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## Toward a More Equitable Balance: Homeowner and Purchaser Tensions in Non-Judicial Foreclosure States

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# TOWARD A MORE EQUITABLE BALANCE: HOMEOWNER AND PURCHASER TENSIONS IN NON-JUDICIAL FORECLOSURE STATES

*Elizabeth Renuart* \*

## INTRODUCTION

We are now facing the fifth year of the fallout from the subprime mortgage meltdown. The economic crisis gripping the United States began when large numbers of homeowners defaulted on poorly underwritten subprime mortgage loans. The percentage of homeowners seriously delinquent on their mortgage payments stood at 2.23% (or almost 980,000 loans) at the dawn of 2007.<sup>1</sup> This percentage rose dramatically to a peak of 9.67% (or almost 4.3 million loans) by the end of 2009. As of the fourth quarter of 2011, those numbers remain shockingly high: 7.73% of all residential mortgage loans were seriously delinquent, *i.e.*, almost 3.3 million loans.<sup>2</sup>

Through securitization, the process of utilizing mortgage loans to back investment instruments, Wall Street funded subprime originations in excess of \$480 billion in each of the peak years—2005 and 2006, thereby fueling the potential hazards should the underlying loans fail.<sup>3</sup> There is growing evidence that the parties to securitization deals handle and transfer the loan notes and mortgages in a careless and, at times, fraudulent manner.<sup>4</sup>

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<sup>1</sup> Mortgage Bankers Association, *National Delinquency Survey*, Q1 2007 at 4, Q4 2009 at 4. This survey defines “seriously delinquent” mortgage loans as those that are ninety days or more delinquent or are in foreclosure.

<sup>2</sup> Mortgage Bankers Association, *National Delinquency Survey*, Q4 2011 at 4.

<sup>3</sup> *Inside Mortgage Finance*, 1 THE 2008 MORTGAGE MARKET STATISTICAL ANNUAL, 2008, at 3.

<sup>4</sup> Elizabeth Renuart, *Property Title Trouble in Non-Judicial Foreclosure States: The Ibanez Time Bomb?*, \*7-\*16, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1968504](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1968504) (4 WM. & MARY BUS. L. REV. (forthcoming 2013)) (compiling examples of this evidence).

Consequently, the foreclosing parties frequently do not possess the right to foreclose and the resulting sales may be unlawful. These defective sales harm homeowners when they lose their homes to the wrong party.<sup>5</sup> Wrongful foreclosures affect another important group, the purchasers. If title to the property is flawed as a result, purchasing parties potentially buy nothing and can transfer nothing. As a result, clear title to real property acquired via foreclosure sales in the United States may be in jeopardy. In non-judicial foreclosure states where the doctrines of finality do not apply and state law may permit post-sale challenges, this uncertainty is most acute.

In a previous article, I explored the recent decisions issued by the Massachusetts Supreme Judicial Court which addressed whether the foreclosing party must be the mortgagee or possess a valid assignment of the mortgage prior to a sale and whether this deficiency voids the sale.<sup>6</sup> I summarized the foreclosure law of Massachusetts and compared it to the law in four other non-judicial foreclosure states to assess whether these opinions could be persuasive authority in those states. I then drew conclusions as to the probability of post-sale title defects and challenges to title that purchasers could face.

In this article, I continue that discussion by exploring the rights and interests of homeowners and purchasers and by addressing potential solutions to conflicts between them. To examine these concerns, Part I describes the authority-to-foreclose issues that can fatally infect a foreclosure sale. Part II identifies the rights and interests of homeowners and purchasers affected by possibly defective sales. Part III outlines selected state laws that permit or restrict post-sale challenges to title. Finally, Part IV analyzes possible legislative solutions to the tensions between and concerns of homeowners and *bona fide* purchasers.

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<sup>5</sup> U.S. Gov't Accountability Office, GAO -11- 433, 41-42, Mortgage Foreclosures: Documentation Problems Reveal Need for Ongoing Regulatory Oversight (2011) [hereinafter GAO Report], *available at* <http://www.gao.gov/new.items/d11433.pdf> (last visited Feb. 28, 2012) (noting that homeowners vacate in anticipation of imminent foreclosures and search for alternative housing; vacant homes increase the likelihood of "crime, blight, and declining property values).

<sup>6</sup> Renuart, *supra* note 4, at \*33-\*38. The Massachusetts decisions reviewed include: *U.S. Bank Nat. Ass'n. v. Ibanez*, 458 Mass. 637, 941 N.E.2d 40 (Mass. 2011); *Bevilacqua v. Rodriguez*, 460 Mass. 762, 955 N.E.2d 884 (Mass. 2011); *Eaton v. Fed. Nat. Mortg. Ass'n*, SUCV201101382, 2011 WL 6379284 (Mass. Super. June 17, 2011), *appeal pending* (addressing the issue of whether the foreclosing party also must possess the right to enforce the note prior to the sale).

## I. POTENTIAL FLAWS IN THE FORECLOSURE SALE PROCESS

Many types of deficiencies or fraudulent behavior can occur in the foreclosure process. These include: the failure to provide contractually or legally required notices; lack of authority to foreclose; fraud in the process; rigging the sale; grossly inadequate sale price; and other irregularity or unfairness.<sup>7</sup> This section focuses on two issues that fall under the category of “authority to foreclose” that appear with some frequency in the current foreclosure crisis: the failure of the foreclosing party to possess the right to enforce the note and mortgage and the lack of authority to foreclose because the homeowner is not in default.

This section also describes the consequences of these defects upon foreclosure sales in non-judicial foreclosure states which encompass the majority of states. In these states, lenders foreclose by exercising the power of sale included in the security instrument.<sup>8</sup> These foreclosures proceed with little or no judicial oversight.<sup>9</sup> Following a default by the homeowner, a specific party, *e.g.*, the mortgagee or its assignee or the trustee listed in a deed of trust, may sell the property after it provides required notices and advertises the sale date.<sup>10</sup> Lenders benefit from the power of sale process because it provides an inexpensive and quick remedy against defaulting homeowners.<sup>11</sup> Depending upon state law, these sales can be completed in twenty to one hundred twenty days.<sup>12</sup> From the homeowner’s perspective, the non-judicial foreclosure process is harsh in its treatment of homeowners because there is no judicial oversight.<sup>13</sup> Defects in title to foreclosed homes and the possibility of

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<sup>7</sup> Molly F. Jacobson-Greany, *Setting Aside Non-judicial Foreclosure Sales: Extending the Rule to Cover Both Intrinsic and Extrinsic Fraud or Unfairness*, 23 EMORY BANKR. DEV. J. 139, 151-156 (2006) (listing certain statutory and common grounds to set aside a sale); *Bank of America v. La Jolla Group II*, 129 Cal. App. 4<sup>th</sup> 706, 713-14, 28 Cal. Rptr. 3d 825, 830-31 (Cal. Ct. App. 2005) (holding that where the loan was current due to an agreement to cure, the beneficiary had no right to foreclose under these circumstances and sale was invalid).

<sup>8</sup> Jacobson-Greany, *supra* note 7, at 144-150.

<sup>9</sup> *Id.* at 151.

<sup>10</sup> 4 POWELL ON REAL PROPERTY § 37.42[4]. Unless otherwise noted, the word “mortgage,” refers to the instrument that secures the debt represented by the loan note by taking an interest in real property and includes all forms of these instruments, such as, mortgages, deeds of trust, and security deeds.

<sup>11</sup> Renuart, *supra* note 4, at \*33.

<sup>12</sup> *Id.*

<sup>13</sup> Jacobson-Greany, *supra* note 7, at 150-151 (arguing for an expansion of the equitable grounds available to challenge a wrongful foreclosure).

post-sale challenges are greater because finality doctrines, such as *res judicata*, do not apply.<sup>14</sup>

### A. Lack of Authority to Foreclose

A “mortgage loan” consists of two distinct documents: a note and a security agreement.<sup>15</sup> The loan note represents the legal obligation to repay money advanced by the lender for use by the borrower.<sup>16</sup> In most states, a mortgage creates a security interest in the borrower’s real property and permits the mortgagee to foreclose in the event of non-payment or a breach of the note or duties listed in the security agreement.<sup>17</sup>

All over the country, courts are scrutinizing whether the parties initiating foreclosures against homeowners legally possess the authority to repossess those homes.<sup>18</sup> Authority to foreclose in this context refers to the failure of the foreclosing entity to possess the right to enforce the loan note and the mortgage.<sup>19</sup> When the authority is absent, foreclosure sales may be reversed.

The complexities of securitization contributed to a breakdown in the transfer of the mortgage loans from one entity to the next along the chain of players.<sup>20</sup> Evidence of this carelessness and, sometimes, fraud appears in court decisions, the findings of investigations, studies by law professors, news reports, Congressional testimony, and shareholder lawsuits.<sup>21</sup>

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<sup>14</sup> In contrast, once the judgment is final in a judicial proceeding, the usual doctrines related to finality apply. Grant S. Nelson & Dale A. Whitman, 1 REAL ESTATE FINANCE LAW § 7.18 (4th ed. 2002) (explaining that finality doctrines eliminate most or all defenses to the action; they also protect the rights of the purchaser at the sale and stabilize title).

<sup>15</sup> *Id.* at § 5.27.

<sup>16</sup> The notes used in mortgage loan transactions usually are “promissory notes” as defined in the Uniform Commercial Code (UCC) § 9-102(a)(65) (“‘Promissory note’ means an instrument that evidences a promise to pay a monetary obligation, does not evidence an order to pay, and does not contain an acknowledgment by a bank that the bank received for deposit a sum of money or funds.”).

<sup>17</sup> 4 RICHARD R. POWELL, POWELL ON REAL PROPERTY § 37.03 (Michael Allan Wolfe ed., LexisNexis Matthew Bender 2010) (hereinafter “4 Powell on Real Property”) (stating that in “title” states, by way of contrast, the mortgage vests legal title in the mortgagee or beneficiary).

<sup>18</sup> Renuart, *supra* note 4, at \*7-\*8 (text accompanying notes 17-19).

<sup>19</sup> RESTATEMENT (THIRD) OF PROPERTY (MORTGAGE) § 5.4(c) states that: “A mortgage may be enforced only by, or in behalf of, a person who is entitled to enforce the obligation the mortgage secures.”

<sup>20</sup> Renuart, *supra* note 4, at \*6-\*18.

<sup>21</sup> *Id.* at \*7-\*16 (compiling examples of this evidence).

Whether lack of authority to foreclose voids the sale in the hands of a purchaser depends on the law in each non-judicial foreclosure state. If the sale is merely voidable, then a purchaser who pays value and purchases without notice of any defect takes good title.<sup>22</sup> By contrast, in Massachusetts, the sale is void.<sup>23</sup> Moreover, the defect in title follows the property such that the purchaser cannot pass title because the purchaser failed to obtain title of the property from the original sale.<sup>24</sup>

Elsewhere, I opine that *Ibanez* should be influential in other non-judicial states, for example, Georgia and Nevada, and result in the reversal of defective foreclosure sales.<sup>25</sup> For the remainder of this essay, I will assume that lack of authority to foreclose renders the sale void and passes no title to the purchaser.

### B. No Default by the Homeowner

Lack of authority to foreclose also arises when the homeowner has not defaulted under the terms of the note, mortgage, or modifications thereof. For example, the homeowner and the servicer agree to a loan modification or to a plan to cure alleged arrearage.<sup>26</sup> The homeowner fulfills her obligations but, nevertheless, the servicer initiates foreclosure. The resulting sale likely is invalid.<sup>27</sup> Professor Porter details examples of servicer abuses, miscalculations, and poor record keeping that can result in wrongful foreclosures.<sup>28</sup> For example, servicers fail to keep complete, accurate, and

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<sup>22</sup> Nelson & Whitman, *supra* note 14, at § 7.21; *Bevilacqua v. Rodriguez*, 955 N.E.2d 884, 897 (Mass. 2011).

<sup>23</sup> *U.S. Bank Nat. Ass'n. v. Ibanez*, 941 N.E.2d 40, 50 (Mass. 2011).

<sup>24</sup> *Bevilacqua*, 955 N.E.2d at 892-83 (also finding, though, that the purchaser was not a BFP).

<sup>25</sup> Renuart, *supra* note 4, at \*61-\*62, \*69-\*70.

<sup>26</sup> The "servicer" acts on behalf of the mortgagee or its assignee to collect the monthly payments, manage the accounts, and interact with the homeowner in the event of disputes, requests to modify the loan, or default. Diane E. Thompson, *Foreclosing Modifications: How Servicer Incentives Discourage Loan Modifications*, 86 WASH. L. REV. 755, 759-65 (2011).

<sup>27</sup> *E.g.*, *Bank of America v. La Jolla Group II*, 129 Cal. App. 4th 706, 713-14, 28 Cal. Rptr. 3d 825, 830-31 (Cal. Ct. App. 2005) (holding that where the loan was current due to an agreement to cure; beneficiary had no right to foreclose under these circumstances and sale was invalid).

<sup>28</sup> *See generally* Katherine Porter, *Misbehavior and Mistake in Bankruptcy Mortgage Claims*, 87 TEX. L. REV. 121 (2008) (illustrating the industry practices which result in wrongful foreclosures).

comprehensible payment records.<sup>29</sup> Servicers rely, in part, upon the fee income they impose upon homeowners, such as late, property inspection, and other default fees, which can drive loans into default.<sup>30</sup>

We now turn to the interests of the two parties with the most to lose by defective foreclosures: homeowners and purchasers. Defective sales also undermine the strong public policy supporting the integrity of the legal and property title systems.

## II. THE INTERESTS OF HOMEOWNERS, PURCHASERS, AND THE LEGAL AND PROPERTY TITLE SYSTEMS

### A. Homeowners

There are at least four major concerns of homeowners that warrant discussion, and, possibly, protection in the context of non-judicial foreclosures: repossession of their homes without meaningful oversight; roadblocks to challenging the validity of the foreclosure; losing their homes to the wrong party; and, incurring double liability. I discuss each of these issues in order.

First, the parties seeking to sell a home, even if the homeowner is behind on payments, should strictly comply with foreclosure requirements in states without readily available judicial oversight. After all, a family's home is at stake. Typically, non-judicial foreclosure is a quicker, easier, and less costly method to repossess a borrower's home than accomplishing the same result through the judicial procedure.<sup>31</sup> In effect, non-judicial foreclosure is a form of self-help repossession of one of the most important assets a person can own—her home. In the words of one law professor:

Courts have noted that a power of sale contained in a deed of trust [or mortgage] is a 'harsh method' of enforcing lenders' right. Indeed, non-judicial foreclosure sales are 'much liable to abuse' and should be 'jealously watched by courts of equity.' With the possibility of abuse in the system, it makes sense that debtors should be protected from the

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<sup>29</sup> *Id.* at 131-132, 134-135

<sup>30</sup> *Id.* at 127; Thompson, *supra* note 26, at 803-805 (describing why and how servicer entitlement to fee income encourages foreclosures).

<sup>31</sup> Nelson & Whitman, *supra* note 14, at §§ 7.11, 7.19 (comparing judicial and non-judicial foreclosure).

wrongful loss of their property.<sup>32</sup>

In short, the homeowner who mortgages her property can lose it without ready access to the courts.<sup>33</sup>

Contrast this situation with that of tenants in possession of a leasehold interest in real property and of borrowers who owe unsecured debt. In the first scenario, the landlord normally must file a lawsuit in the appropriate court to terminate the tenancy based upon non-payment of the rent and seek an order of eviction.<sup>34</sup> Essentially, the landlord must prove its right to possession of the premises.<sup>35</sup> Likewise, in the second situation, the unsecured creditor must pursue collection through the judicial system if its borrower defaults on the debt and fails to repay the arrears.<sup>36</sup> Like the landlord, the creditor must prove its right to collect on the debt. Only after the court enters a judgment against the borrower may the creditor execute on the judgment by obtaining writs to attach the borrower's property to satisfy the judgment.<sup>37</sup> Outside of these contexts, imagine for a moment the outcry that would arise if one business could repossess and sell another's business without first possessing the authority to proceed.

Second, mistakes, misbehavior, and outright fraud by those initiating the foreclosure occur.<sup>38</sup> Homeowners have a legitimate

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<sup>32</sup> Jacobson-Greany, *supra* note 7, at 167 (*quoting* Sys. Inv. Corp. v. Union Bank, 98 Cal. Rptr. 735, 745 (Cal. Ct. App. 1971), and Pugh v. Richmond, 425 S.W.2d 789 (Tenn. Ct. App. 1967)).

<sup>33</sup> The burden rests on the homeowner to challenge the initiation of a non-judicial foreclosure either by filing an affirmative action seeking an injunction or by filing a bankruptcy to obtain the automatic stay, if eligible to do so. If the homeowner is strapped for cash, the cost of pursuing these remedies pre-sale is daunting. Once the sale occurs, the burden remains on the homeowner to challenge the validity of the sale on the grounds available under state law. The same cost roadblock arises but the permissible reasons to contest the sale shrink. Renuart, *supra* note 4, at \*74.

<sup>34</sup> ROBERT S. SCHOSKINSKI, AMERICAN LAW OF LANDLORD AND TENANT §§ 6.5, at 400; 6:11, at 410-412 (Lawyer's Co-operative 1980 & West Supp. 2011) (noting that judicial eviction is required in a growing majority of states).

<sup>35</sup> *Id.* § 6:17, at 421-425.

<sup>36</sup> ELIZABETH WARREN & JAY LAWRENCE WESTERBROOK, THE LAW OF DEBTORS AND CREDITORS, 33-34 (ASPEN PUBLISHERS 2009).

<sup>37</sup> Warren & Lawrence, *supra* note 34; *See, e.g.*, Grupo Mexicano de Desarrollo v. Alliance Bond Fund, Inc, 527 U.S. 308 (1999) (reversing the issuance of an injunction prohibiting the debtor from transferring its assets before the creditor obtained a money judgment).

<sup>38</sup> *See* Porter, *supra* note 28, at 123-28.



interest in a legal process to challenge foreclosure for lack of authority. Nonetheless, former homeowners simply do not have the resources to challenge defective sales in great numbers.<sup>39</sup> The legal obstacles to initiating and prevailing in such contests are daunting. For example, the state may prevent or limit the filing of post-sale challenges.<sup>40</sup> In some states, delivery of the foreclosure deed to the purchaser or the land registry office creates a presumption of compliance with specific contractual and legal requirements in favor of the purchaser.<sup>41</sup> Moreover, a state may require the homeowner to tender the arrearage in an action to cancel the foreclosure deed or plead the conditions showing that tender is inequitable.<sup>42</sup>

Third, the wrong party may foreclose and, consequently, profit from its actions. Such a result may occur when the foreclosing party does not possess the right to enforce the note and mortgage at the relevant time or the homeowner has not defaulted. This concern dovetails with legal maxims often applied in equitable actions. For example, the doctrine of clean hands states that “a party cannot seek equitable relief or assert an equitable defense if that party has violated an equitable principle, such as good faith.”<sup>43</sup> To be sure, a defaulting homeowner is not wholly innocent. Nonetheless, the law should protect such homeowners from the wrong party taking their home because, when weighing the equities between the two, the wrong party has no right to force a sale and is a mere trespasser. As, United States District Court Judge Young explains: “It is clear . . . that [the homeowner] is substantially behind in her payments and appears unable to remediate her default. This, however, does not render her an outlaw, subject to having her home seized by whatever bank or loan servicer may first lay claim to it. She still has legal rights.”<sup>44</sup>

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<sup>39</sup> Renuart, *supra* note 4, at 74. The resources necessary to commence litigation include: the money to become current on the loan, if in default and to hire an attorney and the energy and desire to fight for a home in which they no longer live.

<sup>40</sup> ARIZ. REV. STAT. § 33-811(C) (2012) (limiting the filing of a challenge to 5:00 P.M. on the day before the sale); NEV. REV. STAT. 107.080(5) (2010) (creating a ninety day limitation period on the filing of a post-sale challenge).

<sup>41</sup> See, e.g., ARIZ. REV. STAT. § 33-811(B) (2012); CAL. CIV. CODE § 2924(c) (2011).

<sup>42</sup> HARRY D. MILLER AND MARVIN B. STARR, 4 CAL. REAL ESTATE § 10:212 (3d. ed. updated Oct. 2010).

<sup>43</sup> BLACK’S LAW DICTIONARY 286 (8<sup>th</sup> ed. 2004). See also California’s codification of a general prohibition against profiting from wrongful behavior. CAL. CIV. CODE § 3517 (“No one can take advantage of his own wrong.”).

<sup>44</sup> Culhane v. Aurora Loan Servs. of Nebraska, No. 11-11098-WGY, 2011 WL 5925525, at \*5 (D. Mass. Nov. 28, 2011).

Fourth, if the foreclosing party does not possess the right to enforce the note, the actual holder of the note could attempt to collect after the sale, which potentially subjects the homeowner to double liability.<sup>45</sup> This result is patently unfair to the homeowner even if she has defaulted.

### B. Purchasers

There are two common types of purchasers at foreclosure sales: foreclosing or affiliated parties and unaffiliated parties. The foreclosing party is often the bank acting as trustee on behalf of a trust containing a pool of securitized mortgages.<sup>46</sup> It will purchase the property at the sale if no one bids or the bids are unsatisfactory. When this occurs, the properties are held by the bank in its "real-estate-owned" (REO) inventory until re-sale to third parties.

Generally, purchasers at foreclosure sales or of REO properties consist of affiliated or unaffiliated investors and of individuals who wish to live in the home following purchase. There appears to be little national or state-by-state data on purchaser identity.<sup>47</sup> In Arizona, a state with one of the highest foreclosure

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<sup>45</sup> *Id.* at \*11 (and cases cited therein).

<sup>46</sup> Renuart, *supra* note 4, at \*17-\*18 (identifying the trustee bank as the party to the securitization that is to acquire the notes and mortgages and hold them in trust for the benefit of the investors, according to the deal documents).

<sup>47</sup> Publicly available data shows that, nationally, banks purchased about 66% of the 355,000 residential properties auctioned at their foreclosure sales in 2006. CoreLogic, U.S. Housing and Mortgage Trends 3 (Oct. 2011), [http://www.corelogic.com/about-us/researchtrends/asset\\_upload\\_file312\\_14168.pdf](http://www.corelogic.com/about-us/researchtrends/asset_upload_file312_14168.pdf) (last visited March 22, 2012). Banks re-sold approximately 90% of their 2006 REO inventory; of that, half was resold within six months; but the banks could not dispose of 21% of the properties until more than 12 months after the property entered REO status. Ten percent remained in inventory as of the second quarter of 2010. *Id.*

Nearly 180,000, or 85 percent, of REO sales (of 2006 auctions), were sold again within the subsequent five years. Over 11,000, or 5 percent, of the REO sales sold three times within the subsequent five years, and nearly 70 percent of these 'churned' properties were initially purchased with cash. This is a persistent finding throughout auctions in later years - properties initially sold with cash are much more likely to transact multiple times again. Only 2 percent of REO mortgaged sales went back into REO within the five years since the initial auction. This indicates that REO recidivism is not as significant a concern as previously thought.

As of the end of the third quarter of 2011, REO inventory declined 1.5% from \$51.3 billion the previous quarter and 5% lower than a year ago. John Prior, *Banks*

rates, auctions attract droves of investors “who are eager for cut-rate houses that they can resell or rent out . . .”<sup>48</sup> Other available information sheds light on the type of purchaser in the subset of sales of REO property, rather than the larger universe of all foreclosure auctions. One study shows that of the properties entering REO in Fulton County, Georgia in 2005-2008 and the first four months of 2009, the sales of REO property totaled 21,474.<sup>49</sup> Of these sales, the percentage of “likely investor” buyers ranged from 39.4% to 44.3%.<sup>50</sup>

A bank with REO inventory is faced with property it does not want to own, possible title, repair, lien, and tax issues that it must clear before it can sell, mounting maintenance costs, and other headaches. The larger the inventory, the faster the bank will want to sell and the lower a price it might be willing to accept.<sup>51</sup> As a result, a bank's major concerns include: obtaining clear title to the foreclosed property so that it can resell the property and so that the purchaser can obtain property title insurance; expeditiously ejecting anyone residing in the property; and, re-selling as quickly as possible to avoid additional costs and depreciation of the property.<sup>52</sup>

In some areas, the concerns of investor purchasers and of purchasers intending to reside in the homes overlap. Both sets of buyers need to acquire clear and inviolate title to the properties at as low a price as possible. Additionally, neither group desires to undertake litigation or incur other unexpected costs to fight with former homeowners or subsequent buyers over title.

However, investors differ from homebuyers in ability to

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*Chip Away At REO Inventory*, HOUSING WIRE (Nov. 22, 2011), <http://www.housingwire.com/2011/11/22/banks-chip-away-at-reo-inventory>.

<sup>48</sup> Ken Belson, *Foreclosure Auctions in Phoenix Show a Raw Form of Capitalism*, N.Y. TIMES, Jan. 15, 2012, at A11, available at <http://www.nytimes.com/2012/01/15/us/foreclosure-auctions-in-phoenix-show-capitalism-at-its-rawest.html> (observing: “[T]he auctions have grown into a scruffy economic circus where bargain hunters from around the world have scooped up houses often sold for less than half the value of the mortgage.”).

<sup>49</sup> Dan Immergluck, *Distressed and Dumped: Market Dynamics of Low-Value, Foreclosed Properties during the Advent of the Federal Neighborhood Stabilization Program*, J. OF PLANNING EDUCATION AND RESEARCH 4-5 (Oct. 10, 2011), available at <http://jpe.sagepub.com/content/early/2011/10/06/0739456X11423263>.

<sup>50</sup> *Id.* at 5.

<sup>51</sup> See, e.g., “Wells Fargo and REO Foreclosures,” RealtyTrac, <http://www.realtytrac.com/foreclosure/REO/wells-fargo-reo.html> (last visited Mar. 22, 2012).

<sup>52</sup> Elizabeth Weintraub, *Foreclosure Basics*, [http://homebuying.about.com/od/4closureshortsales/qt/093007\\_Foreclos.htm](http://homebuying.about.com/od/4closureshortsales/qt/093007_Foreclos.htm) (last visited April 24, 2012) (explaining the incentives to quickly sell REO inventory).

navigate the system and to manage risk. Investors are sophisticated and better equipped to discover and assess the risks involved in buying at foreclosure auctions or from REO inventory. Investor buyers also may bid lower than home-buyers because they intend to re-sell or lease out the acquired properties at a profit.<sup>53</sup> Home-buyers may bid higher because they may be more personally invested in the particular home on the auction block.

Purchaser interests and the legal protections they might reasonably expect also vary depending upon whether they acquire *bona fide* purchaser (BFP) status. BFPs are a subset of purchasers who act in good faith, pay value, and lack actual and constructive notice of defects in the sale process or of non-compliance with the legal and contractual prerequisites to foreclosure.<sup>54</sup> BFPs are “innocent” buyers who are more deserving of protection against defects in the sales than mere buyers who are aware of defects in the process.<sup>55</sup> State law typically affords BFPs special protections against subsequent challenges to title.<sup>56</sup> In contests between homeowners and BFPs, courts and policy makers must weigh these varying concerns.

### C. Legal System

The integrity of our legal system depends upon all parties following the rules.<sup>57</sup> Non-judicial foreclosure rules favor the

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<sup>53</sup> Motoko Rich, *Investors Are Looking to Buy Homes by the Thousands*, N.Y. TIMES, Apr. 2, 2012, at B1, available at [http://www.nytimes.com/2012/04/03/business/investors-are-looking-to-buy-homes-by-the-thousands.html?\\_r=1&ref=motokorich](http://www.nytimes.com/2012/04/03/business/investors-are-looking-to-buy-homes-by-the-thousands.html?_r=1&ref=motokorich) (describing the factors that investors who intend to rent purchased properties take into consideration when deciding upon their foreclosure bid).

<sup>54</sup> For example, California and Massachusetts define a BFP to be one who pays value and possesses no knowledge, actual or constructive, of irregularities. See *Bevilacqua v. Rodriguez*, 955 N.E.2d 884, 896 (Mass. 2011); *Melendez v. D & I Inv., Inc.*, 127 Cal. App. 4th 1238, 1251-52, 26 Cal. Rptr. 3d 413, 424-25 (Cal. Ct. App. 2005). (observing that In order to achieve *bona fide* status, a purchaser must pay value in good faith and without actual or constructive notice of another’s rights). In contrast, Arizona defines a BFP as one who pays value without *actual* notice of non-compliance with the contract provisions in the deed of trust and the statutory requirements to foreclose. *Main I Ltd. P’ship v. Venture Capital Const. & Dev. Corp.*, 741 P.2d 1234, 1237-38 (Ariz. Ct. App. 1987).

<sup>55</sup> *Jacobson-Greany*, *supra* note 7, at 171-72.

<sup>56</sup> See discussion in Section III, *infra*.

<sup>57</sup> In discussing the lawsuit that Delaware recently filed against Mortgage Electronic Registration System ( “MERS” ), Attorney General Biden stated: “A man or woman’s home is not just his or her largest investment, it’s their castle. Rules matter. A homeowner has the obligation to pay the mortgage on time, and

foreclosing party, but that party must possess the authority to sell the home—just like landlords and unsecured creditors must prove their right to evict or to a money judgment. To permit otherwise opens the door to abuse.<sup>58</sup>

Disturbingly, the form of the abuse arising in the context of the careless handling of notes and mortgages can rise to the level of fraud upon the court. For example, the Florida Attorney General found forged signatures on mortgages and indorsements<sup>59</sup> of notes; falsifications of dates on mortgage assignments; bogus grantees and grantors listed on mortgage assignments; and lack of knowledge of bank employees who signed transfers of notes and mortgages. Moreover, the investigators discovered that the agents or attorneys for the foreclosing parties recorded many of these defective or fraudulent documents and relied upon them in court.<sup>60</sup> Judges unknowingly used that false information when approving foreclosures. When this occurs, the judicial system loses credibility and the buy-in needed to ensure that parties respect and voluntarily

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lenders must follow the rules if they are seeking to take away someone's house through foreclosure." Press Release, Delaware Attorney General, Biden: Private National Mortgage Registry Violates Delaware Law (Oct. 27, 2011), available at <http://attorneygeneral.delaware.gov/media/releases/2011/law10-27.pdf>. See also Gretchen Morgenson, *From East and West, Foreclosure Horror Stories*, N.Y. TIMES, Jan. 8, 2012, at B1, available at <http://www.nytimes.com/2012/01/08/business/mortgage-servicing-horror-stories-fair-game.html?pagewanted=all> (quoting the Nevada Attorney General Catherine Cortez Maestro in the context of reporting about the lawsuit her office filed against Lender Processing Services containing allegations of widespread document fraud in the context of mortgage transactions and foreclosure: "If you are going to allow banks to skate around the integrity of the system, what kind of justice is that?").

<sup>58</sup> See *Grupo Mexicano de Desarrollo*, 527 U.S. 308, 330 (1999) (raising the issue of abuse in the context of refusing to freeze assets in the hands of the debtor before first obtaining a judgment).

<sup>59</sup> I use the spelling of the word "indorsement" as it appears in the Uniform Commercial Code, § 3-204.

<sup>60</sup> Office of the Attorney General of the State of Florida, Economic Crimes Division, "Unfair, Deceptive and Unconscionable Acts in Foreclosure Cases: Presentation to the Florida Association of Court Clerks and Controllers" 27-35 (2010), available at <http://southfloridalawblog.com/wp-content/uploads/2011/01/46278738-Florida-Attorney-General-Fraudclosure-Report-Unfair-Deceptive-and-Unconscionable-Acts-in-Foreclosure-Cases.pdf> (including actual documents evidencing these practices and highlighting the example of Linda Green whose signature appears on "hundreds of thousands" of mortgage assignments and who is listed as an officer of dozens of banks and mortgage companies; presenting documents in which her signature was forged on many documents).

comply with its mandates.<sup>61</sup>

#### D. Property Title Systems

The recording of title to and conveyances of real property in the United States plays a critical role the American property system: “The policy justifications behind recording statutes are as germane today as they were hundreds of year ago when the first American colonies began adopting the statutes. Society needs an authoritative, transparent source of information on who owns land to protect property rights, encourage commerce, expose fraud, and avoid disputes.”<sup>62</sup>

State law varies as to when interests in real property other than deeds must be recorded. For example, Massachusetts does not require the recording of mortgage assignments; whereas, assignments must be recorded before the foreclosure sale in Georgia.<sup>63</sup> Thus, in some states, purchasers can discover information about the identity of the party possessing the right to enforce the mortgage before the sale. Whether a purchaser can attain BFP status depends, in part, upon whether it has constructive notice of certain defects, including the lack of authority to foreclose. Consequently, recordation of mortgage assignments serves the important public policy of providing accessible information in advance of a foreclosure sale that can affect the legal rights of the foreclosing party, the homeowner, and the purchaser. For these reasons, the accuracy of state recordation systems is essential.

The challenge, then, is to balance these important interests to

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<sup>61</sup> Peter H. Schuck, *Why Regulating Guns Through Litigation Won't Work*, in *SUING THE GUN INDUSTRY: A BATTLE AT THE CROSSROADS OF GUN CONTROL AND MASS TORTS* 244 (Timothy D. Lytton ed., 2005) (noting that the public perception that the law is legitimate induces compliance with and respect for the legal system).

<sup>62</sup> Christopher L. Peterson, *Two Faces: Demystifying the Mortgage Electronic Registration System's Land Title Theory*, 53 WM. & MARY L. REV. 111, 122-23 (2011). See also *Andy Assoc. v. Banker Trust Co.*, 299 N.E.2d 1160, 1164 (N.Y. 1979) (“[T]he recording act... was enacted to accomplish a twofold purpose. First, it was intended to protect the rights of innocent purchasers who acquire an interest in property without knowledge of prior encumbrances.... Second, the statute was designed to establish a public record which would furnish potential purchasers with notice, or at least ‘constructive notice’, of previous conveyances and encumbrances that might affect their interests.”).

<sup>63</sup> *U.S. Bank Nat. Ass'n. v. Ibanez*, 458 Mass. 637, 649-50 (2011) (recognizing that a mortgage assignment must be in writing although it need not be recorded); GA. CODE ANN. § 44-14-162(b) (West 2011) (requiring recordation before the sale).

protect each to the maximum extent possible.

### III. EXAMPLES IN EXISTING STATE LAW OF RULES AFFECTING HOMEOWNER AND PURCHASER INTERESTS

In this section, I summarize a non-exhaustive collection of existing state law provisions that address or affect two competing concerns: those addressing homeowner opportunities to challenge forced sales and those that create and protect finality of title in the hands of purchasers. I draw upon the law in Arizona, California, Georgia, Massachusetts, and Nevada and assess the extent to which the provisions balance homeowner and purchaser interests.<sup>64</sup>

The type of residential real estate security instrument commonly used in these states varies. The instrument predominantly used in Arizona, California, and Nevada to secure a debt or obligation is the deed of trust.<sup>65</sup> Unlike a mortgage, a deed of trust is a three-party instrument in which the trustor (borrower) conditionally conveys title to a third party (trustee) who holds it as security for the debt owed to the beneficiary (lender). In Georgia, the most common real estate security instrument is a security deed.<sup>66</sup> The uniform security deed used in Georgia by Fannie Mae and Freddie Mac labels the homeowner-grantor as the “borrower.” The grantee is referred to as the “lender.”<sup>67</sup> Finally, Massachusetts uses mortgages that label the lender as the mortgagee and the borrower as the mortgagor. When I identify a particular state’s law below and refer to that state’s mortgage security instrument, I will use the applicable generic names for the parties to that type of instrument where relevant.

#### A. Pre-Sale Mediation

Several states have adopted some form of pre-foreclosure mediation since the advent of the foreclosure crisis.<sup>68</sup> For example,

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<sup>64</sup> I rely upon the laws of these states because they have the highest seriously delinquent rates in the nation and because I carefully researched their laws in my previous article.

<sup>65</sup> Renuart, *supra* note 4, at \*45, \*50, \*63.

<sup>66</sup> *Id.* at \*57.

<sup>67</sup> See GEORGIA--Single Family--Fannie Mae/Freddie Mac UNIFORM INSTRUMENT Form 3011, 1/01, available at <http://www.freddie.mac.com/uniform/pdf/3011.pdf>.

<sup>68</sup> GEOFFREY WALSH, NATIONAL CONSUMER LAW CTR., STATE AND LOCAL FORECLOSURE MEDIATION PROGRAMS: CAN THEY SAVE HOMES? (Sept. 2009), available at

Nevada's Legislature created a Foreclosure Mediation Program for owner-occupied residential properties that are subject to foreclosure notices filed on or after July 1, 2009. "Its purpose is to address the foreclosure crisis head-on with the hope of keeping Nevada families in their homes."<sup>69</sup>

This procedure is not mandatory. Rather, the homeowner may elect to participate in the program.<sup>70</sup> Following this election, lenders must participate in good faith and provide certain documentation to the mediator and homeowner, including: the original or certified copy of the deed of trust; the loan note; and each assignment or transfer of the deed of trust and note.<sup>71</sup> The importance of this requirement is that the lender or the party claiming the right to foreclose must prove its entitlement before proceeding to sale. Indeed, if the party cannot show its authority to foreclose, the mediator cannot certify the foreclosure action to proceed.<sup>72</sup>

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[http://www.nclc.org/images/pdf/foreclosure\\_mortgage/mediation/report-state-mediatiion-programs.pdf](http://www.nclc.org/images/pdf/foreclosure_mortgage/mediation/report-state-mediatiion-programs.pdf) (analyzing the strengths and weakness of twenty-five of these programs) [hereafter Walsh I]; GEOFFREY WALSH, NATIONAL CONSUMER LAW CTR., STATE AND LOCAL FORECLOSURE MEDIATION PROGRAMS: UPDATES AND DEVELOPMENTS (Jan. 2010), *available at* [http://www.nclc.org/images/pdf/foreclosure\\_mortgage/mediation/report-state-mediatiion-programs-update.pdf](http://www.nclc.org/images/pdf/foreclosure_mortgage/mediation/report-state-mediatiion-programs-update.pdf) (discussing several additional mediation programs created in 2009). However, most of these states do not require the production of the loan note and mortgage—a deficiency that separates them from the Nevada scheme. Walsh I, *supra* note 68, at 18-19.

<sup>69</sup> See the Nevada Judiciary Foreclosure Mediation website: <http://www.nevadajudiciary.us/index.php/about-foreclosure-meditation>.

<sup>70</sup> Nev. Sup. Ct. Mediation R. 5(4), *available at* [http://www.nevadajudiciary.us/images/foreclosure/adkt435\\_amendedrules.pdf](http://www.nevadajudiciary.us/images/foreclosure/adkt435_amendedrules.pdf) (last visited March 11, 2012). The homeowner must pay ½ of the \$400 mediation fee. Nev. Sup. Ct. Mediation R. 14.

<sup>71</sup> Nev. Sup. Ct. Mediation R. 11. (listing the documentation requirements); *Pasillas v HSBC Bank USA*, 255 P.3d 1281, 1284 (Nev. 2011) (stating that the parties must mediate in good faith).

<sup>72</sup> *Pasillas*, 255 P.3d 1281 (Nev. 2011); *Leyva v. Nat'l Default Serv. Corp.*, 255 P.3d 1275 (Nev. 2011). Data released by the Nevada Judiciary shows that when the homeowner elected mediation, the program has prevented foreclosures and kept a significant number of homeowners in their homes, at least for some period of time. From September 14, 2009 through June 2011, 12,556 mediations were completed. Of these, 11,057 (88%) did not proceed to foreclosure because the mediator did not issue a certification for foreclosure; whereas, 1,499 (12%) did proceed to foreclosure. Of the 11,057 cases, the parties reached an agreement 50% of the time; in the remainder, a certification for foreclosure was not issued because of non-compliance with rules or the case was withdrawn. In the cases where the parties reached an agreement, 66% of the homeowners remain in their homes. Foreclosure Mediation Factsheet, *available at*



The documentation production rule motivates all lenders and their assignees to get their documents in order before proceeding with residential foreclosures in Nevada, regardless of whether the homeowner requests mediation. The mere possibility of having to document the authority to foreclose in a mediation process creates an important incentive. Those that cannot legitimately present these documents may be less likely to foreclose. As a result, pre-sale mediation fulfills three important goals, one explicit and two implicit: stemming the tide of foreclosures and keeping Nevadans in their home by encouraging loan workouts, ensuring that only the proper party ultimately forecloses, and protecting title in the hands of purchasers.

### *B. Post-Sale Evidentiary Presumptions of Compliance*

Once the foreclosing party issues a deed to the purchaser following a foreclosure sale, state law may create a presumption or prima facie evidence of compliance with the terms of the security instrument and certain statutory provisions. Arizona and California law provide examples.<sup>73</sup> The foreclosure deed is not conclusive evidence, unless the purchaser is a BFP.<sup>74</sup> Significantly though, these states differ regarding what it takes to become a BFP. Arizona law states that the purchaser must pay value without *actual* notice of non-compliance with the contract provisions in the deed of trust and the statutory requirements to foreclose.<sup>75</sup> Moreover, in Arizona, the foreclosure deed may not be conclusive where “the notice was insufficient because of fraud, misrepresentation, or concealment.”<sup>76</sup>

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<http://www.nevadajudiciary.us/index.php/viewdocumentsandforms/functionstartdown/1937/>.

<sup>73</sup> ARIZ. REV. STAT. ANN. § 33-811(B) (2012); CAL. CIV. CODE § 2924(c) (West 2011).

<sup>74</sup> ARIZ. REV. STAT. ANN. § 33-811(B) (2012); *Silving v. Wells Fargo Bank, N.A.*, 200 F. Supp. 2d 1055, 1064 (D. Ariz. July 7, 2011) (making this distinction); CAL. CIV. CODE § 2924(c) (West 2011).

<sup>75</sup> The purchaser must be without actual notice, as opposed to constructive notice. See *Main I Ltd. P'ship v. Venture Capital Const. & Dev. Corp.*, 741 P.2d 1234, 1237-38 (Ariz. Ct. App. 1987) (holding that even the named beneficiary in a deed of trust who purchased at the sale may acquire BFP status where it had no actual notice that entities who were not parties to the deed of trust were sent the notice of sale one day late).

<sup>76</sup> *Main I Ltd. P'ship*, 741 P.2d at 1238 (refusing, however, to void a foreclosure sale on the grounds that the trustee mailed the notice of sale to certain entities that were not parties to the deed of trust one day late because the purchaser paid value and took without actual notice, even though it was the beneficiary; no

In contrast, California requires that a purchaser must pay value in good faith and be without actual or constructive notice of another's rights.<sup>77</sup> And the presumption (either rebuttable or conclusive) does not arise when the basis of the challenge relates to non-notice issues, such as, lack of authority to foreclose and agreements to postpone or cancel the sale while the parties are negotiating a loan modification or where the homeowner is making payments under a repayment plan.<sup>78</sup>

Unquestionably, these statutes enhance the stability of title in the hands of BFPs. However, they do not eliminate it entirely for two reasons: first, the purchaser may not qualify for BFP status; and second, they do not restrict all types of challenges. This is positive from the homeowner's perspective, because there remain defects in the non-judicial process that she can raise to void the sale. However, title to the property is not certain and BFPs are not immune from the headaches and costs associated with lawsuits. In addition, the type of notice BFPs must possess to disqualify them from the evidentiary shield is important. As noted, Arizona protects BFPs quite stringently by disqualifying them only if they have actual notice. This approach permits purchasers to put their heads in the sand and to avoid checking public records for readily available information. In my view, California's statute more carefully balances the interests of homeowners and purchasers because it does not confer this special status on those who fail—or refuse—to review the relevant public records.<sup>79</sup> Regardless, neither rule protects the interests of homeowners and purchaser as well as other approaches.

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evidence of fraud, misrepresentation, or concealment presented).

<sup>77</sup> *Melendez v. D & I Inv., Inc.*, 26 Cal. Rptr. 3d 413, 424-45 (Cal. Ct. App. 2005) (rejecting argument that a purchaser cannot achieve BFP status if the purchaser is a speculator who frequents foreclosure sales and pays substantially less than the value of the property).

<sup>78</sup> *See, e.g., Bank of Am. v. La Jolla Group II*, 28 Cal. Rptr. 3d 825, 830-31 (Cal. Ct. App. 2005) (holding no presumption where the loan was current due to an agreement to cure; beneficiary had no right to foreclose under these circumstances; ruling that the § 2924(C) presumption arises only to notice requirements and not to every defect or inadequacy short of fraud); *Melendez*, 26 Cal. Rptr. 3d at 428 (ruling that the § 2924 presumption arises when the challenge to the sale relates to notice issues but not to other matters; finding, however, that repayment agreement was not orally modified and, consequently, there was no procedural irregularity in the sale process).

<sup>79</sup> *Melendez*, 26 Cal. Rptr. 3d at 428 (discussing the notice rationale and stating that the purchaser must make "reasonable inquiry").

### C. Post-Sale Challenges

States generally permit a homeowner to contest a foreclosure sale before it occurs.<sup>80</sup> Failure to initiate an action ordinarily does not prevent the homeowner from filing a challenge after the sale—except in Arizona. There, the homeowner and certain specified parties must commence an action seeking an injunction before 5:00 p.m. on the last business day *before* the scheduled sale.<sup>81</sup> Failure to comply constitutes a waiver of all defenses and objections to the sale.<sup>82</sup> This provision places these parties on an extremely short leash—either raise objections before the sale or potentially lose all rights to attack the sale.<sup>83</sup>

Putting Arizona aside, California, Georgia, Massachusetts, and Nevada permit objections following the sale.<sup>84</sup> Massachusetts also allows a homeowner to defend himself against eviction when the sale purchaser brings a summary action for possession.<sup>85</sup>

States place certain burdens upon homeowners when disputing the validity of the sale. Homeowners may have to tender the secured debt, the delinquent amount and costs, or plead the conditions showing that tender is inequitable or that the sale is void and not merely voidable.<sup>86</sup> Because these suits ordinarily are

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<sup>80</sup> This is the case, for example, in Arizona and Massachusetts. *See* Ariz. Rev. Stat. § 33-811(C)(2012); MASS. GEN. LAWS ch. 214, § 1 (West 2011); MASS. GEN. LAWS ch. 185, § 1(k) (West 2011); 28 Mass. Prac., Real Estate Law §10.2(2) (4<sup>th</sup> ed.).

<sup>81</sup> ARIZ. REV. STAT. § 33-811(C) (2012).

<sup>82</sup> *Id.*

<sup>83</sup> Arizona state courts have not applied this provision in the context of an attack to a completed sale based upon lack of authority to foreclose and an allegedly void sale, at least in published decisions. *See* Renuart, *supra* note 4, at 47 (discussing several unpublished opinions and the limitations of unpublished opinions under Arizona law). Notably, at least one court described the Arizona foreclosure procedure as “draconian.” Schrock v. Fed. Nat’l Mortgage Ass’n, No. 11-CV-0567, 2011 WL 3348227, at \*6-8 n. 7 (D. Ariz. Aug. 3, 2011) (discussing in detail the draconian results of the legislative foreclosure regime in the context of the tort of wrongful foreclosure).

<sup>84</sup> *Melendez*, 26 Cal. Rptr. at 421 (affirming the judgment that the plaintiffs could not prove their case rather than that the cause of action was not applicable); Taylor, Bean & Whitaker Mortgage Corp. v. Brown, 583 S.E.2d 844 (Ga. 2003) (relying on GA. CODE ANN. § 23-1-10); Lyons v. Mortgage Elec. Registration Sys., Inc., No. 09 MISC 416377, 2011 WL 61186 (Mass. Land Ct. Jan. 4, 2011); NEV. REV. STAT. § 107.080(5) (West 2011).

<sup>85</sup> Bank of N.Y. v. Bailey, 951 N.E.2d 331 (Mass. 2011) (ruling that the housing court has jurisdiction to consider the validity of the purchaser’s title).

<sup>86</sup> Miller & Starr, *supra* note 42, at § 10:212.

equitable in nature, unreasonable delays in the initiation of such actions may trigger the defense of laches.<sup>87</sup> In Nevada, homeowners cannot file such a challenge more than ninety days following the sale.<sup>88</sup>

Non-judicial foreclosure states recognize the necessity of permitting post-sale challenges by homeowners. However, without a clear filing deadline, the ambiguity related to whether and when title challenges might arise create uncertainty. Nevada presents a better solution, by allowing homeowners to challenge the foreclosure in court, but only for a specified time. In the next Part, I discuss why ninety days is too short.

#### *D. Post-Sale Confirmation Hearing*

Georgia requires a post-sale confirmation hearing only when the foreclosing party wishes to obtain a deficiency judgment in the event that the sale proceeds do not cover the amount owed by the homeowner.<sup>89</sup> Within thirty days after the sale, the foreclosing party reports the results of the sale to the court and requests an order of confirmation. A hearing must follow at which the court considers evidence of the true market value of the property, the legality of the notice and advertisements, and the “regularity” of the sale.<sup>90</sup>

This version of a post-sale hearing does little to protect the interests of homeowners because its occurrence depends solely upon the decision of the foreclosing party. If that party does not seek a deficiency, there is no readily available forum in which a homeowner may raise issues of the “regularity” or “legality” of the sale. The homeowner must commence a separate case to challenge the sale and raise grounds that void the sale to the BFP. The interests of the BFP are not served because the foreclosing party’s failure to seek a deficiency does not eradicate the homeowner’s rights to contest the sale. Even so, the idea of a post-sale hearing has merit, as discussed in Part IV.B.

### IV. POLICY SOLUTIONS THAT (MORE) EQUITABLY BALANCE THESE INTERESTS

The provisions existing in the laws of the states mentioned

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<sup>87</sup> *Lamas v. Citizens S. Nat’l Bank*, 245 S.E.2d 302 (Ga. 1978).

<sup>88</sup> NEV. REV. STAT. § 107.080(5) (West 2011).

<sup>89</sup> GA. CODE ANN. § 44-14-161(a) (West 2011).

<sup>90</sup> GA. CODE ANN. § 44-14-161(b) (West 2011).

above address the interests of homeowners and purchasers in different ways, often at the expense of one or the other. In this section, I build upon the state laws outlined above that most equitably balance these concerns and offer a menu of new solutions for consideration by state legislatures. I propose these suggestions for use in non-judicial foreclosure states, with the exception of pre-sale mediation. Title trouble and the right of homeowners to contest the potential loss of their homes do not arise in the same ways or to the same extent in judicial foreclosure states.<sup>91</sup> However, pre-sale mediation creates positive outcomes for all stake-holders in both types of states.

### A. Pre-Sale Mediation

With one important change, Nevada's program equitably balances the concerns of homeowners and purchasers by: stemming the tide of foreclosures and keeping Nevadans in their home by encouraging loan workouts; ensuring that only the proper party ultimately forecloses; and protecting title in the hands of purchasers. Mediation is pro-active because of its timing, *i.e.*, before the sale. It also benefits the foreclosing party because that party receives a green light on the question of authority to foreclose if the mediator certifies the foreclosure. If the parties agree to a loan modification, the homeowner makes payments and losses are reduced or eliminated.

The program should be mandatory so it can realize its full potential and spread these positive outcomes to all initiating and facing foreclosure. The cost of the mediator (\$400) is split by the homeowner and foreclosing party. The cost burden on those parties is small given the opportunities the process provides for saving homes and reducing lender losses. The cost to the state, though, will rise because it likely will hire additional staff to oversee the increase in cases.<sup>92</sup> Nevada covers program costs by collecting a \$200 fee when

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<sup>91</sup> Compare John Rao & Geoff Walsh, *Foreclosing a Dream: State Laws Deprive Homeowners of Basic Protections*, NAT'L CONSUMER LAW CENT, 11-12 (Feb. 2009), available at [http://www.nclc.org/images/pdf/foreclosure\\_mortgage/state\\_laws/foreclosing-dream-report.pdf](http://www.nclc.org/images/pdf/foreclosure_mortgage/state_laws/foreclosing-dream-report.pdf) (discussing the benefits of judicial foreclosure), with Debra Pogrud Stark, *Facing the Facts: An Empirical Study of the Fairness and Efficiency of Foreclosures and a Proposal for Reform*, 30 U. MICH. J. L. REFORM 639, 643-47 (1997) (articulating lender concerns about the higher costs and inefficiencies inherent in judicial foreclosures).

<sup>92</sup> Fourteen staff and one deputy director process election/waiver Forms, schedule mediations, process certificate requests, and handle mediation fees.

the foreclosing party files a notice of default.<sup>93</sup> Non-judicial foreclosure states that presently do not require pre-sale mediation will bear higher costs related to creating the program and the infrastructure to support it but, like Nevada, can generate income to offset these expenses. Nonetheless, the benefits outweigh the costs by reducing foreclosures and post-sale title challenges.<sup>94</sup>

### B. *Post-Sale Challenge v. Post-Sale Confirmation Hearing*

Nevada's statute offers homeowners an opportunity to reverse the foreclosure sale and retain title but severely limits the time in which a challenge must be initiated—to ninety days. Moreover, distressed homeowners bear the burden of filing the lawsuit to undo a sale that occurred without any judicial oversight *ex ante*.

A more equitable approach to post-sale challenges is to require a confirmation hearing in every case. In contrast to Georgia's hearing procedure triggered only by lenders who seek a deficiency, I suggest that a post-sale confirmation hearing occur following every residential foreclosure sale in non-judicial states. The scope of the hearing should be broad: to review whether the foreclosing party possessed the authority to foreclose (particularly where the state has not implemented a mandatory pre-sale mediation program like that in Nevada); to determine whether all legal and contractual prerequisites to the sale were properly performed; to assess whether there were other irregularities that should reverse the sale; to confirm any deficiency and distribute any surplus; and, to ratify the sale deed. The parties must produce documents relevant to these issues. All parties have the right to appear, including the purchaser. The hearing should be held within a relatively short time after the sale, say, up to six

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Program Staff Information, available at  
<http://foreclosure.nevadajudiciary.us/index.php/about-program/75>.

<sup>93</sup> Geoff Walsh, *Rebuilding America: How States Can Save Millions of Homes Through Foreclosure Mediation*, NAT'L CONSUMER LAW CENT, 35 (Feb. 2012), available at

[http://www.nclc.org/images/pdf/foreclosure\\_mortgage/mediation/report-foreclosure-meditation.pdf](http://www.nclc.org/images/pdf/foreclosure_mortgage/mediation/report-foreclosure-meditation.pdf) (noting that the state directs approximately \$43 of the fee to cover mediation program costs and \$150 to general revenue; further reporting that Nevada collected over \$6 million in its first year).

<sup>94</sup> *Id.* at 20-22 (citing to evidence supporting the utility of mediation programs because they frequently result in loan modifications that are more cost-effective to the participants and to municipalities and the state than foreclosures).

months.<sup>95</sup> Following the hearing and any applicable appeal deadlines, the sale is final and title is certain. If homeowners do not raise defects in the sale at the hearing, they are waived.

The benefits of such a process are readily apparent. First, a judicial procedure is not required until after the sale, preserving the non-judicial nature of the process until that point in time. Second, the hearing is automatic. At the hearing, the court scrutinizes the legality of the sale. If there are no defects, the court confirms good title in the hands of the purchaser in most cases. Third, purchasers do not obtain title until the court confirms the sale deed.

Like Nevada's mediation program, this review provides the incentive to foreclosing parties to follow the relevant laws and contract provisions governing their conduct during the foreclosure process or risk reversal of the sale. While this produces a period of uncertainty, the strong likelihood of confirmed title and finality within a relatively short time is an immense benefit to purchasers.

The burden on the judicial system inevitably will rise, though the size of the load will wax and wane with the economic stress experienced in each state at any given time. To offset these costs, states can collect a surcharge when certain foreclosure-related documents are recorded, similar to Nevada's approach.<sup>96</sup>

Despite the cost, states should institute both a pre-sale mediation program and a post-sale mandatory confirmation hearing procedure. In combination, these procedures afford timely protection to homeowners against unwarranted sales and the opportunity to negotiate a loan modification.<sup>97</sup> The integrity of the legal and property recordation systems are preserved and clear title to purchasers is ensured.

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<sup>95</sup> The lack of finality following a foreclosure sale is not unusual and knowledgeable purchasers operate under this understanding. For one thing, some states do not impose a specified time limit upon post-foreclosure challenges. See Part III.C. For another, about thirteen states provide homeowners with a statutory right of redemption—"a fixed period of time in which to set the foreclosure sale aside and regain title to the home by paying the foreclosure sale price, interest, and costs of the sale." JOHN RAO, ET AL, FORECLOSURES: DEFENSES, WORKOUTS, AND MORTGAGE SERVICING § 14.1.2.1 (National Consumer Law Center 3d ed. 2010) (identifying these states and stating that the redemption periods range from three months to two years, the most typical period being one year following the sale).

<sup>96</sup> See discussion in Part IV.A, *supra*.

<sup>97</sup> Keeping homeowners in their homes and turning delinquent mortgage loans into performing loans benefits not only the immediate parties to the transaction. Neighborhoods and municipalities avoid the negative impacts of an increasing number of vacant homes. GAO Report, *supra* note 5, at 41-42 (noting that vacant homes increase the likelihood of "crime, blight, and declining property values).

C. *Recordation Requirements and Purchaser Duties to Review Public Records*

States should place more responsibility upon purchasers to search public records for notice of defects related to the sale and title. Buying property at foreclosure sales is “notoriously” risky.<sup>98</sup> These buyers often are savvy investors who factor known risks into the amount they bid for properties.<sup>99</sup> Arizona’s standard, that BFPs must lack only actual knowledge, unfairly allows a protected class of purchasers to actively avoid acquiring knowledge of defects, even when it appears in public records. California more equitably balances the responsibilities of purchasers by attributing publicly available knowledge to them. Thus, imposing a duty to search for defects in public records is reasonable given the enhanced legal protections afforded to BFPs.

In addition to the duty to search, states should mandate that assignments of the security instrument be recorded prior to the initiation of the non-judicial foreclosure process. Georgia amended its laws accordingly in 2008 to ensure that a foreclosure be conducted by the current owner or holder of the mortgage, as reflected by public records.<sup>100</sup>

Unlike mortgages and related assignment documents, no state presently compels the recordation of loan notes, indorsements, allonges, or other documents related to note transfers before the sale. Historically, the loan note and mortgage traveled together. When mortgage loans were securitized at an increasingly rapid pace, financial firms often deviated from this practice.<sup>101</sup> Under the common law, a mortgage may be enforced only by, or on behalf of, a person who is entitled to enforce the obligation, *i.e.*, the note, the mortgage secures.<sup>102</sup>

As a general rule, the party who possesses the right to enforce both the note and the mortgage may sue on the debt or foreclose on

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<sup>98</sup> Jacobson-Greany, *supra* note 7, at 171-72 (stating that purchasers may have to pay in cash in part or in full without any opportunity to inspect before bidding).

<sup>99</sup> *Id.* at 172 (noting that knowledgeable purchasers decline to bid based on the risks or take the risk into account when bidding).

<sup>100</sup> GA. CODE ANN. § 44-14-162(b) (West 2011; 2008 Georgia Laws Act 576 (S.B. 531) (stating the purpose of the amendment).

<sup>101</sup> Renuart, *supra* note 4, at \*27-\*29 (identifying the legal problems that arise when the Mortgage Electronic Registration System, used by a large portion of the mortgage market players, is listed as the nominee of the lender in a mortgage).

<sup>102</sup> RESTATEMENT (THIRD) OF PROPERTY (MORTGAGE) § 5.4(c) (1997).



the security upon default by the borrower. Because the note is so important, states should require recordation of the note and related documents before a party may initiate a foreclosure.<sup>103</sup> In tandem with the recordation of mortgage assignments, the public can determine who has the right to foreclose at any given moment and purchasers can more accurately assess the risk of bidding at sales where proof of authority to foreclose is absent.

## V. CONCLUSION

In the context of a non-judicial foreclosure process, changes in the law can reduce the risk of wrongful foreclosures. The foreclosing party must possess the right to oust the homeowner. Without assurances of obtaining clear title, *bona fide* purchasers face title uncertainty. I propose modest additions to existing state law rather than a comprehensive overhaul, given the significantly lower likelihood of the success of the latter approach. The stakes are high for all parties involved in foreclosures. The rights and interests of homeowners and purchasers deserve a fresh review.

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<sup>103</sup> It is worth noting that the recordation of note-related documents will trigger recordation fees that, in turn, will increase governmental revenue.