghaddar,* Case No. 08LT1282 (19th Jud. Dist. Ct. Jan. 4, 2010); *U.S. Bank Nat'l Ass'n v. Leverette*, Civ. No. 10-303417-LT (Wayne Cnty. Dist. Ct. Apr. 16, 2010); *Wells Fargo Bank, N.A. v. Craig*, Case No. 10-1289-LT (8th Jud. Dist. Ct. Apr. 19, 2010); *Voydanoff v. Select Portfolio,* No. 09-102194-CK (Oakland Cnty. Cir. Ct. Apr. 28, 2010); *Procopio v. Guaranteed Rate, Inc.*, #2010-0290-CH (Macomb Cnty. Cir. Ct. June 4, 2010); *Basinger v. Bank of Am., N.A.*, #10-652-CH (Eaton Cnty. Cir. Ct. July 23, 2010); *U.S. Bank Nat'l Ass'n v. Greficz,* #08-1219 LT (21st Dist. Ct. Nov. 8, 2010); *see also Safford v. Precision Funding,* 2010 WL 548504 (E.D. Mich. Feb. 9, 2010); *Brown v. Countrywide Home Loans*, No. 2010 WL 1136515 (E.D. Mich. Mar. 24, 2010); *Robbins v. Mortg. Elec. Registration Sys., Inc.*, No. 2009 WL 3757443 (W.D. Mich. Nov. 9, 2009); *Corgan v. Deutsche Bank Nat'l Trust Co.*, No 1:09-cv-939 (W.D. Mich. July 20, 2010).

110 *Saurman*, 2011 WL 1516819. The bankruptcy cases cited by Plaintiff at page 27 of his Opening Brief are also inapposite as they apply bankruptcy standards not applicable here.

issue deeds of trust.[111] MERS respectfully submits that this Court should disregard the Michigan appellate court's erroneous ruling in *Saurman*, which is currently under review.[112]

B. Even If MERS Was Not A Proper Beneficiary Under The Deed Of Trust Act, That Would Not Have Any Material Effect.

As discussed above, MERS is a proper beneficiary under the Deed of Trust Act. Thus, the second certified question is moot. But even if MERS was not a proper beneficiary, that would not have any material effect on Plaintiff's purported claims. If MERS was not a proper beneficiary, that would not mean Plaintiff does not have to repay his loan. It would not mean that his Deed of Trust would somehow vanish. And it should not mean that the lender is unable to foreclose on his property, despite his default. All that it would mean is that there was a technical violation of the Deed of Trust Act that all parties were aware of when the loan was originally entered into. At most, the lender should have to

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111 *Id.*

112 The Court should also disregard Plaintiff's blatant efforts to confuse the issues before the Court. For example, the Truth-In-Lending Act's (15 U.S.C. § 1601, *et seq.*) standards relating to rescission when a homeowner refinances a home or enters a non-purchase money mortgage has nothing to do with whether MERS can act as a beneficiary under the Deed of Trust Act, but Plaintiff spends several pages discussing those standards. Further, Plaintiff's loan is not subject to rescission. *See* Opening Brief, at 29-31. Likewise, the federal regulators focus on issues surrounding robo-signing have nothing to do with whether MERS is a valid beneficiary under the Act. *See id.*, at 33-34. Plaintiff's advancement of these types of arguments is telling. Plaintiff spends a bulk of his Opening Brief on misdirected arguments that do not have any bearing on the issues before the Court. The Court should not be misdirected.

establish a clear right to foreclose before moving forward. To do that, MERS would simply need to assign its legal interest in the Deed of Trust to the lender before the lender proceeded with foreclosure. Anything more would be an indefensible windfall for Plaintiff, which is surely not what the Legislature intended when it enacted the Act.[113]

Under Plaintiff's construction, the note would still be secured because, as Plaintiff interprets it, the term "beneficiary" would mean the lender (not MERS as the agent of the lender). Even under this construction, there is (as there must be) a secured party – the lender.[114] Under Plaintiff's definition, therefore, MERS would still have contract rights in the deed of trust, which it could (and would need to before foreclosure) freely assign to the lender. That is all. It is a distinction without a difference.

The Deed of Trust Act was not enacted to add layers of complication and confusion to the foreclosure process. To the contrary, as this Court has stated, the Deed of Trust Act should be construed to further three basic objectives: (1) "the nonjudicial foreclosure process should remain efficient and inexpensive[;]" (2) "the process should provide an

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113 *Tenino Aerie*, 148 Wn.2d at 239 (The court must "avoid literal reading[s] of a statute which would result in unlikely, absurd, or strained consequences.").

114 Under either construction, the secured party is either the lender directly, or MERS as the contractually agreed to agent for the lender.

adequate opportunity for interested parties to prevent wrongful foreclosure[;]" and (3) "the process should promote the stability of land titles."[115] These objectives are not advanced by allowing Plaintiff, who is in default, to challenge the foreclosure of his property based on a claimed technical violation of the Act where Plaintiff contractually agreed to that purported violation.

The purpose of recording statutes are not to protect borrowers.[116] Borrowers know to whom they must make their mortgage payments. Recording statutes are designed to protect lenders and the outside world. It is critical to note that, if Plaintiff's contention were correct – *i.e.*, that MERS cannot be a "beneficiary" under deeds of trust in the State of Washington – it would not only affect non-judicial foreclosures. It would have a profound effect on the stability of land title records of hundreds of thousands of properties in Washington, effectively rendering those records unstable.[117]

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115 *Cox v. Helenius*, 103 Wn.2d 383, 387 (1985) (en banc). Plaintiff discusses *Cox* at length to make the point that, post-*Cox*, any party involved in the foreclosure process in Washington should know that Washington courts expect strict adherence to foreclosure requirements. Opening Brief, at 9-10. MERS need not debate the impact of *Cox*. As discussed above, MERS did not violate the Act and so MERS did not run afoul of *Cox*.

116 It is important to keep in mind that the Deed of Trust Act (and similar statutes around the country) is *not* a consumer protection statute. It is designed to provide for faster, more efficient foreclosures for lenders. *Cox*, 103 Wn.2d at 387. Certainly, its provisions must be followed, but Plaintiff's implication that the Act is designed as a sword for borrowers is inaccurate.

117 For example, without limitation, such a determination would call into question

Moreover, even if there was a recording violation (there was not), it did not harm Plaintiff in any way. And such violation, if any, did not contravene any public policy objectives noted by the Court in *Cox* that underscore the Act. There simply is no public policy basis to restrict a lender from using an agent to act on its behalf as a beneficiary under a deed of trust. Plaintiff's theories are not factually accurate, nor are they compelling. To the contrary, as discussed above, allowing lenders to identify MERS as their agent (acting as a beneficiary) under deeds of trust provides immeasurable positive advantages for the consuming public, for local recording offices, and for lenders (and ultimately the economy).[118]

At most, the only legal impact the violation should have (if the Court were to conclude there was a violation) is that MERS should be

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the status of land title records on thousands of Washington properties where MERS has executed releases of liens or reconveyances of property for borrowers who have paid off their loans.

118 The underlying theme in Selkowitz's Opening Brief is that the existence of MERS somehow conceals from borrowers the true identity of their lenders. *See* Opening Brief at 28 (MERS "[c]onceal[s] the identity of the true note holder"), 18 ("MERS is essentially a 'straw-man' to hide the identity of the real holder of the obligation"), 28 (similar), 32 (similar). This assertion is complete nonsense, and appears to be a fiction created by Plaintiff to cloak the true issues before the Court in conspiracy theory. The simple fact is, 100% of loan servicers are identified (mandatorily) on the MERS® System and 97% of the over 3,000 MERS® System members disclose their investor identity, which is readily available on MERS's website. And further, a borrower has the absolute right to request that information from the servicer under the Truth in Lending Act. *See, supra*, Part III.B. Likewise, Plaintiff's bald assertions that MERS facilitates predatory lending, depletes county coffers, and exposes borrowers to "double liability" are baseless fictions created by Plaintiff with the apparent hope of misconstruing the issues before the Court. Opening Brief, at 19-21, 37. Plaintiff provides no factual or legal support for

required to assign its interest in any deed of trust to the holder of the promissory note, and have that assignment recorded in the land title records, before any non-judicial foreclosure could take place. It certainly should not result in a void deed of trust, both legally and from a public policy standpoint.[119] The existence of MERS as the contractually agreed to "beneficiary" in hundreds of thousands of deeds of trust in the State of Washington cannot reasonably mean that the loans associated with those deeds are not secured.[120]

C. There Is No Consumer Protection Act Claim Against MERS.

Selkowitz, and others similarly situated, do not possess a cause of action against MERS under Washington's Consumer Protection Act

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these assertions and they should be rejected. The positive advantages of MERS cannot be overcome with speculation and conjecture. *See supra*, Part III.A.2.

119 Another theory Plaintiff appears to be advancing is one that has been consistently rejected by courts around the country. The existence of MERS as the beneficiary under the Deed of Trust does not result is a "split" or "separation" of the Promissory Note and Deed of Trust, rendering the Deed of Trust void. *See* Opening Brief, at 38 ("the separation of the Note from the Deed of Trust renders the subject Deed of Trust unenforceable"); *see Horvath v. Bank of N.Y., N.A.*, 641 F.3d 617, (4th Cir. 2011) ("Indeed, common sense suggests that things could not be any other way. If [plaintiff] were correct in asserting that the transfer of a note splits it from the deed of trust ..., there would be little reason for notes to exist in the first place. One of the defining features of notes is their transferability, but on [plaintiff's] view, transferring a note would strip it from the security that gives it value and render the note legally worthless. This cannot be – and is not – the law."); *In re Martinez*, No. 11-7007 (U.S. Bankr. Ct. D. Kan., Feb. 2. 2011 and Apr. 20, 2011) ("no 'fatal' splitting of the Note and Mortgage occurred"). None of the cases cited by Plaintiff support the proposition advanced.

120 *Tenino Aerie*, 148 Wn.2d at 239 (The court must "avoid literal reading[s] of a statute which would result in unlikely, absurd, or strained consequences.").

("CPA"). The elements of a CPA claim are: (1) an unfair or deceptive act or practice; (2) occurring in trade or commerce; (3) that impacts the public interest; (4) causing injury to the plaintiff's business or property; and (5) that injury is causally linked to the unfair or deceptive act.[121] Selkowitz, and others, cannot satisfy at least three of these elements.

1. MERS Has Not Engaged In An Unfair Or Deceptive Act Or Practice.

There are two ways that Plaintiff can establish the first element of a CPA claim:

> [W]e have recognized that consumers may establish the first element in two ways. They may show either that an act or practice 'has a capacity to deceive a substantial portion of the public,' or that 'the alleged act constitutes a *per se* unfair trade practice.'[122]

Only the Washington Legislature can establish a *per se* CPA violation, and it can do so only by making a specific legislative declaration to that effect.[123] Plaintiff cannot assert that MERS committed a *per se* CPA violation. Thus, the only way for Plaintiff to establish a CPA claim against MERS is to show that MERS engaged in deceptive conduct. But as discussed above, Plaintiff has not and cannot do that. MERS is a proper

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121 *Hangman Ridge Training Stables, Inc. v. Safeco Title Ins. Co.*, 105 Wn.2d 778, 780 (1986).

122 *Saunders v. Lloyd's of London*, 113 Wn.2d 330, 344 (1989) (quoting *Hangman Ridge*, 105 Wn.2d at 785-86).

123 *Hangman Ridge*, 105 Wn.2d at 787, 791 ("it has become clear that the Legislature, not this court, is the appropriate body to establish ... a *per se* unfair trade practice").

beneficiary under Plaintiff's Deed of Trust, both contractually and legally. MERS has made no misrepresentations or misstatements to Plaintiff. To the contrary, MERS fully described its role to Plaintiff through the very contract documents that Plaintiff signed. MERS did not engage in any conduct that was unfair, deceptive or misleading. Everything was fully disclosed and agreed to by Plaintiff. Even if, *arguendo*, the Court ruled that MERS incorrectly concluded that it was a legal beneficiary under Washington deeds of trust, MERS fully disclosed its role to borrowers and did not affirmatively misrepresent or knowingly misstate anything to borrowers.

2. The Act Being Challenged Did Not Have The Capacity To Impact A Substantial Portion Of The Public.

A plaintiff asserting a CPA claim must also show that the act complained of impacts the public interest and has the capacity to "deceive a *substantial portion of the public*."[124] Acts that impact only the plaintiff or a limited group do not have the capacity to deceive a substantial portion of the public as a matter of law, "no matter how misleading."[125]

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[124] *Segal Co. (Eastern States), Inc. v. Amazon.com*, 280 F. Supp.2d 1229, 1232 (W.D. Wash. 2003); *Hangman Ridge*, 105 Wn.2d at 780.

[125] *Henery v. Robinson*, 67 Wn. App. 277, 291 (1992); *see also Goodyear Tire & Rubber Co. v. Whiteman Tire, Inc.*, 86 Wn. App. 732, 744-45 (1997) (dismissing plaintiff's CPA claim, in part, because the challenged acts were not directed at the public).

Thus, the foundational question is, what act or acts are being challenged, regardless of whether they are misleading? Here, Plaintiff challenges an isolated act by MERS – *MERS's role as the beneficiary under Plaintiff's Deed of Trust in the context of the foreclosure proceedings on Plaintiff's property.* Plaintiff contends that MERS misled Plaintiff with respect to that role. Even if that were true (which it is not), it would have the capacity to deceive and impact *only* Plaintiff, not a "substantial portion of the public."[126] Other than bald statements that the public was deceived, Plaintiff has made no effort to show how the challenged conduct had any impact on anyone besides Plaintiff. Thus, Plaintiff has not established, and cannot establish, that a substantial portion of the public was impacted by the representations, if any, that MERS made to Plaintiff.

3. Plaintiff Suffered No Injury Caused By MERS.

Finally, Plaintiff must plead and show a causal link between the alleged misrepresentation or deceptive act and his purported injury.[127] In *Indoor Billboard,* the Court applied the proximate cause standard set forth in Washington Pattern Jury Instruction 15.01 to CPA claims, requiring a plaintiff to prove that but

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126 *Segal Co.*, 280 F. Supp.2d at 1232; *Hangman Ridge*, 105 Wn.2d at 780.

127 *Indoor Billboard v. Integra Telecom*, 162 Wn.2d 59, 81-82 (2007).

for the defendant's allegedly unfair or deceptive practice, the plaintiff would not have been harmed.[128]

Plaintiff does not (and cannot) allege a causal link between the alleged wrongful act by MERS and any harm to Plaintiff. Plaintiff took out a loan in 2006, and has been in default since he stopped making payments in 2009. Plaintiff has been occupying the at-issue property since that time without paying for it. The "harm" Plaintiff claims he has suffered is that (he claims) he does not know who to make payments to on his home loan. But there is no allegation or proffered evidence that any purported deficiency in the recording of documents evidencing Plaintiff's loan caused his inability to pay on his loan or confusion about who to pay. Setting aside whether Plaintiff genuinely questions who he must make payments to under his loan to cure the default, that issue has nothing to do with MERS and is not in any way causally linked to MERS's identity as the beneficiary under the Deed of Trust. Plaintiff has suffered no damage as a result of any conduct by MERS.[129]

Plaintiff has not established a CPA claim here, and there is no claim to be had under the CPA for MERS's contractual role as the

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[128] *Id.*

[129] To the extent Plaintiff contends that his claimed emotional distress constitutes "damages," that still would not give rise to damages under the CPA. "Damages for emotional distress are not recoverable for a violation of the CPA." *Johnson v. Cash Store*, 116 Wn. App. 833, 849 (2003).

beneficiary under a deed of trust that is subject to the Washington Deed of Trust Act.

V. CONCLUSION.

For the foregoing reasons, MERS respectfully requests that the Court hold that MERS is a lawful "beneficiary" under the Deed of Trust Act, RCW 61.24.005(2). Further, MERS respectfully requests that the Court hold that a Washington Consumer Protection Act claim does not exist against MERS for its role as a deed of trust beneficiary in Washington deeds of trust.

RESPECTFULLY SUBMITTED this 20th day of October, 2011.

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APPENDIX

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APPENDIX A.1

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

BERNARD R. CORALES, et al., Plaintiffs, v. FLAGSTAR BANK, FSB, et al., Defendants.	CASE NO. C10-1922JLR ORDER GRANTING MOTION FOR SUMMARY JUDGMENT

Before the court are Defendants Flagstar Bank, FSB's ("Flagstar") and Mortgage Electronic Registration System, Inc.'s ("MERS") motion for summary judgment (Dkt. # 48) and Defendant Northwest Trustee Services, Inc.'s ("NWTS") motion to dismiss the amended complaint with prejudice (Dkt. # 53). Having reviewed the motions, all papers filed in support and opposition thereto, and the applicable law, the court GRANTS

Flagstar's and MERS's motion for summary judgment and also GRANTS NWTS's motion to dismiss.[1]

II. FACTUAL AND PROCEDURAL BACKGROUND

On May 21, 2008, Plaintiff Bernard R. Corales borrowed $240,000 by executing a note in favor of Axia Financial, LLC ("Axia"). (Am. Compl. (Dkt. # 37) ¶ 23; 2nd Cruz Decl. (Dkt. # 50) Ex. A (attaching copy of the Note).) Axia subsequently sold Plaintiffs' Note to Flagstar, endorsing the Note directly to Flagstar. (*Id.* Ex. A at 4.) Flagstar continues to hold the Note, and has since endorsed it in blank, rendering the Note bearer paper. (*Id.* at 5.)

Plaintiffs Bernard R. Corales and Maria Corales secured the debt with a Deed of Trust on their property commonly described at 4092 Letitia Avenue, Seattle, Washington ("the Property"). (*Id.* Ex. B (attaching a copy of the Deed of Trust).) The Deed of Trust names Joan H. Anderson, EVP on behalf of Flagstar, as the trustee and grants the trustee the power of sale in the event of default. (*Id.*)

Although Axia was the lender, the parties agreed in the Deed of Trust to designate MERS as the beneficiary, "acting solely as nominee for Lender and Lender's successors and assigns." (*Id.*) The Deed of Trust states that "MERS holds only legal title to the interests granted" by the Deed of Trust, and that MERS "has the right to exercise any or all of those interests." (*Id.*) On or about April 30, 2010, MERS, as beneficiary under the Deed of Trust and nominee for Axia, executed an Assignment of the Deed of Trust

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[1] No party requested oral argument with regard to either motion, and the court finds oral argument to be unnecessary as well.

("Assignment") transferring all beneficial interest in the Deed of Trust to Flagstar. (Am. Compl. Ex. D; Mot. to Dismiss (Dkt. # 53) at 2, Ex. B (attaching true and correct copy of the Assignment).)

In February 2009, nine months after Mr. Corales signed the Note, Plaintiffs stopped making payments and defaulted on the Note. (Morgan Decl. (Dkt. # 51) ¶ 2, Ex. A ("Payoff Demand Schedule"); 1st Cruz Decl. (Dkt. # 15) Ex. E ("Notice of Trustee's Sale").) In March 2009, Mr. Corales sent a letter to his "Home Mortgage Lender" apologizing for not making his February 2009 mortgage payment. (*Id.* Ex. F.) In the letter, he explains that he lost his job in October 2008, and has been unable to find a new one. (*Id.*) After Plaintiffs' default, Flagstar initiated nonjudicial foreclosure proceedings. However, as described below, those proceedings have been continued due to this lawsuit and Plaintiffs' various bankruptcy filings.

On or about May 19, 2010, Flagstar executed an Appointment of Successor Trustee ("Appointment") naming NWTS as Successor Trustee and vesting NWTS with all powers of the original trustee. (*See* Am. Compl. Ex. E; Mot. to Dismiss at 3, Ex. C (attaching true and correct copy of the Appointment).) On or about June 7, 2010, NWTS executed a Notice of Trustee Sale ("Notice"), which set a sale date for the Property of September 10, 2010. (*See id.*, Ex. D (attaching true and correct copy of the Notice).)

Plaintiffs filed this action on November 29, 2010. (Compl. (Dkt. # 1).) In early January 2011, Plaintiffs also filed a bankruptcy petition. (*See* Not. of Bankr. (Dkt. # 10); *In re: Bernard R. Corales*, No. 11-10142-SJS (W.D. Wash. Bankr.), Chapter 13 Voluntary Petition (Dkt. # 1); Mot. to Dismiss at 3, Ex. F.) Plaintiffs voluntarily dismissed this Chapter 13 bankruptcy a few weeks later. (*See id.*; Mem. Resp. to OSC (Dkt. # 13) ¶ 3.)

On February 10, 2011, Flagstar moved for summary judgment on all of Plaintiffs' claims. (1st SJ Mot. (Dkt. # 14).) On February 25, 2011, NWTS executed an Amended Notice of Trustee's Sale ("Amended Notice"), which set a sale date for the Property of April 15, 2011. (*See* Am. Compl. Ex. F; Mot. to Dismiss at 3, Ex. E (attaching true and correct copy of Amended Notice).) On April 4, 2011, more than a month after the parties had completed briefing on Flagstar's motion for summary judgment, Plaintiffs asked the court to dismiss their claims so they could re-file them in bankruptcy court. (Not. of Vol. Dismissal (Dkt. # 29).)

On April 26, 2011, the court denied Plaintiffs' motion for voluntary dismissal, affording them instead the opportunity to "amend their complaint to bring it into compliance with the Federal Rules of Civil Procedure and appropriate Supreme Court precedents." (Order (Dkt. # 36) at 6.) The court also struck Flagstar's pending motion for summary judgment without prejudice to re-filing if appropriate following the filing of Plaintiffs' amended complaint. (*Id.*) Significantly, the court also stated that it appeared "that Plaintiffs [we]re attempting to use the federal courts as a tool to improperly delay adjudication of issues . . . before the court." (*Id.* at 5.)

In the meantime, however, on April 13, 2011, just two days before the scheduled nonjudical foreclosure sale of the Property, Plaintiffs again filed for Chapter 13 bankruptcy. (*See* Mot. to Dismiss at 3, Ex. G; *In re: Bernard R. Corales,* No. 11-14237-TWD (W.D. Wash. Bankr.), Chapter 13 Voluntary Petition (Dkt. # 1).) On June 9, 2011, the bankruptcy court dismissed the petition for failure to file the required schedules. (*Id.* Bankr. Order (Dkt. # 15).)

On May 5, 2011, Plaintiffs filed a "Verified Amended Complaint" seeking fundamentally different relief than their original complaint. (*See* Am. Compl. (Dkt. # 37).) In this verified amended complaint, Plaintiffs state on penalty of perjury that "[o]n or about May 21, 2011, Plaintiff executed a Note and Deed of Trust for the sum of <u>$240,000</u> in favor of [Axia]." (*Id.* ¶ 23 (underlining in original).) In addition, Plaintiffs also admit that "[t]he Deed of Trust names Defendant MERS as 'nominee' and as a 'beneficiary'." (*Id.*)

On June 7, 2011, Mr. Corales filed an "Emergency Affidavit." (Corales Aff. (Dkt. # 45).) In the affidavit, in direct contravention to his sworn statement in the verified amended complaint, Mr. Corales states that he "dispute[s] the authenticity of the purported Note . . . , [and] dispute[s] that the purported Note bears [his] signature . . . ." (*Id.* ¶ 11.) In contravention to his March 2009 letter to Flagstar, he also denies that he defaulted on the Note. (*Id.*)

On June 16, 2011, Flagstar filed its second motion for summary judgment seeking dismissal of all of Plaintiffs' claims contained within its verified amended complaint. (2nd SJ Mot. (Dkt. # 48).) On July 7, 2011, NWTS filed a motion to dismiss with prejudice Plaintiffs' claims against it. (Mot. to Dismiss (Dkt. # 53).) On July 21, Plaintiffs filed a motion to amend their amended complaint. (Mot. to Amend (Dkt. # 59).) The court denied Plaintiffs' motion to amend on October 11, 2011. (Oct. 11, 2011

Order (Dkt. # 74).) The court now considers Flagstar's and MERS's motion for summary judgment and NWTS's motion to dismiss Plaintiffs' claims with prejudice.

III. ANALYSIS

A. Standards

NWTS has brought a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6) with regard to the claims Plaintiffs have alleged against it in their amended verified complaint. (Mot. to Dismiss at 1.) When considering a motion to dismiss under Rule 12(b)(6), the court construes the complaint in the light most favorable to the non-moving party. *Livid Holdings Ltd. v. Salomon Smith Barney, Inc.*, 416 F.3d 940, 946 (9th Cir. 2005). The court must accept all well-pleaded allegations of material fact as true and draw all reasonable inferences in favor of the plaintiff. *See Wyler Summit P'ship v. Turner Broad. Sys.*, 135 F.3d 658, 661 (9th Cir. 1998). "To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" *Ashcroft v. Iqbal*, --- U.S. ---, 129 S. Ct. 1937, 1949 (2009) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007)); *see Telesaurus VPC, LLC v. Power*, 623 F.3d 998, 1003 (9th Cir. 2010). "A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Iqbal,* 129 S. Ct. at 1949. Dismissal under Rule 12(b)(6) can be based on the lack of a cognizable legal theory or the absence of sufficient facts alleged under a cognizable legal theory. *Balistreri v. Pacifica Police Dep't*, 901 F.2d 696, 699 (9th Cir. 1990).[2]

Flagstar and MERS have moved for summary judgment of all claims against them in Plaintiffs' verified amended complaint. (*See* 2nd SJ Mot.) Summary judgment is appropriate if the evidence, when viewed in the light most favorable to the non-moving party, demonstrates "that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a); *see Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986); *Galen v. Cnty. of L.A.*, 477 F.3d 652, 658 (9th Cir. 2007). The moving party bears the initial burden of showing there is no genuine issue of material fact and that he or she is entitled to prevail as a matter of law. *Celotex*, 477 U.S. at 323. If the moving party meets his or her burden, then the non-moving party "must make a showing sufficient to establish a genuine dispute of material fact regarding the existence of the essential elements of his case that he must prove at trial" in order to withstand summary judgment. *Galen*, 477 F.3d at 658.

However, "[t]he mere existence of a scintilla of evidence in support of the non-moving party's position is not sufficient" to meet the burden and one cannot oppose a properly supported summary judgment motion by "rest[ing] on mere allegations or denials of his pleadings." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 256 (1986).

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[2] Because Mr. and Ms. Corales are proceeding *pro se*, the court must construe their complaint liberally even when evaluating it under the *Iqbal* standard. *Johnson v. Lucent Techs., Inc.*, --- F.3d ---, 2011 WL 3332368, at *9 (9th Cir. Aug. 19, 2011). Furthermore, "[l]eave to amend should be granted unless the pleading could not possibly be cured by the allegation of other facts, and should be granted more liberally to pro se plaintiffs." *Id.* (quoting *McQuillion v. Schwarzenegger*, 369 F.3d 1091, 1099 (9th Cir.2004) (internal quotation marks omitted)).

Without specific facts to support the conclusion, a bald assertion of the "ultimate fact" is insufficient. *See Schneider v. TRW, Inc.*, 938 F.2d 986, 990-91 (9th Cir. 1991). Genuine factual issues must exist that "can be resolved only by a finder of fact because they may reasonably be resolved in favor of either party." *Anderson*, 477 U.S. at 250. If the non-moving party fails to make a sufficient showing of an element of its case, the moving party is entitled to judgment as a matter of law. *Celotex*, 477 U.S. at 325.

B. Flagstar's and MERS's Motion for Summary Judgment

1. Alleged Securitization of Plaintiffs' Loan

In their verified amended complaint, Plaintiffs allege that Flagstar "transferred" their loan into a mortgaged-backed security fund related to Fannie Mae. (*See* Am. Compl. ¶ 24 & Ex. C.) However, even assuming that Plaintiffs' allegations are true, they have not established that Flagstar presently lacks authority to enforce the Deed of Trust at issue or that Flagstar lacks authority to initiate foreclosure proceedings. It is undisputed that Flagstar is in possession of the original Note at issue, endorsed in blank. Flagstar therefore is the holder of the Note with the right to enforce it and the corresponding Deed of Trust. *See* RCW 62A.3-205 ("holder of an instrument" is entitled to enforcement); *Fidel v. Deutsche Bank Nat. Trust Co.,* No. C10-2094RSL, 2011 WL 2436134, at *3 (June 14, 2011) ("[D]efendant has provided the Note, which was endorsed to defendant and is currently in defendant's possession. Accordingly, defendant has the authority to institute foreclosure proceedings.") (citing RCW 61.24.005 (defining "beneficiary" as the "holder of the instrument or document evidencing the obligations secured by the deed of trust")).

In a similar case, a federal bankruptcy judge recently rejected precisely Plaintiffs' argument, holding that even if a lender sells a loan to Fannie Mae, the lender's possession of the Note endorsed in blank means that it may foreclose in its own name. *In re Martinez,* --- B.R. ---, 2011 WL 1519877, at * 5 & n. 44 (Bankr. D. Kan. Apr. 20, 2011) (even assuming lender sold Note to Fannie Mae, "the note would still be in [the lender's] possession and would be endorsed in blank – again making it a holder in possession of the note entitled under the [Uniform Commercial Code] to enforce it against Plaintiff."); *see also In re Veal,* 450 B.R. 897, 912 (B.A.P. 9th Cir. 2011) ("[T]he maker [of the Note] should be indifferent as to who owns or has an interest in the note so long as it does not affect the maker's ability to make payments on the note. Or, . . . [the plaintiff] should not care who actually owns the Note—and it is thus irrelevant whether the Note has been fractionalized or securitized—so long as they do know who they should pay."). Thus, even if Fannie Mae has an interest in Plaintiffs' loan, Flagstar has the authority to enforce it. Thus, the court grants Flagstar's and MERS's motion with regard to this issue.

2. MERS's Authority to Act as a Beneficiary

Although Plaintiffs' allegations are somewhat unclear, they appear to be asserting that MERS was not a proper beneficiary under the Deed of Trust and thus could not assign its beneficial interest. (*See* Am. Compl. ¶¶ 34-37.) Plaintiffs, however, have admitted that they signed a Deed of Trust that acknowledged that MERS was a beneficiary under the deed and that MERS had the right to foreclose and sell property covered by the deed. (*See* Am. Compl. ¶ 23 ("On or about May 21, 2008, Plaintiff executed a Note and Deed of Trust . . . . The Deed of Trust names Defendant MERS as a 'nominee' and as a 'beneficiary'") & Ex. B at 3 ("Borrower understands and agrees that MERS holds only legal title to the interests granted by Borrower in this Security Instrument, but, if necessary to comply with law or custom, MERS (as nominee for Lender and Lender's successors and assigns) has the right to exercise any or all of those interests, including but not limited to, the right to foreclose and sell the Property; and to take any action required of Lender including, but not limited to, releasing and cancelling this Security Instrument.").)

This court has repeatedly rejected the argument that MERS is not a proper beneficiary under a Deed of Trust where the plaintiff has executed a deed which expressly acknowledges MERS's status as a beneficiary. *See, e.g., St. John v. Northwest Trustee Servs., Inc.*, No. C11-5382BHS, 2011 WL 4543658, at *2-*3 (W.D. Wash. Sept. 29, 2011); *Rhodes v. HSBC Bank USA, N.A.*, No. C11-5303RJB, 2011 WL 3159100, at *3-*4 (W.D. Wash. July 26, 2011) ("MERS had the authority to act as beneficiary under a Deed of Trust where such authority was explicitly granted by plaintiff upon execution of the instrument."); *Ceburn v. HSBC Bank USA, N.A.*, No. C10-5742BHS, 2011 WL 321992, at *3 (W.D. Wash. Feb. 2, 2011); *Vawter v. Quality Loan Serv. Corp. of Wash.*, 707 F. Supp. 2d 1115, 1125-26 (W.D. Wash. 2010); *Moon v. GMAC Mortgage Corp.*, No. C08–969Z, 2008 WL 4741492, at *5 (W.D. Wash. Oct.24, 2008).[3] Accordingly, the court grants Flagstar's and MERS's motion with regard to this issue.

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[3] Judge Coughenour of this court recently certified three questions on this subject to the Washington Supreme Court. (*See Bain v. Metropolitan Mortg.*, Cause No. C09-0149JCC (W.D. Wash.) "Order Certifying Questions to the Washington Supreme Court" (Dkt. # 159).) Judge

3. Flagstar's Authority to Foreclose

Plaintiffs also appear to be claiming that Flagstar has no authority to foreclose on the property because MERS did not properly record or convey its beneficial interest in the Deed of Trust to Flagstar, and therefore any nonjudicial foreclosure proceeding by Flagstar against them is void. (*See* Am. Compl. ¶¶ 36 & 41(b).) As discussed above, MERS is a proper beneficiary under the Deed of Trust here, and validly assigned its interest under Plaintiffs' Deed of Trust to Flagstar. Moreover, Washington State does not require the recording of such transfers and assignments. *See St. John,* 2011 WL 4543658, at * 3 (citing RCW 61.24.005(2) (defining Beneficiary as the "the holder of the instrument of document evidencing the obligations secured by the deed of trust"); *see also, e.g., In re United Home Loans,* 71 B.R. 885, 891 (Bankr. W.D. Wash. 1978), *aff'd,* 876 F.2d 897 (9th Cir. 1989) ("An assignment of a deed of trust . . . is valid between the parties whether or not the assignment is ever recorded. . . . Recording of the assignments is for the benefit of the parties. . . .") (internal citations omitted.). The purpose of recording the assignment is to put parties who subsequently purchase an interest in the property on notice of which entity owns a debt secured by the property. RCW 65.08.070. Therefore, Plaintiffs claim based on an alleged lack of recording of the assignment from

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Coughenour has also stayed at least two cases pending resolution of the certified questions. *See Dean v. Aurora Bank, F.S.B.,* No. C11-05339 RBL, 2011 WL 3812653, at * 2 (W.D. Wash. Aug. 29, 2011). However, in light of the overwhelming number of decisions from the Western District of Washington upholding the role of MERS in the factual circumstances similar to those at issue here (cited above), the court finds no reason to similarly stay this action.

MERS to Flagstar is unavailing, and the court grants summary judgment to Flagstar and MERS with regard to this issue.

4. **Plaintiffs Are in Default**

Flagstar and MERS are also seeking summary judgment with regard to Plaintiffs' default on the Note, and Flagstar's consequent right to initiate foreclosure proceedings. (2nd SJ Mot. at 11-14.) Flagstar has submitted evidence detailing Plaintiffs' default. (*See* 1st Cruz Decl. ¶ 6 Exs. E (attaching Notice of Trustee's Sale); 2nd Cruz Decl. ¶ 4, Ex. C; Morgan Decl. (Dkt. # 51) ¶ 2, Ex. B (attaching June 8, 2011 Payoff Demand Statement for Plaintiffs' loan, and identifying February 1, 2009 as the date of Plaintiffs' default).) In addition, Flagstar has submitted evidence that Mr. Corales sent a letter to his "Home Mortgage Lender," dated March 20, 2009, in which he apologizes for and admits failing to make his mortgage payment. (1st Cruz Decl. ¶ 7, Ex. F.) Mr. Corales has never disavowed this letter in any of his many filings with this court. Nor have Plaintiffs ever submitted any evidence of timely payment on the Note to contradict or create a materail issue of fact with regard to the evidence of default submitted by Flagstar.

In addition, Plaintiffs have explicitly admitted, under penalty of perjury, signing the Note and the Deed of Trust at issue here. On May 10, 2011, in their verified amended complaint, Plaintiffs state: "On or about May 21, 20008, Plaintiff executed a Note and Deed of Trust for the sum of <u>$240,000</u> in favor of AXIA FINANCIAL, LLC." (Am. Compl. ¶ 23 (underlining and capitalization in original).)

Yet, less than a month later, on June 7, 2011, Mr. Corales filed an "emergency affidavit" with the court, in which he flatly contradicts his previous sworn statement by "disput[ing] that the purported Note bears [his] signature." (Corales Aff. ¶ 11. He also contradicts his prior to letter to Flagstar by stating that he "den[ies] that [he] defaulted on the purported Note." (*Id.*; *see also id.* ¶ 3 ("I . . . deny that I have defaulted on the subject loan. . . .").) Once again, however, Mr. Corales submits no documentary or other evidence of timely payment on the Note to back up his bald assertion denying default.

In the Ninth Circuit, the "sham affidavit rule" prevents a party from creating an issue of material fact by introducing an affidavit that contradicts prior deposition testimony. *Kennedy v. Allied Mutual Ins. Co.*, 952 F.2d 262, 266-67 (9th Cir. 1991). Courts have extended this rule to apply to affidavits that contradict a party's prior admission. *See Container Recovery, Inc. v. Shasta Nw., Inc.*, No. 05-1749-PK, 2007 WL 1724937, at * 6 (D. Or. June 11, 2007). Nevertheless, the rule is in tension with the principle that a court's role in deciding a motion on summary judgment is not to make credibility determinations or to weigh evidence. *Van Asdale v. Int'l Game Tech,* 577 F.3d 989, 998 (9th Cir. 2009). Therefore, the rule should be applied with caution. Inconsistencies in a party's statements must be clear and unambiguous to justify striking an affidavit. *Id.*

Here, the court has no difficulty finding that Mr. Corales's "emergency affidavit" is a sham. The statements quoted above in Mr. Corales's "emergency affidavit" are not minor inconsistencies or clarifying testimony. They are in direct contradiction to Plaintiffs' prior sworn statements in their verified amended complaint concerning execution of the Note at issue, as well as to the admissions Mr. Corales previously made to Defendants concerning his default.[4] Accordingly, the court strikes Mr. Corales's "emergency affidavit" as a sham, and will not consider it in rendering its decision on Flagstar's and MERS's motion for summary judgment.

As a result of the court's finding, there is no evidence in contravention of Plaintiffs' default on the Note, and thus no material issue of fact with regard to default for trial. Accordingly, the court grants Flagstar's and MERS's motion for summary judgment with regard to Plaintiffs' default on the Note at issue.

5. Axia's Alleged Failure to Disclose and RESPA

Plaintiffs claim that they "are uncertain as to their rights under the Note and Deed of Trust" because Axia "failed to disclose all affiliated business arrangements" at their loan's origination. (Am. Compl. ¶ 37.) Plaintiffs appear to seek monetary damages for Axia's alleged failure to comply with the Real Estate Settlement Procedures Act ("RESPA"), 12 U.S.C. § 2601, *et seq*. Plaintiffs, however, do not allege that Flagstar or any other Defendant played any role in Axia's extension of credit to Plaintiffs. (*See generally* Am. Compl.) Defendants therefore cannot be held liable for Axia's alleged failure to comply with RESPA. RESPA uses the definition of "creditor" that is found in the Truth in Lending Act ("TILA"), 15 U.S.C. § 1601, et seq. *See* 12 U.S.C. § 2602(1)(B)(iv) (defining "creditor consistent with the definition found in 15 U.S.C. §

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[4] The court's finding here is bolstered by its previous finding (when it denied Plaintiffs' motion for voluntary dismissal) that it appeared that "Plaintiffs [we]re attempting to use the federal courts as a tool to improperly delay adjudication of issues . . . before the court." (April 26, 2011 Order at 5.) Further, the court cautions Plaintiffs that intentionally making false statements under oath to a court of law can result in prosecution for perjury.

1602(f)). TILA defines a "creditor," in part, as "the person to whom the debt . . . is initially payable on the face of the evidence of the indebtedness . . . ." 15 U.S.C. § 1602(f). Plaintiffs' debt was initially payable to Axia. Accordingly, no Defendant is Plaintiffs' "creditor" under either TILA or RESPA.

In addition, even if Plaintiffs could bring a RESPA claim against Flagstar or MERS (or any other Defendant) for Axia's alleged failure to disclose its affiliated business arrangements, RESPA's one-year statute of limitations has lapsed. The requirement to disclose affiliated business arrangements is governed by section 2607 of RESPA. 12 U.S.C. § 2607(c)(4). Claims under section 2607 must be brought within one year of the alleged violation. 12 U.S.C. § 2614. Plaintiffs' loan closed in May 2008 (1st Cruz Decl. Ex. A.) Plaintiffs did not file suit until November 29, 2010. (*See* Compl.) Thus, Plaintiffs' RESPA claim is time barred. The court grants summary judgment to Flagstar and MERS with regard to this claim.

6. Declaratory or Injunctive Relief

Plaintiffs allege that they are entitled to declaratory or injunctive relief based on the underlying allegations in their amended complaint, and ask the court to enjoin the trustee's sale of the Property. (Am. Compl. ¶¶ 38-41.) Because the court has granted summary judgment to Flagstar and MERS with regard to the substance of Plaintiffs' underlying claims, Plaintiffs are not entitled to declaratory or injunctive relief either. *See*

RCW 61.24.130 (setting out requirements for injunctive relief in the case of a trustee's nonjudicial foreclosure sale).[5]

7. New Claims Raised in Response to Summary Judgment Motion

In response to Flagstar's and MERS's motion for summary judgment, Plaintiffs assert new claims not plead in their amended complaint. For example, Plaintiffs assert that the Note at issue here is a security under the Securities Act of 1933 (*see* Resp. (Dkt. # 52) at 2, 8-9, 11), that Flag star is subject to the Fair Debt Collection Practices Act ("FDCPA"), 15 U.S.C. § 1692g, *et seq.* (*see id.* at 2, 4), and that Axia's endorsement of the Note "without recourse" somehow "materially altered" the Note rendering it unenforceable (*id.* at 4-6).[6] It is improper for Plaintiffs to raise these claims in response to a summary judgment motion, after the deadline for amending pleadings has passed (*see* Sched. Ord. (Dkt. # 24) at 1), and without a showing of good cause pursuant to Federal Rule of Civil Procedure 16(b)(4). Nonetheless, in recognition of Plaintiffs' *pro se* status, the court will briefly address these additional "claims."

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[5] Further, RCW 61.24.130(1) requires, as a condition of injunctive relief, "that the applicant pay to the clerk of the court the sums that would be due on the obligation secured by the deed of trust if the deed of trust was not being foreclosed." There is no evidence on the record that Plaintiffs are capable of making the required payments to the clerk of court which is a statutory prerequisite to injunctive relief here.

[6] While none of these claims are alleged in Plaintiffs' amended complaint (*see generally* Am. Compl.), some of these claims may be alleged (although not adequately so) in Plaintiffs' proposed second amended complaint. (*See* Prop. 2nd Am. Compl. (Dkt. # 59-1) at ¶¶ 24, 28.) The court, however, has denied Plaintiffs' motion for leave to amend its amended complaint and to file a second amended complaint. (Oct. 11, 2011 Order (Dkt. # 74).) Accordingly, the operative complaint here is Plaintiffs' verified amended complaint. (*See generally* Am. Compl.)

The Supreme Court has expressly stated that a "note secured by a mortgage on a home" is "not properly viewed as [a] security[y]" under the Securities Act of 1933. *Reves v. Ernst & Young,* 494 U.S. 56, 65 (1990). There is no dispute that Plaintiffs' Note is secured by a deed of trust on their home. As such, the Securities Act of 1933 is not applicable here. *See also Cowen v. Aurora Loan Servs.,* No. CIV 10-452-TUC-CKJ, 2010 WL 3342196 (D. Ariz. Aug. 25, 2010) ("Plaintiffs have failed to allege any facts that would make a promissory note and deed of trust involving real estate subject to either the Securities Act of 1933 or the Exchange Act of 1934.")

"The trend among Ninth Circuit District Courts has been to hold that enforcement of a security interest through a nonjudicial foreclosure proceeding does not constitute the collection of a debt" under the FDCPA. *Thepvongsa v. Reg'l Trustee Servs. Corp.,* No. C10-1045 RSL, 2011 WL 307364, at *8 (W.D. Wash. Jan. 26, 2011); *see also Litgon v. JP Morgan Case Bank,* No. C 11-2504 MEJ, 2011 WL 2550836, at *3 (N.D. Cal. June 27, 2011) (collecting cases); *Fong v. Prof'l Foreclosure Corp.,* No. C05-448JLR, 2005 WL 3134059, at * 2 (W.D. Wash. Nov. 22, 2005) ("Notably, Washington's Deed of Trust Act provides that a foreclosure action constitutes enforcement of an interest in property via a trustee's sale."). The court notes, however, that there is countervailing authority in both in the Fourth and Fifth Circuits. *See Wilson v. Draper & Goldberg, P.L.L.C.,* 443 F.3d 373, 376 (4th Cir. 2006) and *Kaltenbach v. Richards*, 464 F.3d 524, 529 (5th Cir. 2006).

In any event, even if the FDCPA were generally applicable to nonjudicial foreclosure proceedings, it would not be applicable here because Flagstar acquired its interest in the Note before Plaintiffs defaulted on their obligation. Flagstar committed to purchase Plaintiffs' loan on May 17, 2008, took possession of the Note on May 27, 2008, paid for the Note on June 5, 2008, and has remained in possession ever since. (Daly Decl. (Dkt. # 55) ¶ 2.) Plaintiffs were not in default of their loan until February 1, 2009. (Morgan Decl. (Dkt. # 51) ¶ 2.) Accordingly, Plaintiffs cannot state a plausible claim under the FDCPA because the FDCPA does not apply to lenders acquiring debt before default. *See De Dios v. Int'l Realty & Inv.*, 641 F.3d 1071, 1074 (9th Cir. 2011).

Finally, Plaintiffs assert Axia's endorsement of the Note "without recourse" somehow "materially altered" the Note rendering it unenforceable. (Resp. at 4-6). By endorsing the Note "without recourse," Axia was merely insulating itself from liability with regard to any subsequent Note holders should Plaintiffs default on the Note. *See Hall v. Sec. Planning Serv. Inc.*, 371 F. Supp. 7, 14 (D. Ariz. 1974) ("An indorsement of a note creates a contract (unless without recourse) binding indorser to pay the instrument according to its tenor at time of indorsement to holder."). Plaintiffs offer no authority for their novel and somewhat perplexing argument. Indeed, if the court were to follow Plaintiffs argument to its logical conclusion, then any endorsement of a negotiable instrument "without recourse" would render the instrument invalid. Axia and Flagstar endorsed the Note without recourse to effect the Note's negotiation. The endorsements "without recourse" by either Axia or Flagstar in no way altered Plaintiffs' obligations under the Note. None of the new claims or arguments Plaintiffs assert in response to Flagstar's and MERS's motion for summary judgment, even if permissible at this stage in the litigation, raise material issues of fact warranting a trial. Accordingly, the court grants Flagstar's and MERS's motion for summary judgment.

C. NWTS's Motion to Dismiss

Although it is difficult to discern precisely what claims Plaintiffs assert in their amended complaint against NWTS, Plaintiffs do not appear to allege any claim against NWTS that differs from their claims against MERS and Flagstar. (*See generally* Am. Compl.) As discussed above, the court has already found these claims lacking on summary judgment. Although the motion for summary judgment was brought by Flagstar and MERS, the court finds no reason why its rulings above should not apply equally with regard to Plaintiffs' indistinguishable claims against NWTS.

Nevertheless, construing Plaintiffs' amended complaint as liberally as possible in light of their *pro se* status, the court finds that they may be attempting to allege that NWTS's appointment as trustee was not valid. Plaintiffs, however, fail to allege any specific facts against NWTS to support this assertion. Their amended complaint is devoid of sufficient factual matter against NWTS to "'state a claim to relief that is plausible on its face.'" *Ashcroft v. Iqbal*, --- U.S. ---, 129 S. Ct. 1937, 1949 (2009) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007))

Although not alleged in their amended complaint, in response to NWTS's motion, Plaintiffs also baldly assert (1) that NWTS violated Washington's Deed of Trust Act, RCW 61.24, *et seq.*; (2) that NWTS does not have authority to initiate a foreclosure action on the Property; and (3) that NWTS slandered title to the Property. (*See generally* Resp. (Dkt. # 58).) Even assuming that the court were to permit Plaintiffs to plead these additional claims in response to NWTS's motion to dismiss, they again fail to plead sufficient facts in support of these claims to withstand dismissal under the standards set forth in *Twombly,* 550 U.S. at 557, and *Iqbal,* 129 S.Ct. at 1949. A claim does not suffice if it tenders only "'naked assertion[s]' devoid of 'further factual enhancement.'" *Iqbal,* 129 S.Ct. at 1949 (quoting *Twombly,* 550 U.S. at 557.)

Further, a review of the various publically recorded documents that were submitted by NWTS, and attached to Plaintiffs' amended complaint, supports NWTS's motion to dismiss.[7] Nothing in the Appointment of NWTS as trustee (*see* Am. Compl. Ex. E; Mot. to Dismiss at 3, Ex. C), NWTS's first Notice of Trustee's Sale (*see id.*, Ex. D), or NWTS's Amended Notice of Trustee's Sale (*see* Am. Compl. Ex. F; Mot. to Dismiss at 3, Ex. E) indicate any wrong-doing on the part of NWTS.[8] In face of this documentary evidence, Plaintiffs' bald allegations, devoid of any factual enhancement, cannot withstand NWTS's motion to dismiss. The court, therefore, grants NWTS's motion to dismiss Plaintiffs' claims against it.[9]

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[7] On a motion to dismiss, the court may consider documents or exhibits attached to Plaintiffs' complaint, a writing of unquestioned authenticity that is relied upon in the complaint, or public records. *Swartz v. KPMG, LLP,* 476 F.3d 756, 763 (9th Cir. 2007) (stating that on motion to dismiss court may consider exhibits attached to the complaint or other documents relied upon in the complaint); *Papasan v. Allain,* 478 U.S. 265, 268 n.1 (1986) ("Although this case comes to us on a motion to dismiss under Federal Rule of Civil Procedure 12(b), we are not precluded in our review of the complaint from taking notice of items in the public record . . . .").

[8] Further, Plaintiffs have never alleged that they failed to timely receive either of the Notices of Trustee's Sale. Indeed, the Property has yet to be sold in foreclosure.

[9] The court has already afforded Plaintiffs an opportunity to amend their complaint. (*See* April 26, 2011 Order at 6; *see also generally* Am. Compl.) In so amending, Plaintiffs were unable to draft a complaint sufficient to withstand Flagstar's and MERS's second motion for

IV. CONCLUSION

Based on the foregoing, the court hereby ORDERS that: (1) Flagstar's and MERS's second motion for summary judgment (Dkt. # 48) is GRANTED; (2) NWTS's motion to dismiss Plaintiffs' claims with prejudice (Dkt. # 53) is GRANTED; (3) Flagstar's and MERS's motion to amend the scheduling order (Dkt. # 66) is DENIED as MOOT; and (4) Plaintiffs' case is DISMISSED for the reasons stated herein.

Dated this 14th day of October, 2011.

JAMES L. ROBART
United States District Judge

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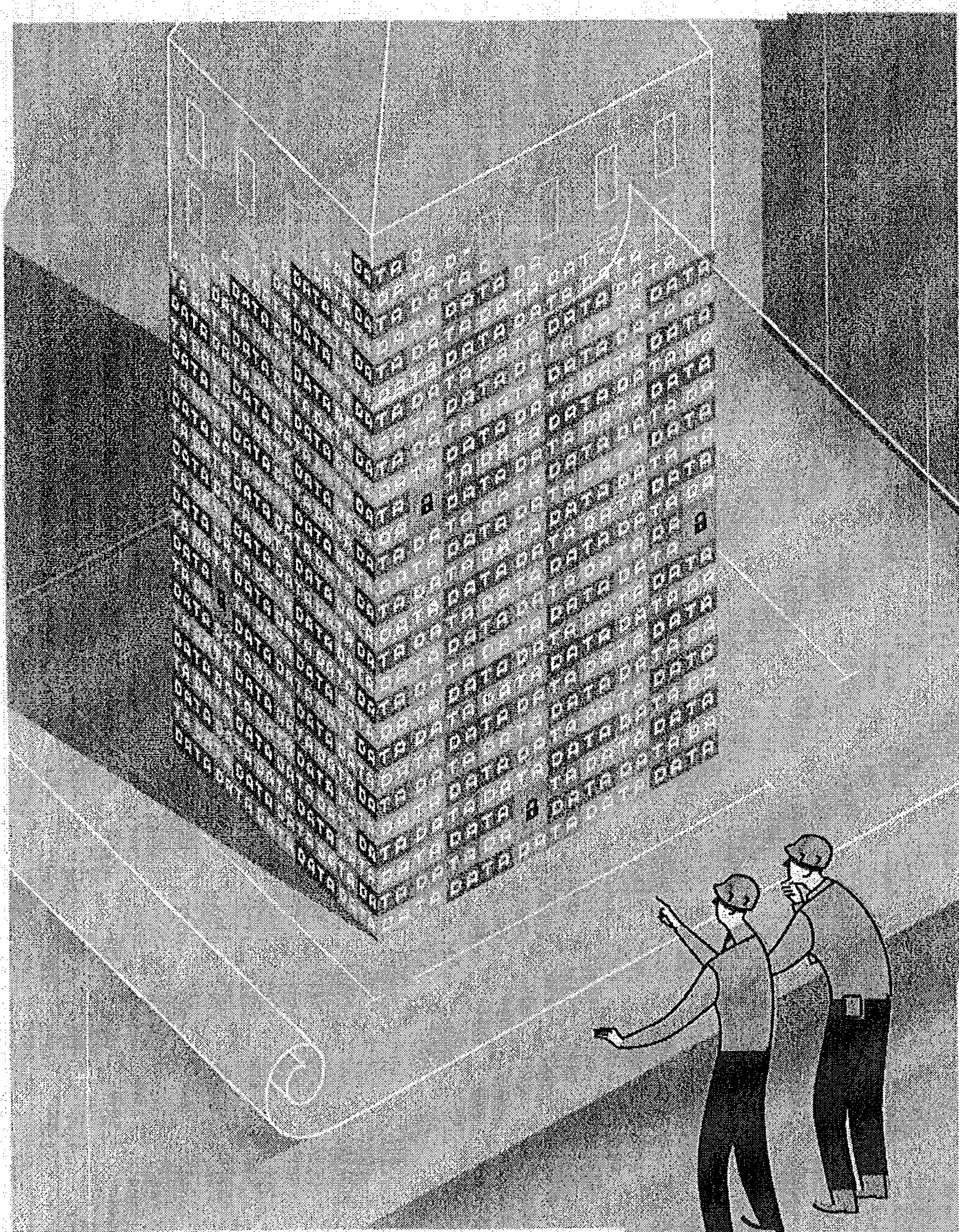
summary judgment and NWTS's motion to dismiss. In addition, the court recently denied Plaintiffs' motion to amend their amended complaint and file a second amended complaint because they failed to show good cause for their delay in seeking amendment after the scheduling order's deadline for amending pleadings had passed. (*See* Oct. 11, 2011 Order (Dkt. # 74).) The court finds that "[n]o amendment could save these plaintiffs," and granting a further opportunity to amend, even in recognition of Plaintiffs' *pro se* status, would be futile. *See Bell v. City of Kellogg*, 922 F.2d 1418, 1425 (9th Cir. 1991).

APPENDIX A.2

SETTING THE RECORD STRAIGHT ON MERS



BY ALLEN H. JONES

The foreclosure crisis ignited a media firestorm around the legitimacy of an electronic registry built by the industry to track ownership of mortgages and servicing. It's taking a while to get to the truth.

It has been decried as a shell corporation. Deemed a destroyer of the Colonial-era land-records system. Its most outspoken critics have argued its very existence marks the demise of the institution of property rights. ■ Despite the unforgiving censure of Reston, Virginia–based Mortgage Electronic Registration Systems Inc. (MERS) in the media, its right to exist, to hold legal title to a mortgage and to foreclose all have been maintained by numerous local and state courts. ■ These decisions, along with recent organizational transformation and procedural changes within MERSCORP Inc., MERS' parent company, could mean the storm of litigation challenging its standing is finally tapering off. But MERS remains largely misunderstood by the public, and is almost regularly berated by the media. ■ As a result, politicians are distancing themselves from MERS. Do such maneuvers indicate awareness of a potential liability or is it simply that the public relations risk is just not worth the cost?

Amidst the din, it is hard to tell. Absent from most of the discourse is an unbiased portrait of MERS, with a history of how and why it emerged, the value it confers to the mortgage lending supply chain and the real problems it faces today with respect to a recent regulatory consent order.

The MERS® System is the registry operated by MERSCORP. MERS is a wholly owned subsidiary of MERSCORP. References in this article to MERS are to the subsidiary. The subsidiary's sole purpose is to serve as beneficiary or mortgagee in the land records, while the electronic registry was designed to track the transfer of beneficial ownership interests in and servicing rights to mortgage loans.

Where things stand

As the summer approaches, the housing finance industry is anticipating significant changes in housing policy designed to mend the loose practices that steered Fannie Mae and Freddie Mac into conservatorship. As the administration and Congress attempt to wind down the mortgage giants and attract private capital back into the markets, the inventory of homes for sale and pending shadow real estate–owned (REO) inventory continues to remain at record levels. In fact, the backlog of delayed foreclosures positions the economy to face a new record volume of foreclosures in 2011.

It was the spike in foreclosure activity in 2009 and 2010 that revealed false affidavits and other improper paperwork tied to foreclosures.

Some were carried out by "robo-signers." Others were executed with improper documentation. A few had even been carried out on the wrong house altogether. The discovery became the catalyst for a national foreclosure processing crisis that prompted several large servicers to temporarily suspend their foreclosure proceedings.

On some of those properties foreclosed with improper or incomplete paperwork, MERS was listed as the mortgagee or beneficiary of record. As a theretofore relatively unfamiliar entity, with the power to foreclose, the mortgage lien holder (MERS) unwittingly fanned the fires of the foreclosure crisis. Though numerous court rulings have since vindicated MERS, recognizing its authority to foreclose, many parties remain unconvinced.

During a self-imposed foreclosure moratorium, servicers revisited their loss-mitigation procedures and default-management practices. After conceding the challenges, many servicing institutions announced that additional remedies had been implemented to ensure that borrowers in default are evaluated for all available loss-mitigation options.

Further, servicers pledged that in the event of a foreclosure, their internal reviews had resulted in new operational procedures that would be meticulously followed in the future. But the consternation and uproar caused by the so-called Foreclosure-Gate has not yet fully settled.

That's not to say MERS has not been without some serious setbacks. On April 13, the results of an interagency horizontal examination conducted by federal regulators were released to the public. The report revealed a concerted effort by the Federal Reserve System, the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC) and the Office of Thrift Supervision (OTS) to review the safety and soundness of mortgage servicing and foreclosure processes at 14 major mortgage servicers as well as a number of third-party vendors that provide significant services to lenders and servicers—including MERSCORP and MERS. The review has resulted in a formal consent order against the two entities.

This article reviews the establishment of MERS, documents its founding premise, explores how it has been used since 1995, evaluates its real impact on the foreclosure crisis, considers the impact of the consent order and shares a perspective on MERS' continued role in the future. The hope is that by providing this account the record will be set straight.

Background

Originally conceived in the late 1980s, the concept for an electronic clearinghouse of critical mortgage information was explained in an October 1993 white paper entitled the *Whole Loan Book Entry [WLBE] Concept for the Mortgage Finance Industry*. The idea was developed by the InterAgency Technology Task Force (IAT), a group composed of prominent industry leaders—the Mortgage Bankers Association (MBA), Fannie Mae, Freddie Mac, Ginnie Mae and servicing executives.

Their vision was simple—use modem-based electronic data interchange (EDI) to allow mortgage loan sellers, warehouse lenders, mortgage loan investors and servicers to "obtain, transfer and track interests in mortgages, essentially on a real-time basis," regardless of any internal proprietary systems that supported their business operations.

All three legs of the tri-party stool contribute to the accuracy and maintenance of the registry in addition to serving as checkpoints.

Up until then, liens were tracked by local land records offices, with varying and often antiquated systems. Though seldom recognized, the purpose of the land records was not to track mortgage ownership rights, but to provide public notice of liens to protect the lien holder.

While other aspects of the mortgage lending supply chain were being digitized, including the 1990s development of automated underwriting systems (AUS) and loan origination systems (LOS), the recordation of the mortgagee or agent for the mortgagee in local land records remained a manual process.

Well-intentioned staff at bustling offices struggled to manage the congestion caused by the growing volume of mortgage loans. Missing and erroneous assignments caused gaps in the chain of title, threatening the integrity of the lending process. The late 20th-century prevalence of secondary market transactions and advancement of management information systems pushed the industry to pursue a more efficient solution.

Process

Traditionally, the borrower executes two essential documents at closing. These two documents make up the mortgage loan. Although the legal distinction between them is fundamental, it is often overlooked in common parlance. The first document is the promissory note, which signifies the borrower's promise to repay the loan over a period of time under stated terms. Notes can technically exist without collateral, so the second document, the mortgage, secures the promissory note by placing a lien on the real property as security for the loan's repayment.

The note is typically endorsed "in blank" and delivered from the lender to the mortgage loan aggregator and/or securitization trust. The note is intended to be a fluid, negotiable instrument in trade where possession is sufficient to confer the right to enforce ownership interest.

The mortgage follows the note. That is to say that a transfer in the ownership of the promissory note also transfers with it the underlying secured obligation to pay.

Traditionally, when a loan was sold to another lender—for example, an aggregator—the mortgage was "assigned" to the purchaser and recorded in the purchaser's name. However, if the servicing remained with the seller, as was often the case, the mortgage usually continued to be recorded under the servicer's name.

The seller would then prepare a "recordable assignment in blank" and deliver it to the trust. Where MERS is the mortgagee of record, subsequent assignments of the mortgage no longer need to be recorded at the local recorders' offices because MERS holds the mortgage in trust on behalf of its member, who owns the note.

The land records have never been an authoritative source for who owns beneficial interests and servicing rights to mortgages. The assignment, which is usually recorded to protect the lien holder, is generally not required by the county, and has nothing to do with the sale of servicing rights. If the servicing rights changed hands, then the county land records were updated *if* the new servicer desired to receive service of process in order to fully perform under its servicing agreement with the investor. The advent of MERS enhanced this last step.

A predecessor to the current configuration of MERS and MERSCORP was officially created in 1995 as an industrywide utility to hold mortgage liens in an agency capacity on behalf of participants in the mortgage banking industry, and to track the changes in the ownership and servicing of any registered loan.

At closing, the lender and borrower make MERS the mortgagee of record, and all subsequent changes in the mortgage loan ownership and servicing rights of the loan are updated in the database provided the loan continues to be registered in the MERS System. Moreover, MERS was established as a part of a tri-party organization managed by the limited staff of MERSCORP, the lender participant and the founding agencies. Accordingly, all three legs of the tri-party stool contribute to the accuracy and maintenance of the registry in addition to serving as checkpoints.

The efficiencies realized by the registry provided incremental value to lenders that sold loans into the secondary market. Mortgage banking was a process that frequently required several assignments, and even before MERS, there was already an active attempt to minimize assignment costs and third-party fees. Lenders had already begun preparing mortgage assignments in blank to enable fluid transmissions, and attempted to immobilize mortgage notes at the original clearinghouse member custodian to avoid future file movement and recertification. These practices merely continued with the introduction of MERS.

'Vault' idea

Because the original WLBE system was closely modeled after the electronic stock and bond registration model implemented by the Depository Trust Company (DTC) a couple of decades earlier, some industry participants in the early 1990s suggested that loan documents, like physical stock and bond certificates, should also be stored in a vault. The idea of a central vault was one of many ideas circulated as the clearinghouse was being brainstormed, although it never became an official feature of the clearinghouse upon its official conception.

The vault idea was forgone presumably because loan document immobilization was already taking place. The Depository Trust and Clearing Corporation's (DTCC's) depository vaults, for instance, immobilized stock and bond certificates. As a result of electronic registrations and transfers, futures, options and bonds are now issued electronically.

But the vault idea did not totally disappear—the mortgage industry continued to pursue the vault concept with the advent of the electronic mortgage (eMortgage). Prior to conservatorship, both Fannie Mae and Freddie Mac pursued initiatives for the electronic storage of eMortgages originated and closed by their approved seller/servicers and signed electronically.

Legal structure

MERS was designed to operate in accordance with existing real property law and the Uniform Commercial Code (UCC). MERS acts as mortgagee in the land records in a nominee (agent) capacity for the originating lender and the lender's successors and assigns.

The MERS System exists so MERSCORP knows who to send the service of process to because, under the MERS process, the current servicer continues to handle the day-to-day servicing responsibilities as it did prior to the advent of MERS.

When the underlying mortgage loan indebtedness (in the form of the promissory note) was sold from one lender to the next, the purchasing lender's interest would continue to be secured because MERS held legal record title for the benefit of the lender. MERS' role as agent for the promissory note owner in the land records is supported by both agency and contract law.

As mentioned earlier, it is not generally necessary to record an assignment to demonstrate mortgage loan ownership or convey a security interest. The benefit of recordation is to ensure that interested parties are apprised of existing liens or other legal encumbrances. Assignments are recorded so that subsequent servicers receive service of process for legal actions affecting the property that is encumbered by the lien.

Because mortgagee-of-record status renders MERS responsible to different parties in the mortgage loan ownership chain, contract agreements are prudently crafted between MERS, MERSCORP and third parties to establish loan ownership and security interests that retain the integrity of the original documents and have legal force.

Legal challenges and victories

Up until the nation's foreclosure crisis emerged, MERS remained largely absent from the public eye. However, with the dawning of the Foreclosure-Gate crisis, the business model of MERS came under scrutiny.

The defects in servicer foreclosure procedures were admittedly serious, and included the robo-signing of affidavits and improper notarization, but investigations did not demonstrate that the vast majority of these foreclosures were otherwise invalid. Nevertheless, the legal right of MERS to commence foreclosure action came under fire in numerous states, where plaintiffs filed suits questioning MERS' authority to foreclose as an entity that was not the actual owner of the loan.

In October 2010, Washington, D.C. Attorney General Peter Nickles issued an enforcement statement declaring foreclosures may not be initiated against a District of Columbia homeowner unless the security interest of the current noteholder is also reflected in the local recorder's office.

As a relatively unknown entity with the power to foreclose, MERS and the MERS System became the focus of intense scrutiny. However, the past couple of years have unleashed a flood of cases in judicial and non-judicial foreclosure states that were adjudicated in MERS' favor.

- *Utah:* Two March 2011 rulings *(Wade v. Meridias Capital Inc., MERS et al;* and *Wareing v. Meridias Capital)* in Utah, a non-judicial foreclosure state, have affirmed MERS' ability to act as the beneficiary of the deed of trust and nominee of the lender and its successors and assigns. The judges confirmed that this authority is conferred when a borrower signs a deed of trust on which MERS is expressly appointed the beneficiary. As such, mortgage assignments by MERS are valid and its execution of foreclosure is legal. These two cases were a small number of the many court decisions and orders in Utah that have upheld MERS' ability to be the beneficiary on a deed of trust and which dismissed challenges to MERS' authority to foreclose or assign.
- *Wyoming:* A similar memorandum *(In re Martinez)* followed in March 2011 in Wyoming, where the authority of MERS relative to assigning a mortgage had likewise been contested. The argument failed because the borrower signed a mortgage at closing expressly authorizing MERS "to take any action required of the lender."
- *California:* Also in March 2011, a plaintiff filed a claim under the California False Claims Act (CFCA), asserting MERS has made false representations in order to circumvent payment of recording fees required to reflect security interests in real property. The suit *(Bates v. MERS)* was dismissed by the District Court for the Eastern District of California, which determined it was without jurisdiction over the plaintiff's action because the plaintiff was not an original source of the information as required under the CFCA.

Further rulings recognizing MERS as the beneficiary of the mortgage or deed of trust, similar to those found in Utah and Wyoming, have also been made in Oregon, New York, Massachusetts, Georgia, New Hampshire, California, Alabama, Nevada, Virginia, Rhode Island, Michigan and Kansas this year. As the mortgagee of record and holder of the original note endorsed in blank, the cases support MERS' legal standing to initiate foreclosure proceedings.

Laurence E. Platt, a partner with K&L Gates LLP in Washington, D.C. with expertise in real estate finance who has worked on MERS issues over the years, acknowledges the significance of the rulings: "With favorable decisions in multiple states, it is clear that the basis for which MERS was founded is valid, and that MERS has the affirmation of the overwhelming majority of courts to act as the lender's nominee as provided in the mortgage documents," he says.

"MERS was created to enable efficiencies in a paper-based business. MERS continues to achieve its objectives, and if an entity like MERS did not exist today, it would have to be created to enable the efficient operation of the capital markets," Platt says.

Although recent litigation has upheld the permissibility of MERS to commence foreclosure action, the practice is slated to come to an end where it has not already ended.

Corporate governance challenges

While MERS' legal standing has been vindicated by state and district courts, its corporate governance structure recently came under the review of federal regulators. The *Interagency Review of Foreclosure Policies and Practices* and consent order for MERS were posted to the Federal Reserve Board's website on April 13.

In testimony before the Senate Committee on Banking, Housing and Urban Affairs on Feb. 17, 2011, Acting Comptroller of the Currency John Walsh explained to the Congress that an interagency examination of MERS' operations, procedures and controls had been under way.

The recent consent order between MERS and federal regulators follows several organizational changes already taking place within MERSCORP. On Jan. 22, 2011, R.K. Arnold, president and chief executive officer of MERS and MERSCORP, resigned. MERSCORP issued a statement on its website acknowledging the resignation and announcing an interim replacement. "MERSCORP Inc. . . . today announced the retirement of President and [Chief Executive Officer] R.K. Arnold. Arnold joined the company at its inception and has been instrumental in the development of the MERS System, a registry of ownership and other mortgage rights for more than half of all outstanding residential mortgages in the United States. . . . Arnold is succeeded on an interim basis by financial services industry veteran Paul Bognanno," the company announced. An announcement on a permanent successor has yet to be made.

While Walsh made general remarks on the review of MERS and MERSCORP in his testimony, he did not mention Arnold's resignation: "[T]he agencies [OCC, the Federal Reserve Board (FRB), FDIC, OTS] conducted interagency examinations of MERSCORP and its wholly owned subsidiary, Mortgage Electronic Registration Systems Inc. . . . which provide[s] significant services to support mortgage servicing and foreclosure processing across the industry. The primary objective of the examinations was to evaluate the adequacy of controls and governance over bank foreclosure processes, including compliance with applicable federal and state law. Examiners also . . . assessed foreclosure operating procedures and controls, interviewed bank staff involved in the preparation of foreclosure documents, and reviewed approximately 2,800 borrower foreclosure cases in various stages of foreclosure. Examiners focused on foreclosure policies and procedures, organizational structure and staffing, vendor management including use of third parties, including foreclosure attorneys, quality control and audits, accuracy and appropriateness of foreclosure filings, and loan document control, endorsement and assignment."

Many of the lapses in safety and soundness cited in the final interagency review were ascribed to servicer performance in the oversight and quality control of MERS. But the agencies also identified non-servicer-related deficiencies that presented "financial, operational, compliance, legal and reputational risks to MERSCORP and MERS, and to the participating members." When the consent order was issued, it was publicly announced that MERSCORP and MERS had already begun implementing remedial procedures.

Moving forward, MERSCORP and MERS have committed to the following actions:

- Forming a compliance committee to monitor compliance with the terms of the consent order;
- Formulating an action plan with a complete description of the actions necessary to comply with the order;
- Engaging an independent third party to assess board, management, officer and staffing needs in order to operate safely and soundly;
- Formulating a communications plan with members to establish a standard protocol for dealing with significant legal matters;
- Formulating a governance plan to strengthen processes as they relate to authorizing MERS certifying officers; and
- Obtaining an independent third party to review the effective operations of the eRegistry system of recording electronic notes.

Financial sanctions against MERSCORP and MERS were not imposed by regulators in the consent order.

MERS: 'No more foreclosures in the MERS name'

Before the consent order was issued, a number of policy changes were announced by MERSCORP. The most notable was published in Policy Bulletin 2011-2 on March 8, 2011, announcing the revocation of member authority to commence foreclosures in the MERS name.

According to the Policy Bulletin, the policy would become effective Aug. 1, 2011, upon approval by the board of directors of MERS and MERSCORP: "The authority to conduct foreclosures in the name of MERS granted to a member's certifying officers under the member's MERS Corporate Resolution is revoked. Effective Aug. 1, 2011, the member shall be sanctioned $10,000.00 per violation for commencing a foreclosure in the name of MERS. The member will automatically be in violation of this rule and subject to the enforcement of the fine when the first legal action is taken in MERS name."

Although recent litigation has upheld the permissibility of MERS to commence foreclosure action, the practice is slated to come to an end where it has not already ended. (Where the practice ends depends on servicer policy and/or whether the securities are Fannie and Freddie securitizations, not on market/jurisdiction.)

Tri-party management allows swift policy change

Concurrent with discussions over Policy Bulletin 2011-2, several major servicers, including Charlotte, North Carolina–based Bank of America, New York–based JPMorgan Chase and San Francisco–based Wells Fargo & Co. implemented internal policy changes requiring the de-registration of loans that were in the MERS name before initiating foreclosure. The purpose of the change was to provide clarity to the defaulted mortgagor and minimize legal and compliance risk to the servicer.

Furthermore, any Fannie Mae and Freddie Mac servicers that did not implement the policy on their own are now required to do so. That change was implemented via the following policy directives:

- *Freddie Mac Bulletin 2011-5, March 23, 2011:* Eliminated the option of Freddie Mac servicers to foreclose in the MERS name. Going forward, the securitization must be assigned from MERS back to the servicer by means of recordation where required by law.
- *Fannie Mae Announcement 2010-05, March 30, 2010:* MERS may not be named as the plaintiff of any mortgage loan owned or securitized by Fannie Mae. The servicer must prepare an assignment via recordation to transfer the security interest from MERS to the servicer. Effective May 1, 2010.

The politics of MERS in the housing crisis

Even as MERS turns the tide by prevailing in state courthouses around the country, the challenges the mortgage industry faces post-boom as a result of the widespread destruction of home values remains a political nightmare.

In addition to the agency consent order, a 50-state attorneys general (AG) task force contends it is negotiating a 27-point draft servicer settlement (or term sheet) with a handful of megaservicers. Conspicuously present in that draft agreement is language stating that the subject of MERS is held for separate review. It appears that the agency consent order has addressed the AG task force reference to MERS and its organizational structure.

The mention of MERS in the AG draft agreement signifies that its utilization may become a matter that is settled between servicers and regulators, rather than litigated or legislated. In light of this possibility, in my view, the probability that MERS will end up a political casualty may be lowered.

The ongoing need for an electronic registry

By serving as the mortgagee in the county land records on behalf of its members, MERS has become a critical component of housing finance. Since its inception, MERS has enabled fluent commerce in the housing finance markets, much like the advent of electronic registration in lieu of stock certificates enabled fluent commerce in an age of trading stocks online.

The soundness of a borrower's property rights is far from compromised by the frugality of paperless business; instead, it is improved, as the enormous volume of mortgages issued and transferred could not be sustained by congesting the land records with reassignments.

In fact, the services of MERSCORP have not been exploited to their full, value-adding potential. If the traditional, paper-based format of the promissory note and the mortgage document were produced electronically (versus manually) at closing and registered within a single system like MERSCORP's MERS eRegistry, it would be virtually impossible to create duplicate notes.

The incidence of fraud would be reduced by the instant visibility conferred by a system like the MERS eRegistry. The legal underpinnings necessary to realize such a system have been in place since 2000, when the Clinton administration passed the Electronic Signatures in Global and National Commerce Act (E-SIGN), recognizing the equivalence of authenticity and enforceability between electronic and paper signatures.

In addition to federal law, 47 states and the District of Columbia have enacted Uniform Electronic Transactions Act (UETA) laws in their own statutes, acknowledging the validity of electronic signatures. The three remaining states—Illinois, New York and Washington—have adopted separate laws recognizing the validity of digital signatures as well.

Chris Christensen, an attorney with PeirsonPatterson LLP law firm in Dallas, has closely followed the foreclosure crisis. Christensen says, "The MERS® eRegistry is the key to solving the lost document problem. As a critical piece of eCommerce infrastructure, the eRegistry is also key to solving the industry's data problem. These two problems have largely contributed to the housing crisis. The good news is that they are not permanent problems if the industry acts now to implement the appropriate solutions. The MERS eRegistry is part of the solution and not the problem."

Christensen adds, "Had the industry focused on understanding the MERS value proposition with its electronic registry, we could have avoided the lost-document and data-based issues at the heart of the foreclosure crisis. But hindsight is always 20/20." **MB**

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Please note the following:

- [x] Some pages in this article were advertisements or were blank and therefore have not been included.
Pages: 37

- [ ] This is the best copy available.

- [ ] The article has a very tight binding.

- [ ] The article provided has a citation slightly different from the original request.

- [ ] There was no color in this article.

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APPENDIX A.3

Practising Law Institute
Friedman on Contracts and Conveyances of Real Property

Milton R. Friedman

Current through Release 11, May 2011

Chapter 6: Assignments of Contracts of Sale
§ 6:1 Buyers' Assignments

***6-10** § 6:1.5 Nominees

As heretofore mentioned, it is familiar practice in real estate transactions to use a nominee (sometimes called a "dummy," "straw," or "straw man") as the buyer instead of the real party in interest. [FN43] ***6-11** Purposes for using a nominee, many of which are legitimate, include: to sign a contract of sale; to take title to the property; to execute mortgage instruments; to avoid claims of creditors; to avoid publicity, particularly in assembling adjoining properties; to facilitate a resale where the owner is married or the property is in multiple ownership; to place property in the hands of a qualified manager; and to give security to one advancing money for the purchase. [FN44] When a corporation is arranging to buy land and will be the beneficial owner, placing title in a nominee avoids questions of power, resolutions, compliance with laws, and receipts for corporate taxes. Where the owner is under a legal disability (a minor, alien, trustee, church corporation, unlicensed foreign corporation) these facts can be kept off the record.

There is nothing fraudulent in using a nominee for the purchase of real estate if no misrepresentations are made. [FN45] Nor is it material that the nominee conceals the fact that he is acting for another. [FN46] But if the ***6-12** nominee misrepresents the identity of his principal, with knowledge that the seller would not negotiate if he were in possession of the facts, the seller may, on learning the facts, refuse to convey or rescind a conveyance. [FN47] And a seller may refuse to convey on discovering the real party in interest is the seller's broker and the party named in the contract is merely his nominee. [FN48] Proof of any such situation may be very difficult to establish. [FN49] A right of rescission that might be available in the circumstances may be lost by laches. [FN50]

These rules mean that the seller cannot assume that he is dealing with, and contracting with, the actual buyer. If the seller cares about the true identity of the buyer, the seller must bargain for express representations in the contract, and restrict assignments of the contract. But even with these measures, there is nothing legally or practically that the seller can do to prevent a post-closing conveyance by the buyer to another person. If the seller's main concern is not the actual identity of the buyer, but rather the possibility that the property ***6-13** may be put to some undesired use, the seller's remedy is to impose a restrictive covenant. [FN51]

Use of a nominee does not normally alter the rights of third parties under preexisting contracts. A broker normally earns her commission if she introduces the principal to the seller, notwithstanding the fact that the principal thereafter selects a nominee to enter into the contract with the seller. [FN52]

Where a purchaser under a contract of sale is a nonexistent corporation, the seller may withdraw its acceptance prior to the purchaser's incorporation. [FN53]

A nominee who has executed a contract of sale as purchaser may enforce the contract in his own name in a suit for specific performance and may maintain an action for recovery of the down payment in case of defective title or, presumably, for damages. [FN54] But there is no legal impediment to the nominee's assigning his rights under the contract of sale to his principal.

If the contract of sale is under seal and is executed by a nominee as purchaser, the principal is not liable wherever the common-law rule obtains, that is, that a principal who is not mentioned in an instrument made by his agent under seal is not liable thereunder. [FN55] Accordingly, in these circumstances the principal is not liable to the seller in an action for the purchase price or for specific performance. [FN56] In these cases the seller's real protection is in obtaining a down payment large enough to protect him against a default on the buyer's part.

Whenever a purchase involves mortgage financing, use of a nominee complicates the deal. One consideration is personal liability on ***6-14** mortgage debt. The real buyers may seek to avoid personal liability on existing or new mortgage obligations. With respect to an existing mortgage, there may be a need for the buyer to assume the mortgage, rather than take subject to the mortgage debt. If so, an individual or corporate nominee takes title at the closing and assumes the debt. With respect to a new purchase money mortgage, the nominee takes title and executes the mortgage instruments. In either case, the nominee will promptly convey to the real parties in interest, subject to the mortgage. In this connection, it is important that: (1) the nominee be solvent and free of judgments [FN57] (in those states in which judgments are liens upon realty), so that the title will not be adversely affected by the momentary ownership of the nominee; and (2) the contract permit such a transaction.

Today nominees are not frequently used for the purpose of avoiding personal liability on assumed or new mortgages. In the past the practice was common, but it is seldom needed due to the widespread use of nonrecourse mortgages and comparable instruments in commercial financing transactions since the 1960s. Moreover, when mortgagees require personal liability, the mortgage usually contains a "due on sale" clauses, which the mortgagee will use to prevent a conveyance from a nominee to the true owners.

When a nominee is used, the insulation of the principal from liability on the mortgage debt is based, in part, on the rule of law that a conveyance subject to a mortgage (as distinguished from an assumption thereof) imposes no personal liability, under the mortgage or the debt thereby secured, on the grantee. It is also based on two rules relating to instruments executed by an agent (the nominee in this situation) and to which the principal is not a party. [FN58] The principal is not liable, as indicated above, if the instrument is under seal, nor if the instrument is negotiable. [FN59] The use of nominees for ***6-15** this purpose is recognized as legitimate unless the mortgagee has been led to believe the real party in interest is personally liable. [FN60] And an owner, who conveys to or shunts title through a nominee, in order to have the latter execute the mortgage instrument, is not liable on the mortgage debt or for a deficiency judgment. [FN61] Nor may the mortgagee, in most cases, succeed in reaching the principal, on the theory of being subrogated to the claim of an agent (the nominee) against his principal for exoneration from liability or reimbursement for his loss, it being understood that

> [a] "straw" is a conduit, usually an impecunious person who cannot respond in damages to anyone and who ordinarily, for this reason, does not expect to be indemnified in the event he suffers a loss. Nor usually does a person who uses a straw in this type of transaction expect in any way to be liable. . . . This is usually understood by all the parties concerned. [FN62]

The nominee is almost invariably irresponsible financially. One of the few cases allowing subrogation against the principal is based largely on the fact that the nominee was a person with substantial income. The court refused to believe the parties intended this nominee to assume a liability of over $100,000 in return for a $25 fee. [FN63] And in a Pennsylvania case a nominee, who defied precedent by subsequently acquiring means and paid a deficiency judgment recovered against him, recovered judgment against the principal for reimbursement. [FN64]

***6-16** In most cases title is placed in the name of the nominee just long enough for signing purposes and then reconveyed the same day. [FN65] In several cases, however, title to groups of property was left in the name of the nominee, who had signed mortgages on these properties. In one such case the nominee, when faced with a deficiency judgment, conveyed twenty-six parcels of real estate, in which she had no beneficial interest, to her principal. An effort to set aside this conveyance as fraudulent was defeated on the ground that the knowledge of the purpose and position of the nominee in the circumstances negated the existence of any fraud. [FN66] But in two New York cases, which were virtually identical except that corporate nominees were involved, the reconveyances to the principal were held fraudulent. [FN67] With the advantages of hindsight, there seems little to commend any practice of permitting a nominee who is liable on mortgage debts to retain title to parcels of real estate.

Changes in the effect of a sealed instrument prompt a reexamination of the use of such instruments in connection with nominee transactions, insofar as their purpose is to insulate the principal from liability. By statute in New York the presence of a seal has lost all legal effect upon the instrument. [FN68] About half the states now have statutes purporting to abolish private seals and making them inoperative when used. [FN69] In other jurisdictions courts have diminished the effect of the seal. [FN70] Where this is true, a nominee's execution of a ***6-17** sealed instrument no longer insulates the principal. [FN71] Even execution of a negotiable mortgage note may be ineffective for this purpose if the accompanying mortgage executed by the nominee contains a covenant to pay the mortgage debt, because this covenant makes the mortgage a bond as well as a mortgage. As a result of these changes in the effect of sealed instruments, cautious principals often seek to include in all instruments executed by nominees--contracts of sale and mortgage notes and bonds, for instance--a statement to the effect that the mortgagee or other creditor recognizes the other party to the instrument as a principal and will not look to the liability of any third person. It is also necessary to obtain a general release, from the nominee to the principal, in order to cut off any claim of the nominee for reimbursement and to cut off, as well, any right of subrogation in or through the nominee.

[FN43]. "The use of a nominee in real estate transactions, and as mortgagee in a recorded mortgage, has long been sanctioned as a legitimate practice [and] is likewise legitimate under the Uniform Commercial Code." *In re* Cushman Bakery, 526 F.2d 23, 30 (1st Cir. 1975), *cert. denied*, 425 U.S. 937 (1976).

[FN44]. *See* 5 A. Scott, Trusts § 440 (4d ed. 1989). Gill, *Straw Man in Missouri*, 14 Mo. B.J. 98 (1943), adds more reasons, including:• to keep information from creditors and tax collectors;• to convey real property at a time of appeal from judgments;• to have warranties given by straw man (provided, of course, the purchaser does not question the solvency of the warrantor);• to make transfers without the knowledge or consent of existing or former wives, thereby avoiding claims of dower or homestead;• to avoid fines for failure to comply with tenement house laws, etc.;• to avoid personal liability on mortgage obligations;• to divide income or profits to lower tax brackets;• to avoid the liens of mortgages with after-acquired mortgage clauses;• to deal with property as if the owner were a broker, and thereby earn a commission which would be unavailable to a principal, or as an agent, and refer all offers to his "principal," to negotiate; higher rent or purchase price;• to carry multiple properties in different names so that a judgment against one will not affect the others;• to use a nominee as the equivalent of an attorney-in-fact when the principal is out of the country;• to handle property with multiple ownership, with respect to interparty transactions or sales and mortgages with greater ease than if all the interests appeared of record;• to avoid administration proceedings in probate courts;• to permit an administrator, executor, guardian, or donee of a power to buy in on his own sale, attempting thus to avoid all attack on the sale;• to avoid the appearance of usury by having a mortgagee purchase the mortgage from a straw lender;• to purchase at a judicial sale, on behalf of a co-tenant in an effort to cut out another co-tenant or to cut out a life tenant.

[FN45]. Benton v. Alcazar Hotel Co., 180 S.W.2d 33 (Mo. 1944).

[FN46]. Roy Annett, Inc. v. Kerezsy, 57 N.W.2d 483 (Mich. 1953); Hirsch v. Silberstein, 227 A.2d 638 (Pa. 1967). *Cf.* Cole v. Hunter Tract Improvement Co., 112 P. 368 (Wash. 1910).

[FN47]. Brett v. Cooney, 53 A. 729 (Conn. 1902); Wloczewski v. Kozlowski, 70 N.E.2d 560 (Ill. 1946), noted in 32 IOWA L. REV. 790 (1947) (overruled in Gould v. Stelter, 152 N.E.2d 869 (Ill. 1958), insofar as *Wloczewski* was based on a supposed want of mutuality, but not with respect to point cited in text); Gray v. Baker, 485 So. 2d 306 (Miss. 1986) (for any reason other than one legally impermissible); Siess v. Anderson, 139 S.W. 1178 (Mo. Ct. App. 1911); *see generally* Walker v. Galt, 171 F.2d 613 (5th Cir. 1948) (rescinding completed conveyance, subject to grantor's payment for improvements made by grantee, measured by the property's increased value to grantor attributable to the improvements; White Tower Mgmt. Corp. v. Taglino, 19 N.E.2d 700 (Mass. 1939) (denying specific performance). Restatement (Second) of Agency § 304 (1958). *But see* Hirsch v. Silberstein, 227 A.2d 638 (Pa. 1967).

[FN48]. Larner-Diener Realty Co. v. Fredman, 266 S.W.2d 689 (Mo. 1954) (despite agreement that seller not liable for brokerage, and purchase price to be net); Carluccio v. 607 Hudson St. Holding Co., 57 A.2d 452 (N.J. 1948) (contract fraudulently obtained when broker presented seller with contract from "straw persons," who assigned to broker's colleague prior to closing; broker misrepresented address of straws and concealed assignment until eve of closing). *Cf.* Huber v. Gershman, 286 S.W.2d 558 (Mo. Ct. App. 1955). But where a contract of sale made the purchaser's obligation to buy parcel *A* conditional upon the broker's selling purchaser's property, parcel *B*, within thirty days for $10,500 net, purchaser could not validly object to the broker's purchase of parcel *B* on the terms specified. Surratt v. Cohn, 134 A.2d 643 (D.C. 1957) (purchase liable on note given as down payment on parcel *A*).

[FN49]. *Compare* Major v. Christian County Livestock Mkt., 300 S.W.2d 246 (Ky. 1957), where purchaser represented his purpose was to erect a home despite a resale within a month to a corporation of which he was an officer and stockholder for a livestock market, rescission was denied on ground of an honest change of mind.

[FN50]. Keyerleber v. Euclid Congregation of Jehovah's Witnesses, 103 Ohio App. 423, 143 N.E.2d 313 (1957).

[FN51]. *See supra* section 5:2. Annot., *Purchaser's Misrepresentations as to Intended Use of Real Property as Ground for Seller's Equitable Relief from Contract and Deed*, 35 A.L.R.3d 1369 (1971).

[FN52]. Helmsley-Spear, Inc. v. New York, 687 N.Y.S.2d 353 (App. Div. 1st Dep't 1999) (buyer selected different nominee than the one originally anticipated; seller owes commission).

[FN53]. Macy Corp. v. Ramey, 144 N.E.2d 698 (Ohio 1957).

[FN54]. Gould v. Stelter, 152 N.E.2d 869 (Ill. 1958); Roy Annett, Inc. v. Kerezsy, 57 N.W.2d 483 (Mich. 1953); Toll v. Pioneer Sample Book Co., 94 A.2d 764 (Pa. 1953). *But see* Houtz v. Hellman, 128 S.W. 1001 (Mo. 1910), where the plaintiff-nominee sought specific performance of a contract of sale he had never signed. The principal or a third person had signed the nominee's name. Recovery was denied on the ground the defendant was entitled to have plaintiff bound at the outset and not merely vested with an option.

[FN55]. Toll v. Pioneer Sample Book Co., 94 A.2d 764 (Pa. 1953).

[FN56]. *In re* Childs Co., 163 F.2d 379 (2d Cir. 1947); Shawsheen Manor Corp. v. Colantino, 110 N.E.2d 380 (Mass. 1953); Crowley v. Lewis, 146 N.E. 374 (N.Y. 1925); Briggs v. Partridge, 64 N.Y. 357 (1876); Toll v. Pioneer Sample Book Co., 94 A.2d 764 (Pa. 1953).

[FN57]. But in United Loan & Inv. Co. v. Nunez, 282 S.W.2d 595 (Ark. 1955), where husband and wife, owners of realty as tenants by the entirety, conveyed to a straw for immediate conveyance to the wife, a judgment against the straw was held without effect on the property. This was on the ground that the judgment attached only to the straw's interest, which was at all times subject to an obligation to reconvey.

[FN58]. *See generally supra* § 6:1.2.

[FN59]. N.Y. Life Ins. Co. v. Martindale, 88 P. 559 (Kan. 1907); *see* Naas v. Peters, 58 N.E.2d 530 (Ill. 1944); Cent. Trust Co. v. Rudnick, 37 N.E.2d 469 (Mass. 1941); Mfrs. & Traders Bank v. Love, 43 N.Y.S. 812 (App. Div. 4th Dep't 1897). The principal may, however, be subject to a quasi-contractual liability where he has received the benefit of the contract. 2 F. Mechem, Agency § 1736 (2d ed. 1914). The most recent version of the U.C.C. rejects the traditional rule that an undisclosed principal is not liable on a negotiable instrument. U.C.C. § 3-402(a) (2005 revision).

[FN60]. Greenwald v. Marcus, 123 N.E.2d 139 (Ill. 1954); Cent. Trust Co. v. Rudnick, 37 N.E.2d 469 (Mass. 1941); Nat'l Ref. Co. v. Cont'l Dev. Corp., 189 S.W.2d 551 (Mo. 1945); *accord In re* Sickle, 138 A.2d 813 (D.C. 1958); Riskin v. Green, 138 A.2d 813 (D.C. 1958); *In re* Childs Co., 163 F.2d 379, 382 (2d Cir. 1947).

[FN61]. Underwood v. Patrick, 94 F. 468 (8th Cir. 1899); Barkhausen v. Cont'l Ill. Nat'l Bank & Trust Co., 120 N.E.2d 649 (Ill.), *cert. denied*, 348 U.S. 897 (1954); State *ex rel.* Mesker v. Reynolds, 245 S.W. 1065 (Mo.

1922).

[FN62]. *In re* Sickle, 138 A.2d 813, 814 (D.C. 1958); *accord* Deitrick v. Ulin, 33 F. Supp. 1001, 1004 (D. Mass. 1940); Riskin v. Green, 138 A.2d 813 (D.C. 1958); Cent. Trust Co. v. Rudnick, 37 N.E.2d 469 (Mass. 1941).

[FN63]. Halsey v. Brown, 177 Misc. 415 (N.Y. County Ct. 1941).

[FN64]. Aronson v. Heymann, 56 Pa. Super. 501 (1914). The opinion cites the Pennsylvania rule, followed in a minority of the states, that whereas a conveyance subject to a mortgage does not make the grantee personally liable to the mortgagee on the mortgage debt, it makes the grantee an indemnitor of the mortgagor against liability. But it will be noted that Halsey v. Brown, 177 Misc. 415 (N.Y. County Ct. 1941), reaches substantially the same result in New York, which follows the majority rule, to the effect that a conveyance subject to a mortgage imposes no liability, either direct or indirect, on the grantee.

[FN65]. A Pennsylvania statute makes the lien of corporate taxes of a corporate owner paramount to a mortgage on the corporation's property, unless the mortgage was created by a predecessor in title to the corporation. 72 Pa. Cons. Stat. § 1401. It was held that a nominee to whom the premises had been conveyed to make a mortgage, and who promptly reconveyed, was such predecessor and that a purchaser at foreclosure took free of a corporate tax levied after there conveyance. Commonwealth v. Hoffman-Henon Co., 114 A.2d 92 (Pa. 1955).

[FN66]. Nat'l Ref. Co. v. Cont'l Dev. Corp., 189 S.W.2d 551 (Mo. 1945).

[FN67]. Natelson v. A.B.L. Holding Co., 183 N.E. 373 (N.Y. 1932); Fraw Realty Co. v. Natanson, 185 N.E. 679 (N.Y. 1933). *Cf.* Hegstad v. Wysieki, 165 N.Y.S. 898 (App. Div. 2d Dep't 1917).

[FN68]. N.Y. Gen. Constr. Law § 44-a ("Except as otherwise expressly provided by statute, the presence or absence of a seal upon a written instrument executed after [Aug. 31, 1941] shall be without legal effect.").

[FN69]. The statutes are collected in 1A A. Corbin, Contracts § 254 (1963); 1 S. Williston, Contracts § 219A (3d ed. 1957); *see* Md. Code Ann., Real Prop. § 4-101B (1990).

[FN70]. Massachusetts discarded the common-law sealed doctrine with respect to instruments executed on behalf of an undisclosed principal in Nalbandian v. Hanson Rest. & Lounge, Inc., 338 N.E.2d 335 (Mass. 1975) (buyer's action for specific performance against corporation that was undisclosed principal; named seller was individual who was president of corporation).

[FN71]. Pittsburgh Terminal Coal Corp. v. Williams, 70 F.2d 65 (3d Cir. 1934).

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APPENDIX A.4

A Century's Milestones in Residential Lending

As we usher in the year 2000, the U.S. mortgage industry can claim an impressive array of accomplishments. Today, outstanding mortgage debt totals approximately $4.4 trillion, making it one of the largest, most liquid debt market segments in the world—a market far surpassing the long-term U.S. Treasury debt of $2.5 trillion. Homeownership levels have reached a historical high, which, when tallied for 1999, should be nearly 67 percent.

To understand how we've reached these remarkable heights, we can look to a century's worth of milestones—some assisted through government support, others representing the sheer determination of competitive business professionals.

One hundred years ago, buying a home meant borrowing purchase funds from a friend, relative or local businessperson. Individuals were the largest category of mortgage lender. In our larger communities, savings and loan organizations—then primarily known as building and loans—were the other major source of mortgage financing. By 1900, approximately 5,800 of these institutions held about half a billion dollars in mortgage loans. On a smaller scale, savings banks and state-chartered banks also made home loans.

During the same time, independent mortgage companies numbered approximately 200. Throughout the latter half of the 19th century, mortgage companies acted as conduits between East Coast investors and frontier farmers who needed financing. Rather than purchase loans, most of these mortgages were production loans—funds which bought equipment and supplies, not a property itself.

In 1914, these mortgage companies formed a professional organization called the Farm Mortgage Bankers Association, to ensure lenders' concerns were understood in Washington, D.C. Responding to both an agricultural depression and a nationwide population shift to urban centers following World War I, the organization changed its name in 1923. The word *Farm* was dropped, creating the Mortgage Bankers Association of America (MBA) and reflecting its focus on residential mortgage lending.

As we usher in the year 2000, the U.S. mortgage industry can claim an impressive array of accomplishments.

—Angelo R. Mozilo—

When discussing the industry's milestones, we should keep in mind the structure mortgage loans took during these times. With few exceptions, mortgage loans were primarily five-year, interest-only, 50-percent LTV instruments with principal due at loan end. Principal on a mortgage loan was rarely repaid; most borrowers simply refinanced at the end of five years. This structure proved disastrous after the Great Crash in October 1929.

Today, the hardships of the Great Depression seem unimaginably acute. In the darkest days, one-third of the country's labor force was unemployed. Between 1931 and 1935, there were 250,000 foreclosures per year, and by 1935, 20 percent of all homes were owned by lenders.

Yet it was because of and through this hardship that modern mortgage finance was born.

The Federal Home Loan Bank Act of 1932 extended $125 million in credit to savings and loan institutions, and created the Federal Home Loan Bank System with 12 regional banks. In 1933, the Home Owners Loan Act gave savings and loans the ability to be chartered by the federal government. The thrifts were given basic lending authority to offer emergency relief for homeowners who could refinance their home loan for 20 years.

The terms of these new loans were revolutionary: fixed-rate, amortized loans at rates as low as 5 percent with an 80-percent LTV. By 1936, one in 10 homeowners had received financing through this law. In fact, in the first two years, 1 million loans totaling $3 billion were made, and the amortized fixed-rate loan became the industry standard.

In that same year, the Banking Act of 1933 helped the nation regain some financial confidence by creating the Federal Deposit Insurance Corporation. The Glass-Steagall Act—a law that defied repeal until 1999—redefined the way banks did business. One year later, the National Housing Act of 1934 created the Federal Housing Administration (FHA) and its government-backed insurance program, standardizing loan requirements and enabling lenders to increase liquidity by selling pools of loans to investors, such as life insurance companies.

One of the last pieces of Depression-era legislation created the Federal National Mortgage Association (Fannie Mae), then wholly owned by the government. In 1938, Fannie Mae purchased its first FHA-insured loans from lenders; the nation now had a government-sponsored secondary market to provide further liquidity.

Even with government support, the Depression devastated the lending industry. In the 10-year period between the stock market crash and 1939, half of all banks and thrifts went out of business. The less numerous mortgage companies fared a little better. Thanks to the servicing and processing expertise gained as nonportfolio lenders, many found their niche in government loan originations and servicing.

After World War II, the pent-up demand for homes launched the largest housing expansion the world had ever seen. Five million servicemen had returned home, the GI bill guaranteeing home loans for them all. In addition, Americans had amassed an estimated $44 billion in savings. But homes—especially homes in good condition—were in very short supply. Thus, in 1949 the National Housing Act declared its goal to provide a decent home for every American family.

Merchant builders—the most famous, William Leavitt and his Leavittowns—began erecting thousands of middle-class homes in new suburban subdivisions. Often funded by the FHA, these projects were a boon to lenders. Mortgage companies offered mostly FHA or VA financing to homebuyers, eventually originating 75 percent of all FHA loans. Homeownership rates rose from 55 percent in 1950 to 62 percent in 1960, and one-third of the nation now lived in a suburb.

Throughout the 1950s and 1960s, the thrift industry held at least 50 percent of origination market share. This dominance continued, with thrifts' market share exceeding 70 percent by 1970.

In 1965, the Department of Housing and Urban Development (HUD) was elevated to cabinet-level status. HUD's mission was "a decent, safe and sanitary home and suitable living environment for every American." Both the FHA and Fannie Mae became agencies within HUD, until Fannie Mae's reorganization in 1968. Fannie Mae was split and the "new" Fannie Mae became a private corporation; while another entity, Ginnie Mae, remained an organization within HUD. The privatization of Fannie Mae had immediate effects on the secondary market. In 1965, the GSE purchased $757 million in government mortgage loans. In just five years, that figure grew to slightly more than $5 billion.

Mortgage banking saw revolutionary changes during the 1970s. In this decade, adjustable-rate mortgages were first introduced, launching the public acceptance of shared interest-rate risk. More importantly, the secondary market expanded, unleashing unprecedented capital into mortgage markets. The Emergency Home Finance Act of 1970 not only created Freddie Mac, but empowered Fannie Mae to purchase conventional mortgages.

At the dawn of the 21st century, our industry continues to be a dynamic, growth-oriented sector.

Concurrent with the modern GSE structure, in 1970 Ginnie Mae issued the first mortgage-backed securities. Freddie Mac followed suit in 1971, and by 1975 lenders began to issue their own private mortgage-backed bonds.

Along with the increase of capital made possible by securitization, mortgage lending's major players changed dramatically during the 1980s. At the beginning of the decade, thrifts held 50 percent of originations market share; mortgage companies and commercial banks equally shared the remaining half. Nine short years later, origination market share was divided nearly equally among the three categories, as the thrift industry faced ruin.

In the "mortgage company" category, new, highly competitive members could be found—firms such as Sears, General Electric and General Motors. Large commercial banks like Citicorp and Chase Manhattan made major moves into home finance, as did more than half of the nation's 20,000 credit unions. New origination records were set in 1986 and 1987, before another October stock market crash brought the economic good times to a close.

As the 1990s began, the nation was experiencing another recession. In 1991, the Federal Reserve lowered interest rates and by late 1993, interest for fixed-rate mortgages dropped below 7 percent. Americans had not seen rates this low in 20 years. The result: 1993 saw $1.1 trillion in mortgages funded. It was in this same year that mortgage companies accounted for more than half of originations, with Countrywide Home Loans taking the position of the nation's largest mortgage lender.

Two and a half years later, the Federal Reserve again dropped rates; fixed-rate mortgages went below 7 percent and created another refinance boom that lasted through early spring of 1999. Again, origination records were set. Two refinance booms in one decade were impressive enough, but perhaps more important to the milestones in this decade were mortgage industry consolidation and electronic commerce. Today, the top 25 firms are responsible for more than half of all originations, and more than $4.1 billion in originations were conducted online during 1998.

At the dawn of the 21st century, our industry continues to be a dynamic, growth-oriented sector. As lenders compete to provide personalized service to customers, product diversification is delivering a wealth of opportunities and benefits to borrowers and lenders alike. The quest to offer one-stop shopping for a full array of financial services is being met through innovative technologies, mergers and acquisitions and business-line diversification. The U.S. industry has begun to reach out to the global market.

Through these efforts, among many others, mortgage lenders are setting the stage for growth, prosperity and new milestones for the 21st century.

Angelo R. Mozilo is chairman and chief executive officer of Countrywide Credit Industries, Inc., in Calabasas, California.

APPENDIX A.5

C

Restatement of the Law — Property
Restatement (Third) of Property: Mortgages
Current through August 2011

Chapter 5. Transfers Of Mortgaged Real Estate And Mortgages

§ 5.4 Transfer Of Mortgages And Obligations Secured By Mortgages

Link to Case Citations

(a) A transfer of an obligation secured by a mortgage also transfers the mortgage unless the parties to the transfer agree otherwise.

(b) Except as otherwise required by the Uniform Commercial Code, a transfer of a mortgage also transfers the obligation the mortgage secures unless the parties to the transfer agree otherwise.

(c) A mortgage may be enforced only by, or in behalf of, a person who is entitled to enforce the obligation the mortgage secures.

Cross-References:

Section 5.5, Effect of Performance to the Transferor After Transfer of an Obligation Secured by a Mortgage.

Comment:

a. Introduction. This section deals with transfers of mortgages and their associated obligations by an original mortgagee to a successor, or from one successor to another. Such transfers occur in what is commonly termed the secondary mortgage market, as distinct from the primary mortgage market in which mortgage loans are originated by lenders to borrowers.

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; see Subsection (c) of this section. When the right of enforcement of the note and the mortgage are split, the note becomes, as a practical matter, unsecured. This result is economically wasteful and confers an unwarranted windfall on the mortgagor.

It is conceivable that on rare occasions a mortgagee will wish to disassociate the obligation and the mortgage, but that result should follow only upon evidence that the parties to the transfer so agreed. The far more common intent is to keep the two rights combined. Ideally a transferring mortgagee will make that intent plain by executing to the transferee both an assignment of the mortgage and an assignment, indorsement, or other appropriate transfer of the obligation. But experience suggests that, with fair frequency, mortgagees fail to document their transfers so carefully. This section's purpose is generally to achieve the same result even if one of the two aspects of the transfer is omitted.

This section applies whether the transfer is outright or is given as collateral or security for some other obligation. When an obligation secured by a mortgage is transferred as collateral for another debt, the person receiving the security interest will generally wish to perfect that interest under U.C.C. Article 9. However, the principles of this section will operate to keep the obligation and the mortgage united whether or not perfection is achieved. Perfection as to the obligation will also constitute perfection as to the mortgage.

b. Transfer of the obligation also transfers the mortgage. A transfer in full of the obligation automatically transfers the mortgage as well unless the parties agree that the transferor is to retain the mortgage. The objective of this rule, as noted above, is to keep the obligation and the mortgage in the same hands unless the parties wish to separate them. This result is sometimes justified on the ground that "[a]ll the authorities agree that the debt is the principal thing and the mortgage an accessory," as the United States Supreme Court put it in 1872 in Carpenter v. Longan, 83 U.S. (16 Wall.) 271, 21 L.Ed. 313 (1872).

Ownership of a contractual obligation can generally be transferred by a document of assignment; see Restatement, Second, Contracts § 316. However, if the obligation is embodied in a negotiable instrument, a transfer of the right to enforce must be made by delivery of the instrument; see U.C.C. § 3-203 (1995). The principle of this subsection, that the mortgage follows the note, applies to either form of transfer of the note. Moreover, it applies even if the transferee does not know that the obligation is secured by a mortgage. See Illustrations 1-3.

Recordation of a mortgage assignment is not necessary to the effective transfer of the obligation or the mortgage securing it. However, assignees are well advised to record. One reason is that, if the assignment is not recorded, the original mortgagee appears in the public records to continue to hold the mortgage. If the mortgagee and mortgagor subsequently enter into and record a purported discharge or modification of the mortgage without the assignee's knowledge or involvement, and the real estate is then transferred to a good faith purchaser for value, the latter is entitled to rely on the record. The result is to prevent the assignee from enforcing the mortgage, in its original form, against the purchaser.

Illustrations:

1. Mortgagor borrows money from Mortgagee and gives Mortgagee a nonnegotiable promissory note for the amount borrowed and, to secure payment of the note, a mortgage on Blackacre. Mortgagee subsequently executes a separate "Assignment of Promissory Note" transferring ownership of the note to Assignee, but makes no mention and no express assignment of the mortgage. By this transfer Assignee becomes the owner of both the note and the mortgage.2. The facts are the same as Illustration 1, except that the note is negotiable, and that rather than executing an assignment of the note to Assignee, Mortgagee delivers the note to Assignee for the purpose of giving Assignee the right to enforce the note. By this transfer Assignee becomes the owner of both the note and the mortgage.3. The facts are the same as Illustration 1 or Illustration 2, except that Assignee has no knowledge that the note is secured by a mortgage. The result is the same as in Illustrations 1 and 2.

A transfer of the obligation with a retention of the mortgage is possible, but only if the transferor and transferee so agree. See Illustration 4. If the full obligation is transferred without the mortgage, the effect of such a transfer under Subsection (c) of this section is to make it impossible to foreclose the mortgage, and hence to make it practically a nullity, unless the transferor is also made the transferee's agent or trustee with authority to foreclose in the transferee's behalf. See Comment *e*.

Illustration:

4. Mortgagor borrows money from Mortgagee and gives Mortgagee a nonnegotiable promissory note for the

amount borrowed and, to secure payment of the note, a mortgage on Blackacre. Mortgagee subsequently executes an "Assignment of Promissory Note" transferring ownership of the note to Assignee, which expressly provides that "the mortgage securing this note is not assigned to Assignee, but is retained as Mortgagee's property." By this transfer Assignee becomes the owner of the note, but not of the mortgage.

There is one situation in which a retention of the mortgage by the transferor of the obligation may be sensible and desirable. That is where the obligation is bifurcated. This may occur, for example, because the original mortgagee transfers only a partial interest in the secured obligation while retaining the residue, or because the obligation is represented by two notes and the original mortgagee transfers one of them while retaining the other. The obligation or the mortgage may, of course, contain terms either authorizing or prohibiting such transfers, and stating how the real estate mortgage is to be dealt with in the event of such a partial transfer of the obligation.

If these documents do not deal with the matter, the parties to the transaction, if well advised, will expressly agree as to the disposition of the security, and thus may express the intent mentioned in § 5.4(a). They may agree either that the mortgage is to pass to the transferee, or that it is to be retained by the transferor. Conceivably, they may agree that it is to be divided between the parties on some basis. If no specific intent is expressed by the parties, either in the original documents or at the time of the transfer, the effect of a partial transfer of the obligation, under § 5.4(a), will be to bifurcate the mortgage as well, and to transfer a proportionate interest in it to the partial transferee of the obligation, leaving the remainder in the transferor's hands. This result is cumbersome, but there is no fair and feasible alternative if the parties fail to agree on the disposition of the mortgage.

c. Transfer of the mortgage also transfers the obligation. When ownership of a mortgage is assigned to another, Subsection (b) of this section provides that the obligation secured by the mortgage is likewise transferred unless the parties agree that the obligation be retained by the transferor. In effect, the obligation will "follow" the mortgage even if not expressly mentioned in any document of transfer. The reason, as noted above, is that this is ordinarily what the parties desire and expect when a mortgage is assigned. Thus this section is designed to carry out the parties' intention even though they, through ignorance or inadvertence, have not fully documented it. See Illustrations 5 and 6. If the obligation is only partially owned by the transferor, or if the obligation is subject to prior liens or security interests, only the interest of the transferor in the obligation passes to the transferee.

Illustrations:

5. Mortgagor borrows money from Mortgagee and gives Mortgagee a nonnegotiable promissory note for the amount borrowed and, as security for payment of the note, a mortgage on Blackacre. Mortgagee negotiates a sale of the loan to Assignee. Mortgagee executes an assignment of the mortgage to Assignee, but the assignment makes no express mention of the note. Ownership of the note passes to Assignee with the mortgage despite the absence of any express transfer of the note.6. The facts are the same as Illustration 5, except that instead of executing an assignment of the mortgage, Mortgagee executes and delivers a deed of Blackacre to Assignee. The result is the same as in Illustration 5.

It is possible for a mortgagee to assign the mortgage while retaining full ownership of the obligation, but only if the parties so agree. See Illustration 7. The practical effect of such a transaction is to make it impossible to foreclose the mortgage, unless the transferee is also made an agent or trustee of the transferor or otherwise has authority to foreclose in the transferor's behalf. See Comment *e*.

Illustration:

7. Mortgagor borrows money from Mortgagee and gives Mortgagee a nonnegotiable promissory note for the amount borrowed and, to secure payment of the note, a mortgage on Blackacre. Mortgagee subsequently executes an assignment of the mortgage to Assignee, but the assignment expressly provides that "ownership of the promissory note secured by this mortgage is retained by Mortgagee, and Assignee acquires no interest in it." Assignee becomes the owner of the mortgage but not owner of the promissory note. Unless Assignee is authorized by Mortgagee to do so on Mortgagee's behalf, Assignee may not foreclose the mortgage.

If the mortgage obligation is a negotiable note, Uniform Commercial Code § 3-203 (1995) is generally understood to make the right of enforcement of the note transferrable only by delivery of the instrument itself to the transferee. Hence, when a mortgage is assigned but the negotiable note it secures is not delivered, the courts may find it necessary to disregard the rule of Subsection (b) in order to effectuate the Code.

Institutional purchasers of loans in the secondary mortgage market often designate a third party, not the originating mortgagee, to collect payments on and otherwise "service" the loan for the investor. In such cases the promissory note is typically transferred to the purchaser, but an assignment of the mortgage from the originating mortgagee to the servicer may be executed and recorded. This assignment is convenient because it facilitates actions that the servicer might take, such as releasing the mortgage, at the instruction of the purchaser. The servicer may or may not execute a further unrecorded assignment of the mortgage to the purchaser. It is clear in this situation that the owner of both the note and mortgage is the investor and not the servicer. This follows from the express agreement to this effect that exists among the parties involved. The same result would be reached if the note and mortgage were originally transferred to the institutional purchaser, who thereafter designated another party as servicer and executed and recorded a mortgage assignment to that party for convenience while retaining the promissory note. Again, the parties' agreement that ownership of the note should remain in the purchaser would be enforced.

Occasionally a mortgagee may wish to assign the mortgage in full, but to retain a partial interest in the obligation. For example, if the mortgage secures two notes, the mortgagee might transfer one note (along with the mortgage) and retain the other. There is no objection to such a transaction if the parties so agree. The portion of the obligation remaining in the mortgagee's hands will be unsecured, while the portion acquired by the transferee will be secured by the entire mortgage.

d. Competing transfers of obligations and mortgages. This section's focus is on the relationship between the transferor and transferee of obligations and mortgages that secure them. It does not purport to resolve conflicts resulting from multiple purported transfers by a transferor to competing transferees. That subject is complex and is governed by other bodies of law, including the recording acts and the Uniform Commercial Code, that are beyond the scope of this Restatement. .

e. Mortgage may not be enforced except by a person having the right to enforce the obligation or one acting on behalf of such a person. As mentioned, in general a mortgage is unenforceable if it is held by one who has no right to enforce the secured obligation. For example, assume that the original mortgagee transfers the mortgage alone to A and the promissory note that it secures to B. Since the obligation is not enforceable by A, A can never suffer a default and hence cannot foreclose the mortgage. B, as holder of the note, can suffer a default. However, in the absence of some additional facts creating authority in A to enforce the mortgage for B, B cannot cause the mortgage to be foreclosed since B does not own the mortgage. See Illustration 8.

This result is changed if A has authority from B to enforce the mortgage on B's behalf. For example, A may be a trustee or agent of B with responsibility to enforce the mortgage at B's direction. A's enforcement of the mortgage in these circumstances is proper. See Illustration 9. The trust or agency relationship may arise from the terms of the assignment, from a separate agreement, or from other circumstances. Courts should be vigorous in seeking to find such a relationship, since the result is otherwise likely to be a windfall for the mortgagor and the frustration of B's expectation of security. See Illustration 10.

Illustrations:

8. The facts are the same as Illustration 4. If Mortgagor defaults in payment of the promissory note, Assignee may sue on the note, but neither Mortgagee nor Assignee may enforce the mortgage.9. The facts are the same as Illustration 4, except that the assignment of the note further states, "Mortgagee is hereby designated agent of Assignee with a duty to foreclose the mortgage upon Assignee's request." If Mortgagor defaults in payment of the promissory note, Assignee may sue on the note, and Mortgagee must foreclose the mortgage if directed by Assignee to do so, subject to the provisions of § 8.2.10. The facts are the same as Illustration 4, except that Mortgagee has often served as Assignee's agent in the past with authority to foreclose mortgages held by Assignee. A court is warranted in finding on the basis of this pattern of prior conduct that Mortgagee is Assignee's agent for purposes of foreclosing the instant mortgage. Upon such a finding, Mortgagee must foreclose the mortgage if directed by Assignee to do so, subject to the provisions of § 8.2.

REPORTERS' NOTE

Introduction, Comment a. General commentaries on the transfer of mortgages and their associated obligations include 1 G. Nelson & D. Whitman, Real Estate Finance Law §§ 5.27-5.35 (3d ed. 1993); G. Glenn, Mortgages § 314 (1943); Ellis & Lowry, A Comprehensive Note Purchase Guide (with Forms), Part I, Prac. Real Estate Lawyer 45 (July 1987); Part II, Prac. Real Estate Lawyer 49 (Sept.1987); Bautista & Kennedy, The Imputed Negotiability of Security Interests Under the Code, 38 Ind. L.J. 574 (1963); Note, Transfer of the Mortgagee's Interest in Florida, 14 U. Fla. L. Rev. 98 (1961); Britton, Assignment of Mortgages Securing Negotiable Notes, 10 Ill. L. Rev. 337 (1915).

The mortgage becomes useless in the hands of one who does not also hold the obligation because only the holder of the obligation can foreclose; see In re Atlantic Mortg. Corp., 69 B.R. 321 (Bankr.E.D.Mich.1987); Swinton v. Cuffman, 213 S.W. 409 (Ark.1919); Stribling v. Splint Coal Co., 5 S.E. 321 (W.Va.1888). When a separation of the two has occurred, some courts have imposed a constructive trust on the mortgage in favor of the holder of the obligation in order to make it available for foreclosure; see Lawrence v. Knap, 1 Root (Conn.) 248, 1 Am.Dec. 42 (1791); Pettus v. Gault, 71 A. 509 (Conn.1908); Kinna v. Smith, 3 N.J.Eq. 14 (1834); Rembert v. Ellis, 17 S.E.2d 165 (Ga.1941), noted 137 A.L.R. 479. The essential desirability of avoiding a separation of the obligation and the mortgage has been explained thus:

> Among the "gems" and "free offerings" of the late Professor Chester Smith of the University of Arizona College of Law was the following analogy. The note is the cow and the mortgage the tail. The cow can survive without a tail, but the tail cannot survive without the cow.

Best Fertilizers of Arizona, Inc. v. Burns, 571 P.2d 675, 676 (Ariz.Ct.App.1977), reversed on other grounds, 570 P.2d 179 (Ariz.1977). See also Carpenter v. Longan, 83 U.S. (16 Wall.) 271, 21 L.Ed. 313 (1872).

Transfer of the obligation also transfers the mortgage, Comment b. Illustrations 1 and 2 are supported by In re Ivy Properties, Inc., 109 B.R. 10 (Bankr.D.Mass.1989); In re Union Packing Co., 62 B.R. 96 (Bankr.D.Neb.1986); First National Bank v. Larson, 17 B.R. 957, 965 (Bankr.D.N.J.1982); Rodney v. Arizona

Bank, 836 P.2d 434 (Ariz.Ct.App.1992); Campbell v. Warren, 726 P.2d 623 (Ariz.Ct.App.1986) (an assignment of a portion of the payments from a promissory note automatically transfers a *pro tanto* interest in the mortgage that secures the note); Domarad v. Fisher & Burke, Inc., 76 Cal.Rptr. 529 (Cal.Ct.App.1969); Margiewicz v. Terco Properties, 441 So.2d 1124 (Fla.Dist.Ct.App.1983); Moore v. Lewis, 366 N.E.2d 594 (Ill. App. Ct. 1977); Jones v. Titus, 175 N.W. 257 (Mich. 1919); Goetz v. Selsor, 628 S.W.2d 404 (Mo.Ct.App.1982); Kernohan v. Manss, 41 N.E. 258 (Ohio 1895); Bartlett Estate Co. v. Fairhaven Land Co., 49 Wash. 58, 94 P. 900 (1908). See generally G. Glenn, Mortgages § 314 (1943).

See also Ala. Code § 8-5-24: "The transfer of a ... note given for the purchase of lands ... passes to the transferee the lien of the vendor of the lands"; Ariz. Rev. Stat. § 33-817: "The transfer of any contract or contracts secured by a trust deed shall operate as a transfer of the security for such contract or contracts"; West's Ann. Cal. Civil Code § 2936: "The assignment of a debt secured by a mortgage carries with it the security."

Some cases reach the same result as this subsection by finding that the transferor of the note is a constructive trustee of the mortgage for the benefit of the transferee. See, e.g., Pettus v. Gault, 71 A. 509 (Conn.1908); Rembert v. Ellis, 17 S.E.2d 165, 137 A.L.R. 479 (Ga. 1941); Kinna v. Smith, 3 N.J.Eq. 14 (1834).

Illustration 3 is based on Mankato First National Bank v. Pope, 89 N.W. 318 (Minn.1902). See also Edwards v. Bay State Gas Co., 184 Fed. 979 (C.C. Del. 1911); Holland Banking v. See, 130 S.W. 354 (Mo.Ct.App.1910); Betz v. Heebner, 1 Pen. & W. 280 (Pa.1830).

With respect to Illustration 4, there is substantial authority that the note and the mortgage are "inseparable." Several of the cases cited above in connection with Illustrations 1 and 2 so state; see Hill v. Favour, 84 P.2d 575 (Ariz.1938). However, under this Restatement a separation of the two rights is permissible if the parties so intend, although under Subsection (c) of this section the person who then owns the mortgage is generally unable to enforce it.

A partial transfer of the obligation effects a partial or pro tanto transfer of the mortgage as well, in the absence of contrary intent. See Allen v. Hamman Lumber Co., 34 P.2d 397 (Ariz.1934); Anderson Banking Co. v. Gustin, 146 N.E. 331 (Ind.Ct.App.1925); New England Loan & Trust Co. v. Robinson, 76 N.W. 415 (Neb.1898) ; Hyman v. Sun Ins. Co., 175 A.2d 247 (N.J. Super. Ct. 1961). However, the case law offers little guidance as to the practical management of such a bifurcated mortgage. Who has the power to make decisions regarding foreclosure, forbearance, and the like? Presumably the courts will permit those holding a majority interest in the obligation and mortgage to decide these questions, but the matter is unclear. See Perkins v. Chad Devel. Corp., 157 Cal.Rptr. 201 (Cal.Ct.App.1979), holding that where the mortgage is held by two co-owners, either of them has the power to foreclose without the consent of the other.

Questions may also arise concerning the relative priority of the parties in the proceeds of mortgage foreclosure. Modern case law generally treats them as pro-rata participants if there is no contrary agreement. See Perkins v. Chad Devel. Corp., 157 Cal.Rptr. 201 (Cal.Ct.App.1979); Domeyer v. O'Connell, 4 N.E.2d 830 (Ill.1936); Farr v. Hartley, 81 P.2d 640 (Ut.1938); 1 G. Nelson & D. Whitman, Real Estate Finance Law § 5.35 (3d ed. 1993); G. Glenn, Mortgages § 318 (1943). Well-advised parties will, of course, enter into a "participation agreement" dealing with all of these issues.

Transfer of the mortgage also transfers the obligation, Comment c. Illustration 5 is based on Gregg v. Williamson, 98 S.E.2d 481 (N.C.1957) (statement in margin of public records assigning a mortgage had the effect of transferring the note as well). See United States v. Freidus, 769 F.Supp. 1266 (S.D.N.Y.1991); Seabury v. Hemley, 56 So. 530 (Ala.1911); Andrews v. Townshend, 1 N.Y.S. 421 (N.Y. Super. Ct. 1888); Loveridge v. Shurtz, 70 N.W. 132 (Mich.1897); Foster v. Trowbridge, 40 N.W. 255 (Minn.1888). See also Lawson v. Estate of Slaybaugh, 619 S.W.2d 910 (Mo.Ct.App.1981) (while an assignment of the mortgage without the note is ordinarily a nullity, it might be held to transfer the note if that was the intention of the assignor); In re United Home Loans, Inc., 71 B.R. 885 (W.D.Wash.1987) (where mortgage is assigned by document which states that the debt is also being transferred, ownership of the note passes to the assignee even though the note is not indorsed or delivered). See Kan. Stat. Ann. § 58-2323: "The assignment of any mortgage as herein provided shall carry with it the debt thereby secured."

There is also substantial contrary authority, holding that an assignment of the mortgage without the obligation is a nullity. That authority is not followed by this Restatement. See In re Hurricane Resort Co., 30 B.R. 258 (Bankr.Fla.1983); Hill v. Favour, 84 P.2d 575 (Ariz.1938); Domarad v. Fisher & Burke, Inc., 76 Cal.Rptr. 529 (Cal.Ct.App.1969) (dictum); Hamilton v. Browning, 94 Ind. 242 (1883); Pope & Slocum v. Jacobus, 10 Iowa 262 (1859); Van Diest Supply Co. v. Adrian State Bank, 305 N.W.2d 342 (Minn.1981); Kluge v. Fugazy, 536 N.Y.S.2d 92 (N.Y.App.Div.1988); Miller v. Berry, 104 N.W. 311 (S.D.1905). See Note, Transfer of the Mortgagee's Interest in Florida, 14 U. Fla. L. Rev. 98 (1961).

Illustration 6 is based on Carr v. Dorenkamper, 556 N.E.2d 1333 (Ind.Ct.App.1990) (quitclaim deed, effective as an "equitable assignment"). See also Welsh v. Phillips, 54 Ala. 309, 25 Am.Rep. 679 (1875) (warranty deed); Ruggles v. Barton, 79 Mass. (13 Gray) 506 (1859); Hinds v. Ballou, 44 N.H. 619 (1863) (quitclaim deed); Welch v. Priest, 90 Mass. (8 Allen) 165 (1864) (release effective to transfer mortgage and obligation). See generally Rollison, Priorities in the Law of Mortgages, 9 Notre Dame Law. 50 (1933).

There is substantial older authority that a conveyance of the land by the mortgagee is a nullity rather than a transfer of both the mortgage and the obligation. See Peters v. Jamestown Bridge Co., 5 Cal. 334, 63 Am.Dec. 134 (1855); Carter v. Bennett, 4 Fla. 283, 347 (1852); Delano v. Bennett, 90 Ill. 533 (1878); Johnson v. Cornett, 29 Ind. 59 (1867); Swan v. Yaple, 35 Iowa 248 (1872); Farnsworth v. Kimball, 91 A. 954, 956 (Me.1914); Smith v. Smith, 15 N.H. 55, 65 (1844); Devlin v. Collier, 22 A. 201 (N.J. 1891); Merritt v. Bartholick, 36 N.Y. 44 (1867). This Restatement does not follow that authority; since the mortgage is plainly an interest in real estate, it is difficult to see why a deed of the land should not be construed as assigning it.

Competing transfers of obligations and mortgages, Comment d. The principle permitting a subsequent good faith purchaser of a note to prevail over a prior assignee of the mortgage who did not obtain the note is supported by In re Vermont Fiberglass, Inc., 44 B.R. 505 (Bankr.D.Vt.1984); Nazar v. Southern, 32 B.R. 761 (Bankr.Kan.1983); Second Nat. Bank v. Dyer, 184 A. 386 (Conn.1936); and Price v. Northern Bond & Mortg. Co., 297 P. 786 (Wash. 1931). The conclusion favoring the second taker is more probable when the note is negotiable; see generally 1 G. Nelson & D. Whitman, Real Estate Finance Law § 5.34 (3d ed. 1993); G. Glenn, Mortgages § 315.2 (1943).

Mortgage may not be enforced except by the owner of the obligation or one acting on behalf of the owner, Comment d. Illustration 8 is explained as follows in In re Belize Airways Limited, 7 B.R. 604, 606 (Bankr.S.D.Fla.1980):

> To allow the assignee of a security interest [who did not also acquire the note] to enforce the security agreement would expose the obligor to a double liability, since a holder in due course of the promissory note clearly is entitled to recover from the obligor. Section 3-305, Uniform Commercial Code.

See also G. Glenn, Mortgages § 314 (1943):

To transfer the mortgage and keep the debt would be futile at best.... [T]he transfer would be ineffectual, because the mortgagee's real interest in the property is a security interest. A mortgagee who parts with this security to a stranger, loses its benefit, nor can the stranger profit, unless he was a *bona fide* purchaser, a case that can happen if the mortgage has taken the form of an absolute deed.

By analogy, U.C.C. § 1-201(37) (1995) defines a security interest as "an interest in personal property .... which secures payment or performance of an obligation." Case law construing the Code holds that a security interest is unenforceable in the absence of its underlying obligation. See Bank of Lexington v. Jack Adams Aircraft Sales, 570 F.2d 1220 (5th Cir.1978). Hence, "in order for a creditor to have lien rights in the property of a debtor, the creditor must hold an enforceable obligation against the debtor"; In re G.O. Harris Financial Corp., 51 B.R. 100 (Bankr.S.D.Fla.1985). See Sobel v. Mutual Development Inc., 313 So.2d 77 (Fla.Dist.Ct.App.1975).

Because a transfer of the mortgage without the obligation is essentially futile, a court may strain to find that the holder of the mortgage holds it in trust for the benefit of the owner of the obligation. See Boruchoff v. Ayvasian, 79 N.E.2d 892 (Mass. 1948).

Research References

1. Digest System Key Numbers

Mortgages ⚿ 219-270.

2. A.L.R. Annotations

Applicability of article 9 of Uniform Commercial Code to assignment of rights under real-estate sales contract, lease agreement, or mortgage as collateral for separate transaction. 76 ALR4th 765.

Comment Note: Effectiveness, as pledge, of transfer of non-negotiable instruments which represent obligation. 53 ALR2d 1396.

Recording laws as applied to assignment of mortgages on real estate. 89 ALR 171, Supp. 104 ALR 1301.

Case Citations

Case Citations through June 2010

— April 2011Case Citations July 2010 — April 2011

Case Citations through June 2010:

C.D.Cal.Bkrtcy.Ct.2008. Quot. in sup. Corporation that was named as beneficiary "acting solely as a nominee" for mortgage lender and "lender's successors and assigns" under a deed of trust supporting an adjustable-rate promissory note filed a motion on behalf of itself and "its assignees and/or successors in interest" for relief from stay in Chapter 7 debtor's bankruptcy case. This court denied the motion, holding, inter alia, that corporation's unidentified "assignees and/or successors in interest" were not permitted in a motion before the court. Noting that corporation had presented no evidence as to who owned the note or of any authorization to act on behalf of the present owner, the court pointed out that, if, as was likely, lender had transferred the note, corporation was no longer an authorized agent of the holder unless it had a separate agency contract with the new undisclosed principal; assignment of a note carried the mortgage with it, while an assignment of the latter alone was a nullity. In re Vargas, 396 B.R. 511, 516.

D.Conn.Bkrtcy.Ct.2010. Cit. in case quot. in ftn. U.S. Trustee moved to dismiss debtor's Chapter 11 case. Dismissing the case, this court held, inter alia, that debtor's use of his Chapter 11 case as a platform to impermissibly attack the final orders in state-court foreclosure proceedings with respect to a certain first mortgage on property in which debtor claimed an interest constituted "other cause" for dismissal of his bankruptcy case. Pointing to debtor's attempt to relitigate the note holder's standing, established in the foreclosure action, the court observed that Connecticut statutory law permitted the holder of a note to foreclose on property when the mortgage had not yet been assigned to him, codifying the common-law principle that the mortgage followed the note, pursuant to which only the rightful owner of the note had the right to enforce the mortgage. In re Van Eck, 425 B.R. 54, 61.

D.D.C.1999. Com. (a) quot. in disc. Buyers of property sued the FDIC, as receiver for the beneficiary of a deed of trust securing two promissory notes, and the parties to which the FDIC transferred the promissory notes and the deed of trust, seeking to avoid foreclosure and to clear title to the property. This court granted buyers summary judgment, holding, inter alia, that the FDIC's June 29, 1993 assignment of the deed of trust transferred all of FDIC's mortgage interest in the deed of trust as opposed to a partial interest. The court stated that it knew of no principle or premise supporting the view that a holder of two obligations secured by the same mortgage could not transfer the entirety of the mortgage interest with just one of the underlying obligations, leaving the second obligation unsecured. Crosby v. First Bank of Beverly Hills, 77 F.Supp.2d 1, 5.

D.V.I.2002. Subsec. (a) quot. in sup. and ftn., com. (b) quot. in sup. Assignee of mortgage loan guaranteed by Small Business Administration (SBA) sued to foreclose on mortgages on individual defendants' properties. This court granted plaintiff summary judgment, holding that plaintiff's suit was timely under unlimited federal statute of limitations of 28 U.S.C. § 2415, since individual mortgages were transferred to SBA in 1994 when it paid off underlying loan to one of the individuals. Plaintiff, as assignee of SBA's interest, stood in agency's shoes, and thus benefited from unlimited statute. Since mortgage automatically followed promissory note, individual mortgages securing guaranty traveled with note when it was assigned to SBA. UMLIC VP LLC v. Matthias, 234 F.Supp.2d 520, 523.

Conn.1998. Cit. in disc. Mortgagee/bank moved to open a foreclosure judgment in order to correct the inadvertent omission of a parcel of the mortgaged property from the judgment. The trial court granted the motion, but the intermediate appellate court reversed, finding that the controlling statutory sections deprived the lower court of jurisdiction to open a judgment of foreclosure. Reversing and remanding, this court held that the statute in question did not preclude trial courts from exercising their equitable discretion to correct inadvertent omissions in mortgage foreclosure proceedings, and that this decision was consistent with both public policy and the doctrine of marshaling, which required a mortgagee, in the case of a mortgage secured by several parcels of realty, to foreclose first on those parcels not securing junior encumbrances. Furthermore, bank's failure to enforce its right to a deficiency judgment against mortgagors did not render the mortgage on the omitted parcel of property unenforceable. New Milford Sav. Bank v. Jajer, 244 Conn. 251, 708 A.2d 1378, 1387.

Conn.App.2006. Cit. in sup. After mortgage-note holder initiated foreclosure proceedings against mortgagor, mortgagor moved to dismiss, alleging that note holder lacked standing to enforce the note and mortgage because it was not an assignee of the mortgage when it initiated the action. The trial court denied defendant's motion to dismiss. Affirming and remanding, this court held that the trial court properly found that plaintiff was the holder of the mortgage note prior to the commencement of this action, and thus had standing to enforce the note and mortgage under a state statute permitting the holder of a negotiable instrument that was secured by a mortgage to foreclose on the mortgage even when the mortgage had not yet been assigned to him. The court observed that the statute codified the common-law principle that the mortgage followed the note, pursuant to which only the rightful owner of the note had the right to enforce the mortgage. Bankers Trust Co. of California, N.A. v. Vaneck, 95 Conn.App. 390, 392, 899 A.2d 41, 42.

Conn.App.2010. Cit. in case quot. in sup. Trustee of structured asset investment loan trust brought a foreclosure action against mortgagor. The trial court denied defendant's motion to dismiss. Affirming and remanding, this court held that plaintiff, as a bona fide holder of the promissory note secured by the mortgage on defendant's property, had standing to bring its foreclosure action, even assuming that the assignment of the mortgage from the original mortgagee's nominee to plaintiff was invalid. The court explained that, under a Connecticut statute, the holder of a negotiable instrument that was secured by a mortgage was permitted to foreclose on the mortgage even when the mortgage had not yet been assigned to him; the statute codified the common-law principle that the mortgage followed the note, pursuant to which only the rightful owner of the note had the right to enforce the mortgage. Chase Home Finance, LLC v. Fequiere, 119 Conn.App. 570, 576, 989 A.2d 606, 611,

Mo.App.2009. Coms. (a)–(e) cit. in disc. Purchaser of real property at a tax sale brought a quiet-title action against delinquent taxpayer and assignee of the deed of trust from a nominee of taxpayer's mortgage lender. The trial court denied assignee's motion for summary judgment and granted summary judgment for plaintiff. Affirming, this court held that assignee had no legally cognizable interest in the property, and thus lacked standing to seek dismissal of plaintiff's petition; since the assignor never held the promissory note, its assignment of the deed of trust to assignee separately from the note had no force. Bellistri v. Ocwen Loan Servicing, LLC, 284 S.W.3d 619, 623.

N.Y.Sup.Ct.2010. Subsec. (b) cit. in ftn. Mortgagee sued to foreclose a mortgage on residential real property. Granting plaintiff's motion for partial summary judgment, this court held that plaintiff, as assignee of the note and qualifying mortgage, had standing to bring its foreclosure action. The court found that where, as here, an entity such as a mortgage electronic registration system was identified in the mortgage indenture as the nominee of the lender and as the mortgagee of record, and the mortgage indenture conferred upon such nominee all of the powers of the lender, its successors, and assigns, a written assignment of the note and mortgage by the registry, in its capacity as nominee, conferred good title to the assignee and was not defective for lack of an ownership interest in the note at the time of the assignment. The court stated that such an assignment did not violate this state's rule that transfer of a mortgage without a concomitant transfer of the debt was void; the court noted that this rule was at odds with the common-law rule that, generally, a transfer of the mortgage also transferred the debt. US Bank, N.A. v. Flynn, 27 Misc.3d 802, 897 N.Y.S.2d 855, 859.

— April 2011:Case Citations July 2010 — April 2011:

E.D.Mich.2010. Cit. in ftn. Borrower that defaulted on a commercial mortgage loan sued lender, as second assignee of the loan, arguing that the first mortgage assignment to a trust was accomplished by three separate unrecorded interim assignments, such that the record chain of title was rendered fatally defective, and thus foreclosure by advertisement by any party was precluded. This court denied plaintiff's motion for reconsideration of its order denying with prejudice plaintiff's motion for a temporary restraining order and preliminary injunction. The court rejected plaintiff's argument that the various contracts assigning the notes and mortgages to interim mortgagees might have reserved rights in the original noteholder, or might have lacked consideration, or might not have been valid under the laws of the state governing those contracts, noting that plaintiff cited no binding authority contradicting the Michigan doctrine that a transfer of a note transferred the mortgage by operation of law—without regard to any agreement otherwise. Livonia Property Holdings, L.L.C. v. 12840–12976 Farmington Road Holdings, L.L.C., 717 F.Supp.2d 724, 751–752.

W.D.Mo.Bkrtcy.Ct.2010. Com. (a) cit. in ftn. Assignee of a deed of trust on Chapter 7 debtor's residence filed a motion for relief from automatic stay with regard to the residence; debtor's trustee challenged assignee's standing to seek relief from the stay, asserting that the deed of trust was unenforceable because assignee was not the holder of both the note and deed of trust on the date of the bankruptcy filing. Granting the motion, this court held that assignee had standing because, when the holder of a promissory note assigned or transferred the note, the deed of trust was also transferred, and an assignment of the deed of trust separate from the note had no "force"; effectively, a promissory note and a deed of trust were inseparable, and when the note was transferred, it vested in the transferee all interest, rights, powers, and security conferred by the deed of trust upon the beneficiary therein and the payee in the note. In re Tucker, 441 B.R. 638, 641.

Md.Spec.App.2010. Subsec. (c) cit. in sup. Substitute trustees appointed by successor to noteholder to enforce its collection rights brought a foreclosure action against mortgagors. The trial court denied mortgagors' motion for an injunction to prevent the foreclosure sale. Affirming, this court held, inter alia, that mortgagors were not entitled to an injunction, because successor was a non-holder in possession of the note who had the rights of a holder, including the right to enforce the note; thus, successor had the same rights as noteholder to name successor trustees to enforce its collection rights, and trustees had standing to do so. Anderson v. Burson, 196 Md.App. 457, 9 A.3d 870, 878.

(1997)

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APPENDIX A.6

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT TACOMA

MICHAEL E. ST. JOHN and ELLEN L. ST. JOHN, Plaintiffs, v. NORTHWEST TRUSTEE SERVICES, INC., et al., Defendants.	CASE NO. C11-5382BHS ORDER GRANTING DEFENDANTS' MOTIONS TO DISMISS AND DENYING PLAINTIFFS' CROSS MOTION TO VOID DEFECTIVE FORECLOSURE PROCESS TRISHAND SALE

This matter comes before the Court on Defendants Bank of America ("BOFA") and Mortgage Electronic Registration Systems Inc.'s ("MERS") motion to dismiss (Dkt. 22) and Defendant Northwest Trustee Services, Inc.'s ("NWTS") motion to dismiss (Dkt. 26). Also before the Court is Plaintiffs' (the "St. Johns") cross motion to void defective foreclosure and sale (Dkt. 28). The Court has considered the pleadings filed in support of and in opposition to the motion and the remainder of the file and hereby grants Defendants' motions to dismiss and denies Plaintiffs' cross motion for the reasons stated herein.

I. PROCEDURAL HISTORY

On July 20, 2011, BOFA and MERS jointly filed a motion to dismiss the St. Johns' Complaint against them under Federal Rule of Civil Procedure ("Fed. R. Civ. P.) 12(b)(6) (failure to state a claim). Dkt. 22. On August 10, 2011, the St. Johns opposed the motion. Dkt. 25. On September 9, 2011, BOFA and MERS jointly replied. Dkt. 29.

On August 15, 2011, NWTS moved to dismiss the St. Johns' Complaint against it under Fed. R. Civ. P. 12(b)(6). Dkt. 26. On September 1, 2011, the St. Johns opposed the motion and filed a motion therein to void defective foreclosure process and sale. Dkt. 28. On September 9, 2011, NWTS replied to the St. Johns' opposition to its motion to dismiss. Dkt. 31. On the same day NWTS opposed the St. Johns' motion to void defective foreclosure and sale. Dkt. 30. The St. Johns did not reply.

II. FACTUAL BACKGROUND

This case arises out of the St. Johns' challenge to the foreclosure of their home, which occurred following their home mortgage default. *See generally* Complaint (Dkt. 1). On or about October 26, 2006, the St. Johns obtained a mortgage to finance the acquisition of residential real property in the amount of $385,000 (the "Loan"). Complaint ¶¶ 3, 20. Exhibit B to the Complaint is a copy of the Deed of Trust for this residential property; it identifies the St. Johns as the borrowers, Countrywide Home Loans, Inc. ("Countrywide") as the lender, and MERS as the beneficiary – "as a nominee for Lender and Lender's successors and assigns. *Id.*, Ex. B.

Shortly thereafter, MERS assigned its beneficial interest under the Deed of Trust to BAC Home Loans Servicing, L.P. (now "BANA"). *Id.*, Ex. D. This transfer is evidenced by record dated December 1, 2009. *Id.* On December 21, 2009, BANA appointed NWTS as the successor trustee under the Deed of Trust. *Id.* Ex. E.

The St. Johns defaulted on their mortgage payements; this fact is uncontroverted. On April 22, 2010, NWTS recorded a Notice of Trustee's Sale on the subject St. Johns' property; the notice referenced the St. Johns' default, arrearages of $62,542.23. *Id.*, Ex. F. The Trustee's sale was set for February 11, 2011. *Id.* To date, the sale is postponed.

On May 18, 2011, the St. Johns filed, and this Court later denied, their motion for temporary restraining order and preliminary injunction. *See, e.g.,* Dkt. 6.

Based on the foregoing, the St. Johns seek declaratory and injunctive relief based on, among other things, the claim that Defendants lack authority to foreclose. *See generally* Complaint.

III. DISCUSSION

A. Applicable Standards

Dismissal under Federal Rule of Civil Procedure 12(b)(6) is appropriate where there is either a "lack of cognizable legal theory" or "the absence of sufficient facts alleged under a cognizable legal theory." *Balisteri v. Pacifica Police Dept.*, 901 F.2d 696, 699 (9th Cir. 1988). In analyzing a Rule 12(b)(6) motion, the Court must construe the complaint in the light most favorable to the plaintiff, accept all well-pleaded factual allegations as true, and determine whether the plaintiff can prove any set of facts to support a claim that would warrant relief. *Cahill v. Liberty Mut. Ins. Co.*, 80 F.3d 336, 337–38 (9th Cir. 1996).

To overcome dismissal, a plaintiff must prove that the complaint complies with Rule 8(a)(2) of the Federal Rules of Civil Procedure by including a "short and plain statement of the claim showing that the pleader is entitled to relief." Additionally,

> [the] complaint must contain sufficient factual matter, accepted as true, to "state a claim to relief that is plausible on its face" . . . . A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged . . . . [Thus] it asks for more than a sheer possibility that a defendant has acted unlawfully."

Ashcroft v. Iqbal, 129 S. Ct. 1937, 1949 (2009) (citations omitted) (quoting *Bell Atlantic Corp. v. Twombly,* 550 U.S. 544, 556, 570 (2007)). Mere "labels and conclusion" or a "formulaic recitation of the elements of a cause of action will not do." *Iqbal,* 129 S. Ct. at 1949.

"[The Court is] not, however, required to accept as true allegations that contradict exhibits attached to the complaint or matters properly subject to judicial notice, or allegations that are merely conclusory, unwarranted deductions of fact, or unreasonable inferences." *Daniels-Hall v. National Educ. Ass'n,* 629 F.3d 992, 998 (9th Cir. 2010) (quoting *Manzarek v. St. Paul Fire & Marine Ins. Co.,* 519 F.3d 1025, 1031–32 (9th Cir. 2008)).

B. BOFA & MERS' Motion to Dismiss

BOFA and MERS move to dismiss the St. Johns Complaint for failure to state a claim upon which relief can be granted; their motion is based on the St. Johns'

Complaint, documents attached thereto, and other documents for which this Court could take judicial notice. *See* Dkt. 22 at 3 (relying on Fed. R. Civ. P. 12(b)(6); *id.*, n. 2).[1]

1. MERS Authority to Act as Beneficiary

The St. Johns predicate their request for injunctive and declaratory relief on the theory that MERS lacked authority to act as beneficiary under the Deed of Trust and thus could not assign its beneficial interest. Complaint. ¶¶ 26, 32. Based on this theory, the St. Johns ask the Court to stay the foreclosure proceedings on their residence due to the alleged defective assignment of the beneficial interest in the Deed of Trust.

However, the St. Johns executed a Deed of Trust that names MERS as a beneficiary and therein consented to MERS having such a role in the transaction. *See* Complaint ¶ 20; *id.*, Ex. B (setting out MERS' right to foreclose and sell the property or to transfer such an interest).

The St. Johns' position on this issue is unavailing. This Court has previously and consistently ruled that, when a plaintiff affixes a deed of trust that he/she signed wherein MERS is named as a beneficiary with the right to transfer such rights, the plaintiff's arguments that MERS is not a beneficiary under the security instrument are without merit. *Cebrun v. HSBC Bank USA, N.A.*, 2011 WL 321992 at *3. The St. Johns' case and arguments are not materially distinct from that of *Cebrun*. *See id.*

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[1] A court may take judicial notice of authentic documents that are publicly recorded, attached to or relied extensively upon in a plaintiff's complaint. *See, e.g., Shaw v. Hahn,* 56 F.3d 903, 908 (9th Cir. 2003); *United States v. Ritchie*, 342 F.3d 903, 908 (9th Cir. 2003); *Parrino v. FHP, Inc.*, 146 F.3d 669, 707 (9th Cir. 1998).

The Court's ruling in *Cebrun* is not without support from state courts and other district courts within the Ninth Circuit. *See* Dkt. 22 at 6-7 (collecting cases). Therefore, the Court rules the same in this case and rejects the St. Johns' argument on this issue.

2. Recordation of Assignments & Timing of Trustee Appointment

The St. Johns seek declaratory relief as to whether "MERS duly and appropriately executed and/or recorded all endorsements and assignments of the beneficial interest in the Note and Deed of Trust and therefore whether non-judicial foreclosure is allowed by statute." Complaint ¶ 32.

However, Washington State does not require recording of such transfers and assignments. *See* RCW 61.24.005(2) (defining Beneficiary as "the holder of the instrument or document evidencing the obligations secured by the deed of trust"). *See also, e.g., In re United Home Loans*, 71 B.R. 885, 891 (W.D. Wash. 1987), *aff'd* 876 F.2d 897 (9th Cir. 1989) ("assignment of a deed of trust . . . is valid between the parties whether or not the assignment is ever recorded"; "recording of the assignments is for the benefit of third parties).

Additionally, the St. Johns argue that the foreclosure proceeds were invalid because the assignment of the Deed of Trust and appointment of a successor trustee occurred after the issuance of a notice of default in June 2009. However, this claim is unavailing because the notice of foreclosure itself states that the "Beneficiary *or* the Trustee" issued the notice of default, which is consistent with the Deed of Trust Act under RCW 61.24.030. Thus, the St. Johns have not established any relevance to the fact of timing in this case.[2]

Therefore, the St. Johns' reliance on a lack of recording argument and the timing of assignment of the deed of trust and appointment of a successor trustee are each unavailing.

3. Failure to Disclose Affiliated Business Arrangements

The St. Johns contend that Countrywide "failed to disclose all affiliated business arrangements regarding [the St. Johns'] loan, hence, [the St. Johns] are in doubt and are uncertain as to their [legal] rights . . . ." Complaint ¶ 33. Because Countrywide is not a party to this action and because the St. Johns have not supplied adequate authority that such an uncertainty on their part creates any cause of action herein, the Court denies relief on this basis.

4. Ownership of the Note

In opposing BOFA and MERS' motion to dismiss, the St. Johns make argument regarding the true "note holder" and claim that BANA is not the true "note holder." The St. Johns further contend that "there is not evidence that the note was transferred," and that Defendants are obligated to produce "an unbroken chain of endorsements of the Note." Dkt. 25 at 2.

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[2] Additionally the notice that the St. Johns' claim was untimely is no longer valid. That notice stated the sale would take place on November 9, 2010, which did not occur. *See* Complaint, Ex. F (notice of trustee's sale); *see also* RCW 61.24.040(6) (notice can only be effective for 120 days). Here, the 120 days has expired and no new notice has been recorded. Therefore, the timeliness argument could also be denied as moot.

However, the undersigned and other courts have routinely rejected this so-called "show me the note" argument. *See, e.g., Freeston v. Bishop, White, & Marshall*, 2010 WL 1186276 (W.D. Wash. 2010); *Wallis v. IndyMac Fed. Bank*, 2010 WL 2342530 at *5 (W.D. Wash. 2010). The St. Johns have not alleged sufficient facts or provided the Court with adequate authority to rule any differently in their case than it has in substantially similar cases presenting the same argument. *See id.*

Therefore, the Court rejects the St. Johns' argument on this issue.

5. TILA & FTC

In opposition to BOFA and MERS' motion to dismiss, the St. Johns argue that they guaranteed a "right of recoupment and setoff pursuant to C.F.R. 16 § 433.2 (Federal Trade Commission ("FTC")), 15 U.S.C. § 1640(e) (Truth in Lending Act, "TILA") <u>without limitation</u> if the loan contract is breached." Dkt. 25 at 5 (underlining in original). Here, the St. Johns have not alleged sufficient facts to invoke these provisions in their case or persuaded the Court that such facts could be alleged to support a claim for such relief.

Therefore, their claims for relief under TILA and the FTC fail.[3]

6. Conclusion

Because the St. Johns have failed to state a claim upon which relief can be granted, they are not entitled to declaratory or injunctive relief for their claims against

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[3] The St. Johns did not allege in their complaint that BOFA or MERS violated TILA or FTC regulations. Instead such relief is requested within their response in opposition to the motion to dismiss, which is improper. This is another basis upon which the Court could deny relief under TILA and the FTC regulations.

BOFA or MERS. *See, e.g., Marin v. Lowe* 8 F.3d 28 (9th Cir. 1993) (a substantial controversy must exist to warrant declaratory judgment); RCW 61.24.130 (setting out requirements for such injunctive relief in the case of a trustee's sale).[4] Therefore, based on the foregoing, dismissal as to the St. Johns' claims against BOFA and MERS is granted herein.

C. NWTS Motion to Dismiss

The only claim or argument made against NWTS that differs from the St. Johns' arguments against BOFA and MERS is that NWTS is not a valid trustee. However, the St. Johns have not alleged any facts to support this assertion. Therefore, for the reasons stated herein, NWTS' motion to dismiss the St. Johns' claims against it is granted.

D. St. Johns' Cross Motion to Void Defective Foreclosure & Sale

Because the notice of trustee's sale has expired and no new notice has issued, the St. John's cross motion to void foreclosure is denied as moot. An additional basis to deny the cross motion is that the St. Johns have failed to follow the statutory procedure required to challenge the alleged invalid non-judicial foreclosure. *See* RCW 61.24.130 (requiring, among other things, payments to the court clerk of sums that would be due on the obligation secured by the deed of trust).

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[4] Additionally, even if the Court were to grant injunctive relief, the St. Johns would be required under RCW 61.24.130(a) to make payments owed on the outstanding mortgage debt to the court clerk every 30 days during the period of any injunctive relief. Here, the St. Johns have not made any claims that they are capable of making such payments and the Court is unaware of any such payments to date.

IV. ORDER

Therefore, it is hereby **ORDERED** that:

(1) Defendants' respective motions to dismiss are **GRANTED**;

(2) The St. Johns' motion to void defective foreclosure is **DENIED**; and

(3) The St. Johns' case is **DISMISSED** for the reasons stated herein.

Dated this 29th day of September, 2011.

BENJAMIN H. SETTLE
United States District Judge