Why "Show Me The Note" Matters

By Wendell Sherk, Missouri Attorney on Mar 17, 2009 in Bankruptcy Practice and Procedure

More bankruptcy courts are demanding mortgage servicers prove they are entitled to collect on a mortgage loan note before foreclosing. The fight over standing to appear in court runs deeper than technicalities and tactics to stall a lender. It is a matter of fundamental rights.

A Missouri state appellate court recently joined the chorus of tribunals demanding that mortgage lenders "show me" the Note in order to appear in court to pursue a home. Although the particular case may have limited impact in Missouri courts since most foreclosures are completed outside court — and therefore without the lender ever having to prove to a third-party that they are legally entitled to take someone's home. That alone should give anyone pause.

But in bankruptcy court — where a lender must have standing to seek relief from the automatic stay in order to start a foreclosure — it matters even more.

Why should courts get caught up in the minutiae of assignments of Notes and Deeds of Trust? After all, the debtor owes a mortgage to *somebody* –it's usually admitted right there on the debtor's sworn schedules. If the same company (or someone claiming rights from them) shows up in court complaining it hasn't been paid, shouldn't the judge just cut to the chase instead of getting in the way? Not if the bankruptcy court wants to fulfill its real purpose, it shouldn't.

Initially, these decisions require the lending industry to disclose what it has been doing with loans. It's a small thing but important. Homeowners rarely understand how their loan ended up where it is. Sometimes they have conflicting information about who is entitled to payments. Servicers don't always talk to each other coherently when they pass paper between them, how can consumers trained in fixing disc brakes be expected to comprehend it?

Just as important, consumers may *discover* (inconveniently for the lender) they have rights and claims which should be vindicated. Consumers don't know when their rights are violated. In fact, they often are outraged by things which are lawful while only confounded by the unlawful.

In the case of mortgage lending, they may have been scammed by a mortgage broker (e.g. promised one loan and sold another). Unless those flaws are obvious on the loan documents, a future holder of the loan is not liable for that claim — unless the assignment was completed only after a default occurred. If proper assignments were not actually completed until just in time for court, the consumer may have plenty of rights to offset the claims made by the servicer. But the consumer won't *know* the option is there if the lender can hide the chain of assignments behind smoke and mirrors.

And then there's the pesky Constitution. A bankruptcy court is a federal court. Federal courts are constitutionally limited to addressing only a "case or controversy" between parties who have a true stake — something to win or lose — in the outcome. And someone claiming such a stake ought to be able to prove it.

Even if outside court everyone seems to "know" who is owed the money on a loan, the court must be satisfied that the actual parties before it have this "standing." As Idaho's bankruptcy court recently pointed out, in most cases this will mean proving that the party appearing in court

has an actual "pecuniary interest" in the case. *See*, *In re Sheridan,* #08-20381 (Bankr.D.Idaho 3/12/09). When a lender has not received a complete assignment — or cannot prove they have based on the documents filed with the court — the court lacks the power under the Constitution to act.

This is a critical but easily-ignored point. American federal courts are limited creatures because Americans rightly fear uncontained power — and federal district judges with lifetime terms have the potential for tyranny. The constitutional limits on the "reach" of federal courts was meant to contain this great power.

Neither the parties nor the court can simply wish away the requirements as "inconvenient." Democracy is not meant to be efficient — because in the tangle of inefficient rules lies the safety and security of popular rights. The judge is not there to clear the sand from the gears of the machine — *the judge is the sand.*

Finally there's the broader role of the law in a democracy. In the 1930s, when homes across the country were being foreclosed, it was typically being done by the bankers in town, or at least in your state. It was not a faceless corporate name which shielded another faceless trust which in turn shielded large institutional or foreign investors that wanted to take your home. It was Bob the Banker who lived a few blocks away.

Why would that matter? A local banker has to think hard about whether foreclosing on a property and reselling it is a good investment decision for the bank. And he has to decide how that will affect the community the bank makes loans in as well — dragging down the local economy is not usually good for the local bank in the long run. A faceless, unknown amalgam of investors shielded by layer upon layer of middlemen, agents and lawyers doesn't care about the community any more than a fox cares about the health of the chickens.

By forcing servicers to prove who owns the loan, courts are opening the door — just a little bit — so the homeowners and, ultimately, the American public can see who is taking their homes, and who is potentially helping to lay waste to their community. And, in a democracy, knowledge is power.

Edit: For those keeping score, the Western District of Washington has weighed in last week on this issue as well. *See* *Jacobson*. (Hat tip to Ford Elsaesser, for highlighting this case.)