Show Me the Original Note and I Will Show You the Money

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As mortgage delinquencies rise each month, and as the number of foreclosures increase each quarter, the "new mantra" of many pro-se and represented consumers is to demand that the mortgage servicer "prove up the original note." Is this just some new and creative gimmick that has been sold to the desperate homeowners and to a few lawyers who have attended "progressive" seminars or is there really something to it? I submit that there is really something to it.

In my last *Credit Slips* post, I wrote about what I call the "Alphabet Problem." Succinctly stated, this problem arises out of the necessity for a true sale of the mortgage note and mortgage from the originator to the sponsor for the securitized trust; then from the sponsor to the depositor for the securitized trust; and finally from the depositor to the owner Trustee for the trust. These multiple "true sales" are necessary in order to make the original asset (the note and mortgage) bankruptcy-remote and FDIC-remote from the originator in the event the originator files for bankruptcy or is taken over by the FDIC.

Under the securitization model, all of these "true sales" with supporting documentation must be confirmed and all of the documents must be held by the Master Document Custodian for the securitized trust. Finally, the ability of the rating agencies such as Fitch, S&P and Moody's to rate the bonds to be issued by the underwriter for the trust is based in part on confirming that there are unbroken chains of transfers and assignments of all notes and mortgages from the originators all the way to the trust; that a "true sale" occurred at each stop along the way; and that the Master Document Custodian has all of the "original documents."

The source of the "Show Me the Original Note" arguments arises out of bankruptcy and foreclosure cases where the mortgage servicer failed to attach a copy of the duly negotiated original note to the Proof of Claim, the Motion for Relief from Stay, or the foreclosure complaint. In a growing number of these cases, bankruptcy judges have characterized these practices as gross recklessness, extraordinary incompetence, systemic abuse, providing evidence of more concern about increasing the time line completion rates of the local law firms than about the accuracy of the documents and papers filed with the courts.

In the recent case of *Niles and Angela Taylor, 2009 WL 1885888 (Bankr. E.D. Pa. 2009),* Judge Diane Weiss Sigmund described in great detail how the default mortgage servicing and foreclosure systems really work. The servicer in Taylor was HSBC Mortgage Corp; the out-source provider was Lender Processing Services, Inc., f/ka/ Fidelity National Information Services, Inc.; the national law firm was Moss Codilis LLP; and the local law firm Udren Law Office.

The system described by Judge Sigmund starts with LPS, the largest out-source provider in the United States for mortgage default services, with offices in Minneapolis and Jacksonville. LPS maintains a "network" of national and "local" law firms, all of who sign contracts with LPS. Under these "Network Attorney Agreements," the national and local firms have no authority to

communicate directly with the mortgage servicer about any issues that may arise in any given case. Likewise, the servicers must execute a 51-page Default Service Agreement with LPS that delegates to LPS all functions with respect to the default servicing work. LPS, in turn, then uses a software communication system called "NewTrak" to deliver instructions and documents to the LPS network attorneys and to deliver any information to the servicers. LPS also has access to the servicers data-base platforms so that LPS can review loan histories, enter payments, apply payments, enter charges and fees, reverse charges, place funds in suspense accounts, etc. The purpose for this business model is to "manage without human interaction" the relationship between the Servicers and the LPS network attorneys. *See In re Taylor, supra, at 1885889 to 1885891*.

The dysfunctional nature of this system and the lack of any real attorney supervision are demonstrated by the way the Moss Codilis law firm prepared the Proof of Claim form in *Taylor*. Moss Codilis apparently has a Proof of Claim document production team for each servicer. Each team consists of 10 people that "set-up" the form, 10 people who process the claims and 3 people who are allegedly quality control personnel. None of these team members are lawyers or even paralegals. A claims processor would retrieve the mortgage default data directly from the servicers accounting system (with 70% of the Servicers, this would be MSP, which is owned and supported by LPS) and complete the Proof of Claim form. The signature of the "Compliance Director" or "Team Leader" is then electronically affixed to each Proof of Claim and then it is e-filed using the Pacer system. In *Taylor*, the LPS "Team Leader" testified that the she randomly sampled about 10% of the claims filed and that even though she was employed by LPS she signed the claims as an officer of the servicer pursuant to a "signing authority." The evidence in *Taylor* also established that the servicer, HSBC, did not "undertake to review the proof of claim either before it is filed by Moss or after although it could do so as the proof of claim is uploaded into the LPS NewTrak" communication system.

In *Taylor*, the amount of the alleged arrears and other payment data included in the Proof of Claim was simply not accurate. Also, the "wrong note" was attached to the Proof of Claim. The Team Leader testified that one of the team processors should have "caught the payment error." She then attributed the attachment of the wrong note to an e-filing error and explained that since no one reviewed the claims after they were e-filed there was no way this error could have been discovered (unless, of course, some one took the time to reviewed the filed claims).

The motion for relief from stay in *Taylor* was not filed by Moss Codilis but by the Udren Firm, which is noted as a local "Fidelity-LPS Network Firm." According to the Network Agreement, the servicer is deemed to be the "mutual client" of both LPS and the local firm and LPS is designated as the agent for the servicer. Mr. Adrien, the senior partner of the local firm, testified that they delegated all of the LPS work to an administrative staff and that they relied solely on electronic data and had no paper files. The Udren firm employs 10 attorneys and 130 paralegals, processors and administrative personnel, including employees in the referral department that monitor NewTrak for LPS referrals.

The *Taylor* case confirmed that once a mortgage loan in bankruptcy becomes 60 days in default pursuant to the MSP system, a code is entered into MSP which automatically triggers a NewTrak communication to the designated local firm to file a Motion for Relief from the Automatic Stay.

There is no human involvement in the designation or authorization of counsel for the task for which the referral is made nor is there any authority granted to counsel other than to perform the task for which the referral is made. The 60-day coding will also cause MSP to upload the mortgage payment data, including the note, mortgage and assignments (if any) and any other necessary documents for the filing, into NewTrak to be retrieved by local counsel. NewTrak provides the local attorney with the precise information it is coded to produce to perform the given task. NewTrak also creates specific time lines for the performance of each task by local counsel, since such counsel is rated, paid and retained pursuant to their annual APR Ratings (Attorney Performance Ratings). The paralegal operation of the local firm will then prepare the motion and notice of hearing. The motion is they made available on the NewTrak screen for the designated bankruptcy attorney who then may or may not review the same. The electronic signature of the attorney is then affixed and the motion and notice are then filed ECF by the paralegal. None of these pleadings and exhibits are ever reviewed by any employee of the servicer before they are filed with the court. The *Taylor* court characterized these motions as "canned pleadings prepared by a paralegal from NewTrakl screens."

The Motion for Relief from Stay filed in *Taylor* included numerous errors including misapplication of payments, charges that had not been approved by the Court, and funds held in suspense (money received by the servicer but not yet applied to any account associated with the loan). None of these facts were apparent from the Motion and no one with the local firm could explain any of these matters or how they might impact the right to relief from stay or the status of the debtors' outstanding payment obligations.

It seems obvious that the LPS "Network System" is not organized to assure accuracy and accountability. A study performed in 2007 by *Credit Slips* own Professor Katie Porter and funded by the National Conference of Bankruptcy Judges found that in 70 percent of the cases studied mortgage servicers claimed homeowners owed an average of $6,309.00 more on their loans that the homeowners believed was owed. Professor Porter also testified before the Congress earlier this year that servicers commonly foreclosure when they do not have the legal right to do so, impose unwarranted or illegal fees or charges to the loan, and miscalculate how much families owe.

Judge Elizabeth Magner, in McCain v Ocwen, _____, stated that the evidence adduced in multiple cases involving Ocwen showed that the servicer regularly acted in "bad faith" and engaged in a "systematic abuse" of the bankruptcy process by charging improper fee and attempting to collect bankruptcy-related fees without court approval and after many of the cases had been closed upon the debtor's successful completion of their Chapter 13 plans.

We could go on and on with example after example of similar systematic abuses by almost every mortgage servicer but the extraordinary incompetence and recklessness of the mortgage servicers and their out-source providers speak for themselves. After reviewing *Taylor*, including all 62 of the detailed footnotes, there is nothing more one can say about the system other than the final comments by Judge Sigmund:

"When an attorney appears in a matter, it is assumed he or she brings not only substantive knowledge of the law but judgment. The competition for business cannot be an impediment to

the use of these capabilities. The attorney, as opposed to the processor, knows when a contest does not fit the cookie cutter forms employed by the paralegals. At that juncture, the use of technology and automated queries must yield to hand-carried justice. The client must be advised, questioned and consulted. The thoughtless mechanical employment of computer-driven models and communications to inexpensively traverse the path to foreclosure offends the integrity of our American bankruptcy system. It is for those involved in the process to step back and assess how they can fulfill their professional obligations and responsibly reap the benefits of technology. Noting less should be tolerated."

And, this finally gets us back to the "Show Me the Original Note" argument. When you have a system that is devoid of any meaningful review by trained and competent lawyers; when you have a system where the documents are prepared by an automated software program with no review at all by a trained attorney or incredibly by the actual moving party; when you have teams of non-lawyers and non-paralegals preparing documents in a "production line operation" who are only graded on how many motions they "produce" per hour; when you have no one reviewing the attached mortgage note or mortgage or any assignments; well, when you have all this, then it is very easy to understand why so many motions for relief from stay and complaints in foreclosure are filed with a mortgage note that appears to have no legal or factual relation to the moving party and in some cases to the consumer debtors. Hence, the etiology of the "show me the original note" defense. The creditors own mass-production automated systems of "out of mind and out of sight" computer generated forms gave rise to this new defense.

However, the hodgepodge of motions for relief with improper notes cannot be blamed entirely on the need for speed and the use of automated document producing programs. In many cases, especially those where the mortgage was originated between 2005 and 2007, the originators were so busy that in lieu of transferring the notes and documents "up the line in an unbroken chain" they just keep the originals and transferred the "data" electronically. In short, there were no true sales and negotiations of the original notes and no true assignments of the mortgages and deeds of trust. As a result, when a court demands that the Trustee for a residential mortgage backed securitized trust produce the original note duly negotiated in an unbroken chain they simply cannot do it. They just do not have the hard copy documents. All they have is data and information in a computer file.

This incompetence of the non-paralegals in the local law firms on the one hand and the desire of the mortgage originators to cut-corners and save paper on the other hand form the basis for what I call the "Alphabet Problem" that was the subject of an earlier *Credit Slips* post. Let me provide an example from a real SEC securitized trust filing. Between January 1 of 2006 and February 1 of 2006, Argent Mortgage Company LLC originated thousands of residential mortgage loans to be securitized. Exactly 7,767 of those mortgage notes were eventually securitized in a residential mortgage backed trust named "Argent Securities Inc., Asset-Backed Pass-Through Certificates, Series 2006-W2." The closing date for all of the notes and mortgages to be delivered to this Trust was February 27, 2006. According to the Prospectus Form 424B5 filed with the SEC, Argent Mortgage Company, LLC, sold the notes and assigned the mortgages to Ameriquest Mortgage Company as the Sponsor; Ameriquest then sold the notes and assigned the mortgages to Argent Securities, Inc, as the Depositor; and Argent Securities, Inc., them sold the notes and

assigned the mortgages to Argent Securities Trust, Asset-Backed Pass-Through Certificates, Series 2006-W2.

In this example, the A to B transfers were from Argent Mortgage to Ameriquest Mortgage Company; the B to C transfers were from Ameriquest to Argent Securities; and the C to D transfers were from Argent Securities to Argent Securities Trust, Asset-Backed Pass-Through Certificates, Secires 2006-W2. And, according to the Prospectus, ALL of these transfers were finalized before the closing date of February 27, 2006.

Given this complex and detailed securitization structure, what happens when LPS sends a NewTrak assignment to a local firm to file a motion for relief from stay for Argent Securities Trust Asset-Backed Pass-Through Certificates, Series 2006-W2, and the system attaches as an exhibit the original note and mortgage that names Argent Mortgage Company LLC as the beneficiary? If the court or the debtor raises an issue about "standing" or "failure to prosecute the motion in the name of the real party in interest," what normally happens? First, remember that the local firm under the LPS Network Agreement cannot communicate with the servicer or trust, who is the movant in the case. The local firm can only send a NewTrak "issue" to LPS. LPS has what it calls "document execution teams" for every LPS "Servicer Partner." These teams do not include lawyers or trained paralegals but rather include individuals who have been trained to produce documents. So, what do they do to resolve the issue about the Argent Mortgage Company note and mortgage? Well, they will do the one thing that ensures maximum speed and efficiency and meets the attorney APR time lines. They prepare and sign as a Vice President of Argent an endorsement of the Argent Mortgage Note from Argent directly to Argent Securities Trust, Asset-Backed Pass-Through Certificates, Seris 2006-W2 and date it August 11, 2009. They prepare and sign as a Vice President of Argent an assignment of the mortgage from Argent Mortgage Company to the same Trust and date it August 11, 2009, with an effective date of February 27, 2006.

What is wrong with these LPS created documents? First, they are what I call A to D transfers and assignments. Such transfers could not have occurred after the "closing date" for the named trust. Argent Mortgage Company had no note to transfer to the Trust in 2009, having sold the same back in February of 2006. Second, the A to D transfers ignore two of the most important entities in the securitization process—the Sponsor, Ameriquest Mortgage Company, and the Depositor, Argent Securities, Inc. Third, such transfers are totally inconsistent with the mandatory conveyancing Rules established by Section 2.01 of the Pooling and Servicing Agreement. Fourth, such transfers are totally inconsistent with the representations and warranties filed by the Master Document Custodian for the Trust with the SEC, the Owner Trustee, and the Rating Agencies. Fifth, such documents are inconsistent with the Real Estate Mortgage Investment Conduit Rules promulgated by the Internal Revenue Service for this type of trust. And, finally, from the point of view of the Chapter 13 debtor, these transfers and similar variations of the same raise serious issues about whether or not the Trust was really and truly a secured creditor on the petition date. If these A to D documents were filed in connection with a contested Motion for Relief from Stay, then one could infer that the Trust did not in fact hold and own the mortgage note on the petition date.

Another example of a similar but different problem occurs when you have an A to D transfer to try to prove up standing in a judicial foreclosure case and the debtor then files for Chapter 13 relief within 90 days of the date of the document. Under these facts, do we have an avoidable preference to the Trust under Section 547? Also, in the motion for relief from stay context does the A to D transfer post-petition expose the servicer, the trust and the originator to automatic stay liability under Sections 362(a)(4) and (a)(5)? These Sections prohibit "any act to create, perfect or enforce any lien against property of the estate" and "any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secured a claim that arose before the commencement of the case." It would seem to be basic "Hornbook" law that the Trust would have to own and hold the note to "enforce" the mortgage. As a result, if the Trust did not actually acquire the note until after the case was filed it would appear to be a clear violation of these sections.

In closing, I would not want the servicer to just "Show Me the Original Note." I would want the servicer to show me that the original note had been duly and timely negotiated from A to B, B to C and C to D, with D being the securitized trust. I would want proof of an unbroken chain of such negotiations between all of parties. I would want to see the same timely assignments of the mortgage or the deed of trust. Consequently, the defense should not be limited to "Show Me the Original Note" but should be expanded to show me that the "Original Note" was duly transferred and negotiated between all of the parties involved in the deal and was in the possession of the Master Document Custodian for the Trust BEFORE the closing date for the due transfer and delivery of such documents. Thus, there is much more to this than a simple request to produce the Original Note. Given how hard it has been for servicer to comply with such a seemingly simple request, how they comply with this expanded version of the question will be a real test. Stay tuned.

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