Foreclosure and the Failures of Formality, Or Subprime Mortgage Conundrums and How to Fix Them

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Joseph William Singer[β]

ולפני עור אל תתן–מכשל.

Do not put a stumbling block before the blind.[γ]

–Leviticus (Vayikra) 19:14

For prevention of many fraudulent Practices … All Leases Estates Interests of Freehold or Termes of yeares or any uncertaine Interest of in to or out of any Messuages Mannours Lands Tenements or Hereditaments made … by Parole and not putt in Writeing…, shall have the force and effect of Leases or Estates at Will onely and shall not either in Law or Equity be deemed or taken to have any other or greater force or effect…[δ].

–An Act for the prevention of Frauds and Perjuryes, England 1677

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[γ] Leviticus (Vayikra) 19:14.

[δ] An Act for prevention of Frauds and Perjuryes, 29 Chas. 2 ch. 3 (1677).

THE SUBPRIME CRISIS SHATTERED both the world economy and our illusions. In that innocent time before the crisis, New Deal government policy made mortgages widely available and relatively affordable while, over time, both state property laws and common practice imposed minimum standards on transactions that protected homeowners from onerous, discriminatory, unfair, or deceptive mortgage terms.[1] Those who could not afford to buy housing either rented or relied on alternative government programs to obtain it. To be sure, we had poverty, homelessness, discrimination, and injustice, and the quality of housing for low-income families left much to be desired. Things were far from perfect. But state recording statutes and real estate practice worked tolerably well, both clarifying property titles and making that information publicly available. Beginning around 1980, however, a new era of banking deregulation unleashed vast changes in the ways mortgages were sold, marketed, and recorded.[2] After 1990, these developments eventually led to the widespread sale and securitization of subprime mortgages. Cheered on by President Bush's call for an "ownership society,[3] these mortgages helped fuel a housing bubble that grew like a rocket until they turned sour and the bubble burst in 2007, plunging us into the worst recession since the Great Depression. Now in 2013, we find ourselves still living with the effects of the subprime crisis and cleaning up the mess it left us in.[4]

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[1] Peter W. Salsich, Jr., *Homeownership —Dream or Disaster?* 21 J. OF AFFORDABLE HOUSING 17, 25–27 (2012).

[2] KATHLEEN C. ENGEL & PATRICIA A. MCCOY, THE SUBPRIME VIRUS: RECKLESS CREDIT, REGULATORY FAILURE, AND NEXT STEPS 16 (2011).

[3] *Fact Sheet: America's Ownership Society: Expanding Opportunitites,* The White House, Aug. 2004, http://georgewbush-whitehouse.archives.gov/news/releases/2004/08/20040809-9.html; *President Hosts Conference on Minority Homeownership,* Oct. 15, 2002 (White House, Office of the Press Sec'y), http://www.policyalmanac.org/social_welfare/archive/wh_minority_housing.shtml; ENGEL & MCCOY, *supra* note —, at 21.

[4] For analyses of the subprime crisis, see ENGEL & MCCOY, *supra* note —; MICHAEL LEWIS, THE BIG SHORT: INSIDE THE DOOMSDAY MACHINE (2010); ROBERT J. SHILLER, THE SUBPRIME SOLUTION: HOW TODAY'S GLOBAL FINANCIAL CRISIS HAPPENED, AND WHAT TO DO ABOUT IT (2008). *See* Brooksley Born, *Foreword: Deregulation: A Major Cause of the*

One of the striking features of the subprime era is that banks acted without adequate regard to state property law. They were intent on serving the national and international financial markets with new and more profitable products and they treated state property law as an obstacle to get around rather than a foundation on which to build. Rather than sell mortgages to families that could afford them, they hoodwinked the vulnerable by picking their pockets. Rather than honestly disclose the high risks associated with subprime loans, they hired rating agencies to rate them AAA, inducing investors to take risks they neither understood nor were prepared for. The banks made huge amounts of money marketing mortgages to people who could not afford to pay them back while offloading the risks of such deals onto hapless third parties. And rather than observe longstanding laws and customs designed to clarify property titles, banks evaded requirements of publicity and formality that traditionally governed real estate transactions. In short, the banks misled both borrowers and investors while undermining property titles. This was both a clever and a profitable way to engage in business, but it was neither honorable nor responsible.

To be fair, the participants in this scheme undoubtedly thought that they were complying with state property law. At the same time, it is apparent that they viewed existing practices and legal requirements as inefficient, costly, archaic, and unnecessary technicalities that prevented them from selling valuable financial products desired by homeowners and investors alike. So they invented ways to get around these laws. They convinced themselves that what they did complied with the letter, if not the spirit, of state laws. However, with the benefits of hindsight, it is clear they did not think through the myriad legal implications of what would happen if the housing market crashed. Nor did they pay sufficient study to the details of state property law or the implications of their new marketing practices on the clarity of property titles. They did not do so because they did not anticipate anything going wrong. But then

Financial Crisis, 5 HARV. L. & POL'Y REV. 231, 233 (2011) (explaining the "devastating role that inadequate regulation played in causing the financial crisis").

the housing market crashed — as some predicted it would — and the system they invented came crashing down with it. In dealing with the debris left by the crash, many state courts are now holding that the marketing and titling mechanisms the bankers invented did *not* comply with state property laws. These laws include statutes regulating consumer protection, recording, foreclosure, and negotiable instruments, as well as the statute of frauds.

In adjudicating foreclosure cases, courts are currently facing a number of significant problems. First, by selling mortgages to millions of people who could not afford to pay them back, the banks inflicted novel individual and systemic risks.[5] Borrowers and investors participated in these markets because they were led to believe the investments were safer than anyone had a right to think they were. The ones who created that impression of safety were the bankers that issued the loans and sold the securities. These new marketing practices require courts to reinterpret the meaning of

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[5] One study argues, to the contrary, that predatory lending accounted for few defaults relative to non-predatory lending. Sumit Agarwal, Gene Amromin, Itzhak Ben-David, Souphala Chomsisengphet, Douglas D. Evanoff, *Predatory Lending and the Subprime Crisis,* Fisher College of Business Working Paper Series, Charles A. Dice Center for Research in Financial Economics, Dice Center WP 2012-8, Fisher College of Business WP 2012-03-008, http://ssrn.com/abstract=2055889. However, the analysis is weak since it is not based on a comparison of similarly-situated borrowers who obtained subprime loans versus those who did not or who obtained prime loans, but instead on a comparison of defaults in an area regulated by a Illinois state-mandated lender-funded counseling process for risky borrowers seeking risky loans versus defaults on similar loans in an unregulated area. While many subprime lenders exited the market in the regulated area, the percentage of defaults in the regulated area were only a little bit higher than in the nonregulated area. The study's authors conclude that predatory lending did not contribute substantially to increased default rates, but the study is not capable of supporting such a conclusion. Instead, the study merely shows that loans precluded because of the increased closing costs created by the regulation would have had slightly a higher default rate than the loans that were actually made. Only by labeling the precluded loans as "predatory" is the study able to make its claim regarding predatory lending. The problem with this definition is that by almost any measure (including the fact that they triggered mandatory counseling) the loans that were actually made would also be deemed predatory. Thus, the study is not actually comparing predatory and non-predatory loans, but predatory loans that were still profitable to originate even with mandatory lender-funded counseling and those that were not. The study does not actually tell us about the effect of predatory lending on default rates.

longstanding consumer protection laws prohibiting unfair or deceptive business practices.[6]

Because "everyone was doing it," some courts are reluctant to characterize subprime mortgages as unfair or deceptive. But the truth is that many mortgage brokers and banks actively misled both homeowners and investors about the benefits and stability of subprime mortgages.[7] High interest, adjustable rate mortgages were not suitable over the long run for people who could not afford them, and the securities based on them were not suitable for investors, such as municipalities and pension funds, that depend on safe investments. The bankers assumed that subprime mortgages were lawful because no law specifically prohibited them. But they forgot that formal rules are always supplemented by equitable standards such as consumer protection and securities regulations statutes that prohibit unfair or deceptive business practices. They should not have been so quick to assume that it was lawful to saddle borrowers with mortgages they could not repay and investors with mortgages that were, in truth, ticking time bombs. The courts are confronting hard normative and legal questions about applicability of consumer protection statutes to these transactions.

Second, in attempting to lower the costs of mortgage transactions, the banks devised a privatized form of recording property titles that led them to be prolific about securitizing those mortgages but complacent about formalizing mortgage assignments. The result was that the banks made many, many mistakes in keeping track of these transactions.[8] Formal records of mortgage transfers are often

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[6] *See N.Y. Sues Crédit Suisse Over Mortgages,* N.Y. TIMES, Nov. 21, 2012, (claim that bank misled investors in mortgage-backed securities).

[7] *See* Ben Protess, *U.S. Accuses Bank of America of a "Brazen" Mortgage Fraud,* DEALBOOK, N.Y. TIMES, Oct. 24, 2012.

[8] David A. Dana, *Why Mortgage "Formalities" Matter,* 24 LOY. CONSUMER L. REV. 101, 108 (2012)(noting myriad mistakes in foreclosure procedures); Elizabeth Renuart, *Property Title Trouble in Non-Judicial Foreclosure States: The Ibanez Time Bomb?,* at •7–•16, 4 WM. & MARY BUS. L. REV. — (forthcoming 2013), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1968504 (reviewing evidence of inadequate documentation of mortgage transactions); Alan M. White, *Losing the Paper — Mortgage Assignments, Note Transfers and Consumer Protection,* 24 LOYOLA

incomplete or incorrect; the chain of title for many properties appears to be irretrievably broken. The new procedures invented by the banks created title problems that the courts had never confronted before, and on such a massive scale as to have the potential to destabilize the entire housing market as well as the general economy. Not only have underwater mortgages helped prevent recovery from the recession caused by the subprime debacle, but the banks' collective failure to comply with traditional property law has left real estate titles in a shambles.

Worse still, the new procedures the banks established made it impossible for potential buyers to consult public recording offices to determine the state of title on any piece of property. The privatization of mortgage transactions impedes the alienability of land. The banks bypassed public recording systems and have wrecked the well-functioning U.S. recording systems that had supported our property infrastructure since the offices were first established in the mid-1600's in colonial Massachusetts Bay.[9]

Third, because the banks combined new procedures with sloppy record keeping, the courts now find themselves between a rock and a hard place. Traditional rules were intended to clarify property titles, but the banks' combination of cleverness and incompetence means that property titles will be clouded whether the courts strictly enforce the statute of frauds or relax its formality requirements. The traditional rules and requirements created a legal infrastructure that enabled property markets to work well. The banks' willful evasion of those practices and laws created precisely the results the tradition would have predicted; titles have become clouded and even unmarketable. But, contrary to first instincts, we cannot solve the problem simply by strictly enforcing the traditional rules. The evasion of property law was so pervasive that rigid enforcement of the statute of frauds would destabilize property titles as badly as relaxing it would do. We would be cutting off our noses to spite our

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CONSUMER L. REV. 468, 475–476, 488 (2012) (documenting failures to correctly handle note and mortgage assignments and rampant inaccuracies in MERS records).

[9] Christopher L. Peterson, *Foreclosure, Subprime Mortgage Lending, and the Mortgage Electronic Registration System,* 78 U. CIN. L. REV. 1359, 1364 (2010)("in 1636 the General Court of Massachusetts' Plymouth Bay Colony adopted its first recording law").

faces. The fix for the banks' failure to follow the rules of formality cannot be to wholly ignore transactions that did not follow those rules; this would leave existing owners with titles that are clouded rather than clear. Courts adjudicating foreclosure cases are left with conundrums that have no easy resolution.

All this means that courts must reinterpret existing rules to fit the current circumstances. It also means that we may need some changes in banking and negotiable instruments law as well as basic mortgage and foreclosure law. More fundamentally, participants in the real estate market need to change their attitude toward property law. The bankers approached the law the way Holmes's "bad man" would, seeking to get away with everything they could on the assumption that anything that is not expressly prohibited must be lawful.[10] It would have been better if they had acted responsibly, considering not only the letter of the law, but its purpose and the reasons behind it, rather than just seeing what they could get away with.

The history of mortgage law from the Middle Ages on is one of strict regulation followed by efforts to avoid it followed by new regulation, *ad infinitum.*[11] Property law is intended to clarify title and the rules of the game; it protect owners while unleashing property development and transfer. But those rules cannot provide a safe harbor to actions that lead to substantial injustice or disorder.[12] While property law cannot work unless it is tolerably predictable, it also cannot work if it immunizes actors from irresponsible schemes. Experience and history prove that our need to manage property as a basic part of the infrastructure of social and economic life requires flexibility as well as formal structures if we are to manage human affairs in a tolerable way. The boundless nature of human ingenuity

[10] Oliver Wendell Holmes, *The Path of the Law,* 10 HARVARD L. REV. 457, 459 (1897) ("If you want to know the law and nothing else, you must look at it as a bad man, who cares only for the material consequences which such knowledge enables him to predict, not as a good one, who finds his reasons for conduct, whether inside the law or outside of it, in the vaguer sanctions of conscience.").
[11] Ann M. Burkhart, *Lenders and Land,* 64 MO. L. REV. 249 (1999) (excellent history of mortgage law).
[12] On the banks' continuing efforts to seek such safe harbors, see Peter Eavis, *Banks Seek a Shield in Mortgage Rules,* N.Y. TIMES DEALBOOK, Dec. 18, 2012.

means that we need nuance rather than rigidity if we want legal mechanisms that can protect the vulnerable from schemes designed to pick their pockets while offloading the social costs of exploitation onto the rest of us. And formality requirements, while crucial to the efficient functioning of property markets, can wind up biting us in the face if we do not apply them with some flexibility when they fail.

In Part 1, I will explain the failures that arose in the origination, transfer, and foreclosure stages of the subprime mortgage market. The main problems were (1) unfair and deceptive consumer practices; (2) failure to formalize mortgage assignments; and (3) privatization of the title and recording system. In Part 2, I will develop principles to guide our response to this attack on property law. Fundamentally, we need a change in attitude about regulation. Contrary to what the bankers thought, property law is not a regulatory impediment to efficiency; it is the foundational infrastructure that allows property and property markets to exist. I will argue that mortgage law is governed by two basic principles: (a) protect homeowners and (b) promote housing transactions. Importantly, I will explain why the second principle is subordinate to the first. I will also explain what it means to "protect homeowners." At a minimum this includes outlawing unfair or deceptive practices and regulating property transactions to ensure clear titles and public notice of them.

Given these principles and our hard-won experience with the subprime crisis, I will propose some remedies for our current conundrums. I will leave for others to handle needed changes in banking and securities and negotiable instruments law, instead focusing on consumer protection, mortgage and foreclosure law. I will also suggest ways courts might handle some of the perplexing foreclosure cases still in the pipeline. The foreclosure crisis reminds us that we have an obligation to act responsibly and honorably not only because we have a moral and legal obligation to treat others with due respect but in order to preserve the infrastructure of our property system that is the foundation of our wealth and tranquility.

1. SUBPRIME MORTGAGE CONUNDRUMS

1.1. Unfair and deceptive consumer practices

The subprime crisis was not just a typical market bubble. It happened because banks developed a business model that exploited vulnerable people by leading them to take out loans they could not afford. If they had had adequate information about what they were getting themselves into, they would have run the other way. And even if they understood and were willing to take those risks, subprime loans imposed undue risks to third parties.[13] Subprime mortgages were an innovation designed to fail, harming both those who bought them and the rest of us as well.

Once upon a time, banks would not lend money to people who could not pay it back. You had to *qualify* for a loan. The banks cared about your income, your credit history, even your reputation in the community. If you could not make your mortgage payments, the bank would have to foreclose, and banks historically lost half their investment if they had to foreclose.[14] But then the banks figured out a way to make money by loaning it to people who could not pay it back. They took advantage of the fact that property values were rising and that mortgages could be bundled and securitized. The banks made money, not by slowly recouping mortgage payments over thirty years, but by selling the mortgage rights immediately to someone else, thereby off-loading the risk of nonpayment onto a third party.[15] The bank would make its money immediately while transferring the risk to someone who might or might not understand how great the risk was. For all this work, people had to be convinced to take out loans they could not pay back and investors had to be convinced that the loans were safe. How to accomplish all this?

The loans were made affordable initially by using adjustable interest rates. Borrowers felt comfortable paying the initial low

[13] On the link between predatory lending practices and predatory securitization practices, see Christopher L. Peterson, *Predatory Structured Finance,* 28 CARDOZO L. REV. 5 (2007).
[14] ENGEL & MCCOY, *supra* note —, at 4.
[15] White, *Losing the Paper, supra* note —, at 471 .

interest rates. They either did not know about the later, higher rates, or they were assured that rising property values meant that they could either refinance the loan or sell the property at a profit when the higher interest rates kicked in.[16] The system was, for a time, self-reinforcing. Promoting investment in real estate by making mortgage loans to borrowers who could not have previously qualified for them helped fuel a housing bubble. Greater demand for housing led to steadily increasing housing values which would enable high-risk borrowers to sell or refinance when adjustable rate mortgages raised monthly payments to unaffordable levels.

Investors bought securities in subprime loans because they earned high rates of interest. They were induced to do so because the banks took advantage of mixed messages and inconsistent arguments. On one hand, the securities paid high rates because the loans were risky. On the other hand, the banks suggested that the risk was apparent rather than real. The loans were not really risky because rising property values made them a sure thing. And even if some defaults might happen, the banks argued that securitization "spread the risk" because the loans would not all default at once. The cherry on top was the AAA rating given by trusted, professional rating agencies, ratings on which investors relied in making their investment decisions.[17] Both individuals and institutions such as pension funds relied on the AAA ratings to justify the risks they were taking even though some of those securities were in high risk, "no doc" (no document) loans.

Little did the investors know that the banks hired the rating agencies, thereby making the rating agencies' fees dependent on doing what the sellers of the securities wanted; obviously what they wanted was AAA ratings for the securities to induce investors to buy

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[16] ENGEL & MCCOY, *supra* note —, at 10.

[17] *See* ENGEL & MCCOY, *supra* note —, at 5–6 ("many investors relied on rating agencies' grades of the quality of mortgage-backed bonds, in the belief that investment grade bonds were good investments"); David Reiss, *Subprime Standardization: How Rating Agencies Allow Predatory Lending To Flourish In The Secondary Mortgage Market,* 33 FLA. ST. U. L. REV. 985, 1012– 1053 (2006) (explaining the role of the rating agencies in promoting subprime mortgages).

the securities in the mortgage bundles.[18] Rather than doing a complete evaluation of the mortgage-backed securities they were being asked to rate, the rating agencies relied on the securities arrangers to conduct "due diligence."[19] Worse still, the arrangers found the securities to be sound, not because they were safe investments deserving of a AAA rating but merely whether the packaged loans adhered to the lender's guidelines.[20] The rating agencies also helped the arrangers to game the system by telling them what they needed to do to get a AAA rating, and it was possible to arrange the loans in a manner that satisfied the rating agencies' AAA formula without a reasonable belief that the securities were actually safe. What all this meant was that a AAA rating no longer meant a safe investment; what it actually meant was "buyer beware."

Banks therefore changed the substantive terms on which they made mortgage loans in conjunction with the way they made money from mortgages. The entire business model switched from long-term repayment of mortgage loans by those who were likely to be able to make the payments (with foreclosure an unusual and secure backup in case of default) to a short-term market dependent on risky borrowers and compliant investors. And none of this would have been possible unless both homeowners and investors had been

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[18] ENGEL & MCCOY, *supra* note —, at 49–51.

[19] ENGEL & MCCOY, *supra* note —, at 48.

[20] ENGEL & MCCOY, *supra* note —, at 46. *See* Andrew Ross Sorkin & Mary Williams Walsh, *U.S. Accuses S. & P. in Suit on Loan Bundles,* N.Y. TIMES DEALBOOK, Feb. 4, 2013, http://dealbook.nytimes.com/2013/02/04/u-s-and-states-prepare-to-sue-s-p-over-mortgage-ratings/?emc=eta1 (Justice Department brings civil suit against Standard & Poors for defrauding or misleading investors by making investments in mortgage-related securities seem safer than they actually were); Mary Williams Walsh & Ron Nixon, *S. & P. E-Mails on Mortgage Crisis Show Alarm and Gallows Humor,* N.Y. TIMES DEALBOOK, Feb. 5, 2013, http://dealbook.nytimes.com/2013/02/05/case-details-internal-tension-at-s-p-amid-subprime-problems (rating agency correspondence suggests knowledge that mortgage-related securities that were being rated as safe were of low quality). *See also* John M. Griffin & Dragon Yongjun Tang, *Did Subjectivity Play a Role in CDO Credit Ratings?* http://ssrn.com/abstract=1364933 (even when rating agency revised its views about the safety of mortgage-backed securities (CDO's), it failed to reclassify older issues as less than AAA).

misled into believing these investments were safer than anyone had a right to believe.[21]

Nor was any of this unforeseeable. There were individuals who understood that subprime mortgages were bound to fail.[22] The banks scoffed at those skeptics but we know now it was the bankers and not the skeptics who were living in a dream world where black is white. *The bankers should have known better.* And that means that the subprime mortgage market was built on fraudulent or quasi-fraudulent business practices. The banks used procedures for mortgage creation and marketing that obscured the real terms of the mortgages as well as their inherent risk. They misled both borrowers and investors not by outright lies but by a combination of puffery and misdirection.[23] They thought that they were safe as long as they did not lie or make affirmative misstatements. They thought they were acting within the bounds of the law as long as they could not find any clear, formal legal regulation that prohibited their conduct.

They felt comfortable doing this because the ideology of freedom of contract suggests that we view the agreements as voluntary. No one forced anyone to take out these mortgages; if the borrowers and investors wanted to invest in risky loans, who is to say they should not have the freedom to do so, as long as no law prohibits the transaction? The problem, of course, is that the banks acted like Holmes's "bad man" who wants to know what the formal law prohibits and then is content to "walk the line" and engage in behavior that contravenes the spirit of the law.[24] This problem leads courts and legislatures to protect both consumers and the public interest by making the edges of rules fuzzy. Rather than giving banks the comfort that their actions are legal if they cannot find a clear rule

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[21] Born, *supra* note —, at 234 (one reason banks leant to risky borrowers was because they "passed on the risks of the laons and had little incentive to maintain high lending standards").

[22] ENGEL & MCCOY, *supra* note —, at 61 ("The truth is, many saw it coming…"); LEWIS, *supra* note —, at 15 (recounting how Steve Eisman correctly foresaw the subprime crisis ten years before it happened by understanding the implications of loaning money to people who could not pay it back).

[23] *See, e.g.,* LEWIS, *supra* note —, at 17 (example of a bank charging a 12.5 percent interest rate but telling the consumer it was an "effective rate" of 7 percent).

[24] Holmes, *supra* note —, at 459.

prohibiting their conduct, we have both common law doctrines and statutes that force market actors to consider whether their conduct will be thought to fit within the spirit if not the letter of the law. Thus, the concept of fraud has expanded in recent years to include nondisclosure or misleading statements, as well as outright false statements. Federal securities law prohibits any misleading communication and requires disclosure in order to avoid being misleading.[25] And both state consumer protection laws and the Federal Trade Commission Act prohibit "unfair or deceptive practices."[26] Those laws had not previously been applied to mortgage loans but they were in force at the time the subprime market got off the ground and some courts have found it to be "unfair" to sell someone a mortgage you know cannot pay it back.[27]

The banks wrongly adopted a formalistic conception of law. They thought that whatever was not clearly prohibited must be allowed. They did not seem to realize that they are subject to multiple sources of law and that among these are statutes that outlaw "unfair or deceptive practices," as well as the common law. The fact that no statute formally outlaws a practice is no guarantee than it is in fact lawful. Our legal system contains resources that can be shaped to respond to new inequitable practices. The banks failed to realize that they would have to justify themselves substantively to judges and juries. They treated the law as rule-based system that created a safe harbor for their questionable activities and failed to engage in the

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[25] Securities and Exchange Act, 15 U.S.C. §78j (unlawful to use any "manipulative or deceptive device or contrivance" in connection with the sale of any security); 17 C.F.R. §240.10b-5 (unlawful, in connection with the sale of any security, to "defraud" or "to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading").

[26] Federal Trade Commission Act, 15 U.S.C. §45 (prohibiting "unfair or deceptive acts or practices in or affecting commerce"); *see, e.g.,* MASS. GEN. LAWS ch. 93A, §§ 1–11 (unlawful to engage in any "unfair or deceptive acts or practices in the conduct of any trade or commerce"). *See* Joseph William Singer, *Subprime: Why a Free and Democratic Society Needs Law,* 47 HARV. CIV. R.-CIV. LIB. L. REV. 141, 155–156 n.45 (2012)(collecting cites of state consumer protection statutes).

[27] Comm. v. Fremont Inv. & Loan, 897 N.E.2d 548, 556–561 (Mass. 2008).

moral reflection required of standards-based law applicable to their conduct.[28]

In addition to misleading both borrowers and investors, the banks failed to prepare adequately for the results of the massive foreclosures that resulted from the market they created. As foreclosures multiplied and the housing bubble burst and lowered property values, the banks began to own many housing properties that they could not sell. The banks were not equipped to handle the situation. They normally had few foreclosures and were able to sell properties quickly after foreclosure. But now they were forced by economic circumstances to hold onto properties after foreclosure and they were not prepared to undertake the legal obligations the law imposes on real estate owners. The banks became landlords for the foreclosed homeowners or their tenants. But many banks failed to comply with local housing codes and the warranty of habitability. They denied that they were "landlords," but of course they were. They sometimes violated the legal rights of tenants to have habitable housing and housing code compliance. And when foreclosed properties became vacant, the banks were not equipped to ensure their upkeep and safety, allowing many to deteriorate, causing nuisances in many areas, harming the interests of neighboring property owners and the municipalities in which those properties were located.[29] The banks' failure to foresee the results of the subprime crisis not only led them to ignore the substantive rights of tenants to safe and habitable housing but the rights of neighboring owners to be free from nuisances. And of course, the whole thing wrecked the world economy, diminishing the amounts in many private college and pension funds and the value of stocks held by universities and private investors. The loss of jobs and the continuing recession have caused untold suffering. The failure to foresee the

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[28] *See* Seana Valentine Shiffrin, *Inducing Moral Deliberation: On the Occasional Virtues of Fog,* 123 HARV. L. REV. 1214 (2010) *and* Jeremy Waldron, *Vagueness and the Guidance of Action,* (October 29, 2010), NYU School of Law, Public Law Research Paper No. 10-81. Available at SSRN: http://ssrn.com/abstract=1699963 (both arguing that vague standards can guide action through inducing moral reflection).

[29] ENGEL & MCCOY, *supra* note —, at 143 ("When far-off entities end up owning homes after foreclosure, they often lack incentives to adequately maintain the property.").

consequences of misleading consumer marketing has unfairly wreaked havoc on many lives.

To respond to these problems, we need both more and less formality. We need *more* formality because clearer disclosure requirements might induce fewer people to enter risky transactions like these. This is one of the goals championed by Senator Elizabeth Warren: better disclosure requirements for consumer debt transactions.[30] Beyond disclosure requirements, we may need to protect consumers, banks, and the general public from toxic loans likely to harm the whole society by regulating mortgage transactions to ensure they are sold only to those who can afford them.

On the other hand, we need *less* formality because we need businesses like banks to understand that practices that are not clearly prohibited by formal laws might *nonetheless be unlawful.* Consumer protection laws *deliberately* use vague and normatively charged language, outlawing all "unfair practices." They do so in order to induce businesses to imagine whether they can justify themselves to a jury or a judge. Before selling a subprime mortgage to a bunch of strangers, it might help to consider whether you would advise your daughter to take out such a loan. If the answer is no, then perhaps you should not sell one to someone else's daughter. Law needs fuzzy edges and informality to induce proper moral reflection in those who are prone to weakness or enraptured by the prospects of easy money earned at the expense of the vulnerable.

1.2. Failures to formalize transactions and clarify title

The subprime crisis has been hard to fix because of myriad failures to comply with basic formal requirements of state real property law. The procedures for transferring interests in property – including mortgages – were simple and clear. First, put property transactions in writing. Second, record them in the registry of deeds for the county in which the property is located. How hard could that be? These rules have been in effect in the United States for hundreds of years. The

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[30] Elizabeth Warren, *Unsafe at Any Rate,* DEMOCRACY: A JOURNAL OF IDEAS, Summer 2007, http://www.democracyjournal.org/5/6528.php?page=all.

first statute of frauds was passed in England in 1677. The Middlesex County Registry of Deeds in the Commonwealth of Massachusetts was established in the 1636.[31] These legal regulations should be neither surprising nor controversial. Their purpose is to clarify title to property and to make a public record of that title available so potential purchasers and government entities know who claims an interest in any piece of real estate. Clear titles are essential because we will be deterred from using or developing property if we do not know who owns it. Nor will we buy property from someone who may not own it nor sell our own property if we cannot assure buyers that they will get what we purport to give them.

We generally assume that formalities promote clarity and avoid misunderstandings and disputes. We assume people know what the law is and comply with it and if they do not, they suffer the consequences of having failed to adequately formalize their transactions. Holding people to the rules is thought to be a powerful incentive to induce them to learn what the law is and to comply with it. That, in turn, will promote clear and mutually understood contractual and property arrangements.

But formalities often fail. Why? While ignorance of the law is no excuse, it is extremely common for people to ignore or fail to comply with the statute of frauds. Sometimes this happens because of negligence. A building contractor may misread building plans or put the borders of property in the wrong place. Sometimes it happens because of the cost or difficulty of finding out what the law is or because social custom diverges from legal requirements. A home purchaser may not hire a surveyor when purchasing property to ensure that the written records accord with the borders on the ground. It may not be customary to pay for such a survey. Moreover, oral agreements among neighbors about borders may be the norm; indeed, seeking to reduce such understandings to writing may insult the neighbor and indicate mistrust. I myself talked to my neighbor about where our border was before building a fence around our backyard, both of us agreeing to eschew the costs of a formal survey. Property law recognizes the disjunction between possession and

[31] Peterson, *Foreclosure, supra* note —, at 1364 .

formal title through myriad doctrines such as adverse possession, prescriptive easements, oral agreement, acquiescence, estoppel.

The banks did not have any of these excuses. The rules were simple and clear: put your transaction in writing and record it. *Yet this simple, clear system failed.* The rules were clear *but the bankers did not follow them.* They wanted to make money through securitization and that requires multiple transfers of multiple mortgages. That would be costly and cumbersome if each mortgage assignment had to be reduced to writing and a fee paid to record in it in the relevant registry of deeds. So the banks invented MERS, the Mortgage Electronic Registration System.[32] This corporation was designed to stand in for the real parties in interest in mortgage transactions and allow them to avoid recording mortgage assignments every time those mortgages were transferred. In the olden days, if you borrowed money from the Bank of America to buy a house, you signed a *note* that constituted a contract between you and the bank stating the amount of the loan and the repayment terms. You also gave the bank a *mortgage* to the property, allowing the lender to foreclose on the property in either a judicial or a nonjudicial proceeding if you defaulted on your mortgage payments. That mortgage document would name Bank of America as the mortgagee and it would be recorded. If Bank of America assigned its rights in the mortgage to another bank, a written mortgage assignment would be drafted, signed, and recorded and the note would be signed over to the new mortgage holder.

Instead of doing this, the MERS system allowed the original mortgage to be placed in the name of MERS rather than the Bank of America. If you went to the public registry of deeds to see if there were any liens or encumbrances on the property, all you would see was that the owner had granted a mortgage to MERS. MERS would keep an electronic database that would list Bank of America as the real mortgagee of the property; it would also list the name of any loan

[32] Mortgage Electronic Registration Systems, Inc., www.mersinc.org; Nolan Robinson, *The Case Against Allowing Mortgage Electronic Registrations Systems, Inc. (MERS) to Initiate Foreclosure Proceedings*, 32 CARDOZO L. REV. 1621 , 1621–1623 (2011) (explaining the creation of MERS); White, *Losing the Paper, supra* note —, at 486 (explaining how MERS works).

servicer hired by Bank of America or its successors in interest to collect the mortgage payments from the homeowner. When Bank of America transferred its mortgage to a second bank, say Cambridge Trust, the theory was that Cambridge Trust would notify MERS and MERS would change the name of the mortgagee for that property on its books. Nothing would be changed in the public registry of deeds, however; since MERS was holding the mortgage as the "nominee" for the real owner, no new recording would be needed. Yet MERS also maintained, inconsistently, that it was *both* the mortgagee and merely the "nominee" (a limited agent) for the real mortgagee.[33] This system effectively created a national electronic registry for mortgages, bypassing the need for new paper assignments recorded in the various state registries of deed with their attendant fees. Using this method, the banks thought they could both comply with state recording acts and avoid the costs and complexity associated with them.

The MERS system failed in several ways, all predictable from the start.[34] First, the banks apparently did not carefully research state property law. They operated in the context of a national or international securities market; they did not focus on the fact that property law is state law. Every state has a Uniform Commercial Code that regulates negotiable instruments and the courts interpret those laws to apply to many housing loan notes. Every state has statutes that allow for and regulate the recording of real property titles and mortgages. Every state has statutes that regulate the foreclosure

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[33] *See* Dustin A. Zacks, *Standing in Our Own Sunshine: Reconsidering Standing, Transparency, and Accuracy in Foreclosures*, 29 QUINNIPIAC L. REV. 551, 559–585 (2011) (analyzing conflicting theories about MERS's role in the mortgage transactions). *See also* Christopher L. Peterson, *Two Faces: Demystifying the Mortgage Electronic Registration System's Land Title Theory*, 53 WM. & MARY L. REV. 111, 118–125 (2011) (explaining the problems that arise from these inconsistent claims). *See also* Robinson, *Case Against MERS, supra* note —, at 1645 ("from a legal standpoint, MERS cannot simultaneous[ly] be both principal *and* agent").

[34] *See* David Waks, *Mortgage Electronic Registration Suspense: What's Happening*, (Feb. 1, 2011), http://ssrn.com/abstract=2197135 (detailing myriad foreclosure issues generated by the MERS system).

process. *The states' laws are not uniform.*[35] It might be possible to develop a business model that would satisfy the rules of every state, and the banks that established MERS clearly thought they had accomplished that. In retrospect, it is clear that they did not understand or research the complexities of state foreclosure law. Foreclosure litigation is now revealing that the MERS system, as implemented by the banks, often did not comply with the requirements of the laws of the several states.[36]

Second, the MERS system made the banks complacent. They thought that if they ever had to foreclose, then MERS could either bring the foreclosure proceedings itself or MERS could assign the mortgage to the real party in interest and that party (or the loan servicer) could conduct the foreclosure. The banks did not think there was a reason to have a clear chain of title showing the written mortgage assignments from the first mortgagee to the current one that was seeking to foreclose. The banks also securitized and transferred so many mortgages that they made mistakes. Their records are incomplete in some cases and inaccurate in others. They failed to carefully document all the mortgage transfers, relying on the MERS mechanism to get them around the statute of frauds. In the past, the courts had always been solicitous of the banks. Most home owners never contested foreclosures because they were indeed behind in their payments and neither the borrowers nor the courts had any reason to question whether the foreclosing bank had a right to do so.

The subprime crisis changed all of this. When people stopped being able to pay the higher interest rates associated with adjustable rate mortgages and the housing bubble burst, making refinancing

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[35] *See* Andra Ghent, *America's Mortgage Laws in Historical Perspective* (Oct. 24, 2012), available at SSRN: http://ssrn.com/abstract=2166656 (detailing differences among state laws).

[36] *See* U.S. Bank Nat'l Ass'n v. Ibañez, 941 N.E.2d 40 (Mass. 2011)(foreclosure improper when bank could not demonstrate clear chain of title to mortgages); Montgomery Cty. v. MERSCORP, Inc., 2012 WL 5199361 (E.D. Pa. 2012) (MERS title system violates Pennsylvania recording statutes); Gretchen Morgenson, *Guilty Pleas in Foreclosure Fraud Cases,* N.Y. TIMES, Nov 21, 2012 (foreclosure processing company founder pleads guilty to charge of fraudulently preparing false documents to evict troubled borrowers from their homes).

impossible, defaults skyrocketed and foreclosures along with them. For the first time, homeowner/borrowers started questioning whether the bank bringing the foreclosure action was entitled to the property. It is a settled principle of real property law that a peaceable possessor is entitled to remain in possession unless someone can prove they have a better title. But when MERS began bringing foreclosure proceedings, homeowners' lawyers began to focus on the fact that MERS was not the mortgagee; it was merely an agent for the real mortgagee. But an agent's powers cannot exceed those of the principal. For MERS to foreclose, it had to show that it was an agent for the *real* mortgagee.[37] But how could it do that? It would have to show a clear chain of title to the mortgage from the original mortgagee to the current mortgagee. Because its records were unclear or incomplete, it could not do that.[38]

Some states have allowed MERS to bring foreclosure proceedings in its own name.[39] They view the MERS system as beneficial to the real estate market and feel that the homeowner had agreed to let MERS act as an agent for the real mortgagee, whoever that was. So they shifted the burden of proof onto the homeowner to show that

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[37] Bain v. Metropolitan Mortgage Group, Inc., 285 P.3d 34, 46 (Wash. 2012)("MERS offers no authority for the implicit proposition that the lender's nomination of MERS as a nominee rises to an agency relationship with successor noteholders. MERS fails to identify the entities that control and are accountable for its actions. It has not established that it is an agent for a lawful principal.").

[38] *But see See* Dustin A. Zacks, *MERS is Dead: Long Live MERS,* 44 CONNTEMPLATIONS 62, *68 (2012)(arguing that most courts have held MERS to be an agent for the mortgagee and/or note holder or occupies an equivalent status that allows it to act on behalf of the real party in interest).

[39] MINN. STAT. § 507.413; Gomes v. Countrywide Home Loans Inc., 121 Cal. Rptr. 3d 819, 826–827 (2011) (MERS may initiate nonjudicial foreclosure under deed of trust); Mortgage Electronic Registration Systems, Inc. v. Revoredo, 955 So. 2d 33, 34 (Fla. Dist. Ct. App. 2007) (MERS may foreclose as agent of the note holder); Residential Funding Co., LLC v. Saurman, 805 N.W.2d 183 (Mich. 2011) (MERS had sufficient "interest in the debt" to initiate nonjudicial foreclosure proceedings); Jackson v. Mortgage Electronic Registration Systems, Inc., 770 N.W.2d 487, 494–495, 501 (Minn. 2009)(applying MINN. STAT. §507.413 allowing MERS to initiate foreclosure proceedings). *Cf.* Culhane v. Aurora Loan Servs. of Neb., — F.3d —, 2013 WL 563374 (1st Cir. 2013)(MERS possesses a legal interest in the mortgage enabling it to transfer to mortgage to the holder of the beneficial interest or the bank that owns the right to foreclose to secure the underlying debt).

MERS was *not* acting on behalf of the real party in interest. Other courts, however, have refused to let MERS bring foreclosure proceedings on the ground that it had no title to the property or any interest whatsoever.[40] If you are going to eject someone from their home, you have to show you have a better right to their property than they do. But MERS has no property rights of any kind; it does not own the mortgage and it is not the one to whom the loan is owed. For that reason, it may have no power to assign rights in the mortgage to the real owner of the mortgage to enable it to foreclose.[41] And even if it can serve as an agent for the real mortgagee, it cannot serve in that capacity without a clear record of who its principal is.[42] For the same reason, some courts refused to allow loan servicers to foreclose unless they can show a chain of mortgage assignments giving them the right to foreclose as agents for the mortgagee.[43] They also are agents for a principal and unless they can show that the principal has rights in the mortgage, they are in no better a position than MERS.[44]

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[40] LaSalle Bank Natl. Ass'n v. Lamy, 824 N.Y.S.2d 769, 2006 WL 2251721, at *1 (N.Y. Sup. Ct. 2006) ("only the owner of the note and mortgage at the time of the commencement of a foreclosure action may properly prosecute said action"); Bain v. Metropolitan Mortgage Group, Inc., 285 P.3d 34, 36–37 (Wash. 2012) (because MERS does not hold the note, it can neither initiate nonjudicial foreclosure proceedings not assign an interest in the note to a trustee who can do so). *Cf.* Fed. Home Loan Mortgage Corp. v. Schwartzwald, — N.E.2d —, 2012 WL 5359243, at ¶3, *1 (Ohio 2012)(foreclosure action can be brought only by party that is the note beneficiary at the time the action is brought).

[41] Bank of N.Y. v. Silverberg, 926 N.Y.S.2d 532, 538–539 (App. Div. 2011); LaSalle Bank Nat'l Ass'n v. Lamy, 2006 WL 2251721, at *1–*3 (N.Y. Sup. Ct. 2006). *But see* In re Relka, 2009 WL 5149262, at *3 (Bankr. D. Wyo. 2009)(MERS has power to assign the note and mortgage).

[42] Bank of N.Y. v. Alderazi, 900 N.Y.S.2d 821, 824 (Sup. Ct. 2010)(the "party who claims to be the agent of another bears the burden of proving the agency relationship"). On the difficulty of figuring out what when the principal is unclear, see Bain v. Metropolitan Mortgage Group, Inc., 285 P.3d 34, 47–49 (Wash. 2012).

[43] In re Maisel, 378 B.R. 19, 22 (Bankr. D. Mass. 2007), *quoting* In re Parrish, 326 B.R. 708, 720 (Bankr. N.D. Ohio 2005) (agent cannot foreclose without proof of its agency relationship and a showing of the chain of mortgage assignments giving its principal a right to foreclose).

[44] *Robinson, Case Against MERS, supra* note —, at 1644 ("an agent cannot augment or reduce the legal rights of its principal").

That left the current mortgagee to bring the foreclosure proceeding itself. But again, in the case of judicial foreclosures, some courts started insisting on proof that the mortgagee actually possessed rights in the property at the time the foreclosure proceedings began. Because of the sloppy record keeping and the undue reliance on the MERS system, some banks could not make that showing.[45] In the case of nonjudicial foreclosures, the bank would conduct the foreclosure; usually it would buy the property itself at the foreclosure sale. At that point, title shifted from the mortgagor or the deed of trust owner to the foreclosure purchaser (usually the mortgage holder). That new owner would then try to evict the homeowner who no longer had title to the property. In these court cases, once again, some courts put brakes on the whole affair.[46] If the foreclosure was conducted by someone who was not the real mortgagee, then it had no right to foreclose on the mortgage. You can foreclose on your own mortgage but not on someone else's mortgage. I can give you a deed to the Empire State Building and you would get what I have the right to sell – which is nothing, since I do not own the Empire State Building. It is a staple of real property law that, absent a statute to the contrary (such as recording acts), you cannot convey more than you own. So if the bank that conducted the foreclosure did not own the mortgage, it could not foreclose and certainly could not transfer title to itself as foreclosure buyer. Since it obtained no title, it now had no right to eject the homeowner because it cannot prove it

[45] *See, e.g.,* In re Foreclosure Cases, 521 F.Supp.2d 650 (S.D. Ohio 2007) (no right to foreclose without possession of properly endorsed note); Deutsche Bank Natl. Trust v. Mitchell, 27 A.3d 1229 (N.J. Super. Ct. App. Div. 2011) (same); White, *Losing the Paper, supra* note —, at 474-477 (sloppy treatment of notes was widespread making it difficult for lenders to show properly endorsed notes to prove they had a right to foreclose); White, *Losing the Paper, supra* note —, at 495 (noting the "extensive inaccuracy of MERS" records).

[46] Bevilacqua v. Rodriguez, 955 N.E.2d 884, 893–897 (Mass. 2011)(if nonjudicial foreclosure is invalid because the foreclosing party could not prove it possessed the right to foreclose, then the purchaser at the foreclosure sale cannot transfer good title to a third party); U.S. Bank Nat'l Ass'n v. Ibañez, 941 N.E.2d 40, 49–51 (Mass. 2011) (foreclosure is invalid unless the foreclosing party proved a right to possession of the property before the foreclosure occurred, so subsequent purchaser could not prove that it acquired good title sufficient to claims rights against the current possessor).

has a better title to the property than does the peaceably possessing homeowner.

What to do now? We could strictly enforce the statute of frauds and hold that the banks that cannot prove that they "own the mortgage" through showing a clear chain of title simply cannot foreclose. They would lose their interest in all such properties. Is that a viable solution to this problem? One problem is that this would reduce the market value of mortgages the bank cannot prove it owns to zero. That, in turn, would reduce the capital held by the bank and require it to replace that capital if needed to meet regulatory requirements to have a certain amount of money on hand. If it cannot replace that capital, there is a chance the bank could become insolvent. If this is a problem many banks face and if many of them become insolvent, we could plunge the economy into a second major recession unless we bail out the banks a second time.

A second major issue that would arise is that the mortgagee might lose its interests in the mortgage but *this would not clear title for the borrower/mortgagor.* There would still be an undischarged mortgage on the books in MERS's name. That means the property appears still to be encumbered by a mortgage. Just because the current mortgagee cannot prove it has title does not mean a prior assignee of the mortgage could not show a complete chain of title. So the current mortgagee could go back to the bank it purchased the mortgagee from and get a written assignment. But it would have to get information about the full chain of title for this to work and what would induce the prior bank to give the new written assignment? Suppose the prior bank also does not have a full chain of title; what happens then? Suppose it grants an assignment; how is that proof that *that bank* was entitled to give the assignment? Unless a *full* chain of mortgage assignments is granted, we are still not able to clear title.

Now suppose the prior bank sits on its laurels, happy that it has back a mortgage it thought it had sold; after all, the transfer was null because it was not in writing, or in a writing anyone can find, or which is sufficiently detailed to prove the assignment was made. That bank got money for selling the mortgage and now has the mortgage back, as it were, for free. Would the bank that bought that mortgage accept this? No, it would sue the earlier bank either for an order to

execute a mortgage assignment or it would sue the earlier bank for unjust enrichment for taking money for a mortgage that it never in fact sold. And how would the current mortgagee ensure that it could get that money? It might bring a lawsuit against the earlier bank and the homeowner and try to slap a lien on the property to ensure payment of that obligation. Thus we would have a new encumbrance on the property arising out of the unjust enrichment lawsuit. Title is no closer to being cleared than it was before.

Suppose the borrower/homeowner is fed up by all this and just wants to bring a quiet title action against everyone who might have an interest in the property to determine who, if anyone, has a mortgage in it. Under the due process clause, that requires notice to all concerned.[47] But the homeowner has no way of knowing who those parties are. The public records in the registry of deeds say that the mortgage is held by MERS. The homeowner could call up MERS and ask for the information on its books about the chain of mortgage assignments, but until recently all MERS would tell the homeowner was the name of her loan servicer, not the current mortgagee or prior holders of the mortgage. Because of litigation limiting its power to foreclose, MERS changed its policy several years ago and will now tell the homeowner the identity of the bank that MERS records show is the current mortgagee.[48] In addition, 2009 amendments to the Truth in Lending Act (TILA) require borrowers to be notified when mortgages are assigned.[49] But MERS will not reveal the chain of title to show all the mortgage assignments from the original to the current mortgagee. And even if it agreed to do so, because of the failures to formalize these transactions, that chain is likely to be broken. So if the homeowner cannot find out all the parties who claim an interest in the property, what can she do? Perhaps she can sue MERS and the current mortgagee and any prior mortgagees she can find out about and she can post a notice in the newspaper trying to notify all others about her claim. Perhaps this will satisfy due process requirements for notice before you lose a property right.

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[47] Mullane v. Central Hanover Bank & Trust Co., 339 U.S. 306, 313 (1950).

[48] http://www.mersinc.org/information-for-homeowners/faq-information-for-homeowners#canyouhelpme.

[49] 15 U.S.C. §1641(g).

But now we face another problem. This lawsuit is being brought by the homeowner who has defaulted on her loan. Where does she get the money to hire a lawyer and pay for the lawsuit? Perhaps a potential purchaser would be willing to pay that cost. That would only make sense if the increased costs for the property associated with a lawsuit, as well as the time needed to prosecute a quiet title action, would still make the property attractive to the potential buyer. Perhaps the buyer could simply purchase title insurance to facilitate the deal. That requires a title insurance company willing to ensure the title to property for which there are no public records of mortgage assignments, i.e., for an unknown risk. Any of these solutions increase the costs associated with the property and decreases its market value. That in turn creates impediments to alienability.

The result of all this is that the title to the property is under a (perhaps permanent) cloud. The property seems to be subject to a mortgage in MERS's name but since MERS cannot be the mortgagee, then the encumbrance on the property cannot be clearly identified.[50] Some mortgagee at some point could come forward and claim rights in the property under the mortgage through a full chain of title, but until that happens the property has an uncertain encumbrance. In conjunction with the costs of a quiet title suit or enhanced title insurance, we have impediments to the title that could render the property unmarketable.[51]

This creates a situation in which both the home owner and the current purported mortgagee have some bargaining power against each other. The mortgagee may want to foreclose or renegotiate the mortgage payments since it needs the money from the property to fulfill its capitalization requirements and to lessen any loss of profits from its investment in the property. The homeowner needs to clear

[50] MERS's website takes the contradictory positions that MERS is the "original mortgagee" and that it is the "agent" for the "owner of the loan" as well as the "mortgage lender." This waffling in legal positions is part of what has confused the courts about what MERS's legal status is. *See* http://www.mersinc.org/about-us/faq.
[51] David E. Woolley & Lisa D. Herzog, *Mers: The Unreported Effects of Lost Chain of Title on Real Property Owners,* 8 HASTINGS BUS. L.J. 365, 367 (2012)(MERS may make various titles unmarketable).

title so she can sell the property or get a new loan and to fix her credit rating. They have an incentive to reach an agreement since both would like to clarify title. But of course, negotiations between them could fail for any number of reasons: they mistrust each other; they are mad at each other; they overestimate the other side's reserve price. And if the mortgage is held by a trust as part of a securitization, that trust may be subject to contractual limitations on its ability to renegotiate mortgages while the thousands of investors in the securities have no ability to contact each other, much less agree on a course of action.[52] Moreover, even the current mortgagee and mortgagor reach agreement, that does not change the fact that under the law, the two of them cannot divest a prior mortgagee of any persisting interest in the property. Remember that if we strictly enforce the statute of frauds, the current mortgagee owns nothing and the homeowner cannot free herself from an existing mortgage simply by saying so. So an agreement between them would not discharge the rights of a prior mortgagee.

What to do? The courts get around all this by allowing the current bank to file an affidavit swearing that it is the current lawful holder of the mortgage, while public notice of foreclosure serves to place prior mortgagees on notice that they may lose their rights. But once again, in an effort to save costs, some banks hired people to sign hundreds of affidavits a day. They did so with no research whatsoever.[53] This "robo-signing" was not only a fraud on the court but constituted perjury. For this to work the way it is supposed to, the banks actually have to research each mortgage and explain the evidence that leads the bank to believe that it actually has the right to foreclose on the property. But if there is no clear chain of title, what evidence would suffice? By definition, we are only in this position because the written chain of evidence is broken or incomplete. The affidavit constitutes a sworn testimony that the bank believes what it contains but it must be backed up by objective facts and evidence. It is not clear the banks have sufficient ability to carry this out. But if

[52] Robert C. Hockett, *Paying Paul and Robbing N o One: An Eminent Domain Solution for Underwater Mortgage Debt That Can Benefit Literally Everyone,* Cornell Law School research paper No. 12-64, at 6–7, http://ssrn.com/abstract=2173358.
[53] White, *Losing the Paper, supra* note —, at 469–470.

they do come up with reliable evidence and we allow them to claim the mortgage by an affidavit, notice that *we have fixed the title problem by relaxing the statute of frauds*. We are forgiving the bank for failing to comply with formality requirements. And we are doing so because *strict adherence to formality would muddy property titles rather than clarify them.*

An alternative to relying on the mortgage documents is to rely on the note as the basis for foreclosure. Whoever possesses that note (or has a contract making it the agent of the note holder) arguably has the rights in the accompanying mortgage. Traditionally, "the mortgage follows the note."[54] The note is the primary legal obligation and the mortgage is simply a device to protect the interests of the note holder. Also traditionally, when the mortgage is assigned to another bank, the note should be endorsed and transferred along with it. But what if that doesn't happen? This was a common occurrence in the subprime mortgage market. Some courts hold that the mortgage and the note cannot be owned by different parties.[55] But what happens if they are separated? Some courts say the note holder's rights are primary and the mortgage holder holds those rights for the benefit of the note holder.[56] Other courts say the holder of the

[54] Chase Home Finance, LLC v. Fequiere, 989 a.2d 606, 611 (Conn. App. Ct. 2010); White, *Losing the Paper, supra* note —, at 489; RESTATEMENT (THIRD) OF PROPERTY (MORTGAGES) §5.4(c) ("A mortgage may be enforced only by, or in behalf of, a person who is entitled to enforce the obligation the mortgage secures.").

[55] Saxon Mortgage Services, Inc. v. Hillery, 2008 WL 5170180, at *5 (N.D. Cal. 2008) (*quoting* Carpenter v. Longan, 83 U.S. (16 Wall.) 271, 274 (1872)).

[56] Chase Home Finance, LLC v. Fequiere, 989 a.2d 606, 610–612 (Conn. App. Ct. 2010)(proper holder of the note may foreclose even if it has not been assigned the mortgage) (applying CONN. GEN. STAT. §49-17); Mortgage Electronic Registration Systems, Inc. v. Coakley, 838 N.Y.S.2d 622, 623 (App. Div. 2007). Note also that a party may hold the note for the benefit of another party and act as an agent for that party, thus occupying a status as a "person entitled to enforce the note" although the proceeds of any such enforcement action belong to the principal who "owns" the note. BAC Home Loans Servicing v. Kolenich, 2012 WL 5306059, ¶39 (Ohio Ct. App. 2012) (mortgage can be foreclosed by holder of a negotiable note, even if the note is "owned" by a different party).

mortgage owns it and along with it the rights under the note.[57] Some states hold that the foreclosing party must possess both the mortgage and the note or be in an agency relationship with the note holder.[58] Some states had clear rules about this prior to the subprime crisis but others did not.[59]

The prevailing view is that most mortgage notes are negotiable instruments governed by Uniform Commercial Code (UCC) Article 3 and that mortgage obligations are owed to the "person entitled to enforce the note" within the meaning of UCC §3-301; that person may be different from the person who "owns" the note and has the ultimate right to the economic value of the note.[60] To make things even more complicated, Article 9 of the UCC was amended recently and it is not clear whether it or Article 3 regulates the transfer of notes issued to finance real property transactions.[61] Nor is the relationship clear between the UCC and state recording and foreclosure statutes as to how to regulate the assignment of mortgages and the rules governing the evidence sufficient to start a foreclosure procedure.[62] The failure of the banks to assign MERS the role of holding the notes and ensuring their endorsement either in blank or with the series of mortgage transfers endorsed on it has

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[57] Crum v. LaSalle Bank, N.A, 55 So.3d 266, 269 (Ala. Civ. App. 2009); Wells Fargo Bank, N.A. v. Marchione, 69 A.D.3d 204, 209, 887 N.Y.S.2d 615 (App. Div. 2009); Wells Fargo Bank, N.A. v. Byrd, 897 N.E.2d 722 723 (Ohio Ct. App. 2008).

[58] In re Agard, 444 B.R. 231, 254 (Bankr. E.D. N.Y. 2011); Eaton v. Federal Nat'l Mortgage Ass'n, 969 N.E.2d 1118, 1121 (Mass. 2012).

[59] On the complexity of the issues involved in determining the relation between the note and the mortgage see Adam Levitin, *The Paper Chase: Securitization, Foreclosure, and the Uncertainty of Mortgage Title* (11/5/12)(manuscript in possession of author) (explaining the ambiguities in Article 3 and Article 9); Note, *Consumer Law – Mortgage Foreclosure — Massachusetts Supreme Judicial Court Unanimously Voids Foreclosure Sales Because Securitization Trusts Could Not Demonstrate Clear Chains of Title — U.S. Bank Nat'l Ass'n v. Ibanez, 941 N.E. 2d 40 (Mass. 2001),* 125 HARV. L. REV. 827, 831–833 (2011).

[60] U.C.C. §3-301; Report of the Permanent Editorial Board for the Uniform Commercial Code, Application of the Uniform Commercial Code to Selected Issues Relating to Mortgage Notes (Nov. 14, 2011), http://www.ali.org/00021333/PEB%20Report%20-%20November%202011.pdf.

[61] Levitin, *Paper Chase, supra* note —; White, *Losing the Paper, supra* note —, at 473.

[62] Levitin, *The Paper Chase, supra* note —; White, *Losing the Paper, supra* note —, at 471–472, *passim.*

created another, independent problem in clarifying who has the right to foreclose.

Unlike mortgage and foreclosure law, the UCC rules governing notes associated with mortgages were not clear at the time of the subprime mortgage debacle.[63] Perhaps the banks could be forgiven for not knowing what the law was. But then again, they arguably created this ambiguity by amending Article 9 in a manner that made the rules unclear. The architects of the revisions to Article 9 thought that this would validate the securitizations because Article 9 seems to recognize contracts that purport to transfer negotiable instruments but which fail to adhere to the requirements of Article 3 that the notes be endorsed or the requirements of state mortgage law that requires mortgage assignments to be in writing and recorded.[64] In a sense then, the banks relied not on clear legal authority but on the assumption that the courts would roll over and protect the banks' interests regardless of the legal uncertainties surrounding the transactions. They assumed that, as in the past, the banks would assume that foreclosing entities had the right to foreclose and that defaulting homeowners deserved to lose their homes. They assumed that multiple sources of legal authority would benefit them rather than muddy the waters.

The opposite has turned out to be the case. Because the banks diverged so sharply from prior practice, they took a risk that the courts would interpret state law to validate their arrangements. Their rush to make money and their lack of care in documenting mortgage transfers led to the massive foreclosures we have been experiencing. They did not anticipate that courts would both hold them to traditional statutory formality requirements and burdens of proof and rule in favor of homeowners and against the banks' interests. Because of the failures to clearly document mortgage assignments and because of the robo-signing scandal, *the courts no longer trust the banks.* The old system worked because the courts trusted the banks, and now that that trust is gone, we are beset by

[63] Levitin, *The Paper Chase, supra* note —; White, *Losing the Paper, supra* note —, at 471–472.
[64] Levitin, *The Paper Chase, supra* note —.

dilemmas. The banks did not realize that an efficient and well-working market system depends on trust, both among market actors and contracting parties and between market actors and government regulators, including judges. The banks cut corners and many judges are in no mood today to cut them slack. To make things worse, many states allow nonjudicial foreclosure; that system is much less expensive than judicial foreclosure and it especially depended on courts and legislators trusting banks to exercise their powers appropriately. But now that trust in banks has been shattered, eviction lawsuits following nonjudicial foreclosure are reintroducing the costs that nonjudicial foreclosure was supposed to avoid.

Amazingly, over the last ten years, the banks have wrecked a property recording system that worked relatively well for hundreds of years.[65] It is astonishing that they did this and tragic that we are suffering the price of their arrogance. We are left today with clouded titles, rampant litigation, insecure property rights. All this inhibits the use and alienability of land. The banks' practices violated the core norms underlying private property law.[66] The banks thought they could make money by getting around the rules or even by ignoring them. We had clear rules but the banks ignored them. Clear rules did not lead either to clear titles or predictable results.

That leaves us with a paradox. If we do not have a writing requirement for property transactions, then property rights will not be clear; people can always claim they acquired rights by informal arrangements or oral contracts and it is easy to lie about such things. But if we strictly enforce the writing requirement, title will also not be clear; because of the massive refusal to comply with the writing requirement and because of the importance of mortgages to the banks' capital structure and bottom line, strict enforcement of the writing requirement will either cause a new recession or generate

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[65] For a detailed explanation of various title problems MERS created, see Woolley & Herzog, *supra* note —.

[66] Joseph William Singer, *Democratic Estates: Property Law in a Free and Democratic Society*, 94 CORNELL L. REV. 1009, 1023 (2009) (traditional core of property law is the the promotion of alienability); Joseph William Singer, *The Rule of Reason in Property Law*, — U.C. DAVIS L. REV. —, — (forthcoming, 2013) (property law aims to achieve clear titles).

massive lawsuits to renegotiate property rights. We're damned if we do and damned if we don't. If we don't have formal writings, we don't have clear title, but if we strictly enforce the writing requirement, we don't have clear title either. Rigid rules, including rules governing formalities, do not necessarily lead to clear property rights even if you attempt to apply them mechanically. Rules do not promote predictability or clear property rights if people do not follow them; this turns out to be a far more serious problem that we may have thought.

1.3. Privatization of public land records

The MERS system failed not only because it led to careless record keeping and was carried out in a manner that violated the real property law of many states but because it *privatized* information about mortgages. State recording acts generally promote but do not require interests in real property to be recorded to be valid. A few states, like Pennsylvania, do require real property interests not only to be in writing but to be recorded to be legally valid.[67] Most states rely on the self-interest of mortgage lenders to record mortgages to ensure that they have priority over later interests. The system not only promotes a clear record of who owns property and what encumbrances attach to it but makes that information available to the general public. This means that anyone who wants to buy property or provide a loan secured by a mortgage in the property can determine who owns the property and what prior liens exist on it. Making the information public serves the old-fashioned goals of property law by promoting the alienability of land. MERS destroyed this system and, in so doing, constitutes a major drag on the marketability of real estate.

Because only MERS' name appears in the public records, there is no longer publicly available information about who owns particular

[67] Montgomery Cty. v. MERSCORP, Inc., 2012 WL 5199361 (E.D. Pa. 2012)(interpreting Pennsylvania statutes, 21 PENN. STAT. §351, to require recording for transfers of interests in land to be valid). *Cf.* Hooker v. Northwest Trustee Services, 2011 WL 2119103 (D. Or. 2011) (nonjudicial foreclosure not available in Oregon unless all mortgage assignments are recorded).

mortgages; that information is all on MERS's private computers.[68] Until recently, MERS did not even make that information available to the homeowners who were obligated to pay the mortgages; all MERS would tell homeowners was the name of the loan servicer hired to collect their payments.[69] For that reason, the homeowner who wanted to avoid foreclosure by negotiating with the beneficial owner of the mortgage could not find out who that was by searching either public records or by consulting MERS.[70] MERS has now partially changed that policy but it still does not make mortgage ownership information available to the public; it will not tell strangers who owns the mortgage in an particular piece of real estate.[71] Nor will MERS reveal the chain of title so potential buyers of land can determine if the current mortgage holder could foreclose on the property if it sought to do so.

What effects does this new secrecy of property titles have? For one thing, homeowners seeking to renegotiate their mortgages could not do so when MERS would not tell them who owned the mortgage. MERS would only tell them the name of the loan servicer and loan servicers often had incentives to foreclose rather than renegotiate.[72] The loan servicers' contracts gave them more money that way and sometimes the contracts prohibited them from renegotiating the

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[68] MERS's website misleadingly asserts that it does not "hide the mortgage note owner" because all MERS mortgages "are recorded in the public land records" while acknowledging that the purpose of the MERS system is to make it unnecessary for lenders to record mortgage assignments. "Because MERS is a common agent for its members, recording an assignment of the mortgage is not necessary when ownership of the promissory note or servicing rights transfer between members." http://www.mersinc.org/about-us/faq. *See also* Peterson, *Foreclosure, supra* note —, at 1400–1404 (noting the negative effect of MERS on public land title records).

[69] Tanya Marsh, *Foreclosures and the Failure of the American Title Recording System,* 111 COLUM. L. REV. SIDEBAR 19, 23 (2011), http://www.columbialawreview.org/assets/sidebar/volume/111/19_Marsh.pdf.

[70] Robinson, *Case Against MERS, supra* note —, at 1638.

[71] Marsh, *supra* note —, at 23. See Complaint, Comm. of Mass. v. Bank of America ¶ 150(b), Civ. A. No. 11-4363 (Dec. 1, 2011), http://www.mass.gov/ago/docs/press/ag-complaint-national-banks.pdf.

[72] Adam J. Levitin & Tara Twomey, *Mortgage Servicing,* 28 YALE J. ON REGULATION 1 (2011)(analyzing servicer incentives).

deal.[73] But even though MERS has changed that policy, neither the homeowner nor others can determine what encumbrances there are on the property. Because of past business practices by both MERS and the banks, neither homeowners nor potential buyers nor the banks themselves nor the courts have any reason to treat MERS records as either complete or accurate. And since they cannot trust those records, they seek information about the actual chain of transactions affecting the property. But MERS treats its computers and the information on it as private property from which it has the right to exclude outsiders. The result of all this has been to destroy our public recording system. *We no longer have trustworthy public records of property title in the United States.*

Property scholars have long argued that property rights cannot work if they are not clear.[74] They have also recently emphasized that they cannot work if they are not *publicly known.* Henry Smith's work on the *in rem* nature of property rights emphasizes the information cost benefits of knowing who is the gate keeper for property.[75] Privatizing information in property rights requires us to trust MERS to be accurately determining who the current mortgagee is. But we have no reason to trust MERS both because the records are not public and because the MERS system induced banks to fail to keep complete and accurate records of mortgage assignments. While freedom of contract is traditionally assumed to be the core value of our contract law system, promoting the alienability of land is traditionally assumed to be the core value of our property law system.[76]

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[73] ENGEL & MCCOY, *supra* note —, at 131; White, *Losing the Paper, supra* note —, at 496.

[74] *See, e.g.,* Abraham Bell & Gideon Parchomovsky, *Reconfiguring Property in Three Dimensions,* 75 U. CHI. L. REV. 1015, 1022 (2008) ("There cannot be ownership in land without some clear idea of who owns the land, what land is owned, and what rights accrue to the owner as a result of her status."); Steven J. Eagle, *Private Property, Development and Freedom: On Taking Our Own Advice,* 59 SMU L. REV. 345, 352 (2006) ("Individuals working to grow their assets must be supported by clear laws defining their property rights").

[75] Henry E. Smith, *Exclusion v. Governance: Two Strategies for Delineating Property Rights,* 31 J. LEGAL STUD. 453 (2002); Henry E. Smith, *Property and Property Rules,* 79 NYU L. REV. 1719, 1797 (2004) ("Property rules have informational advantages").

[76] Henry E. Smith, *Property as the Law of Things,* 125 HARV. L. REV. 1691, 1691, 1698, 1700–1713 (2012).

Alienability concentrates property rights in an owner free to use property within limits determined by law and contract and to sell or mortgage it. But neither freedom to use property nor freedom to sell it nor freedom to buy it can exist if government regulation does not provide clear public notice of who owns land and how it is encumbered. In their zeal to make money, the banks have broken the foundational structures on which our property law system sat. They viewed regulations as costly interferences with their pursuit of profit and they failed to understand how those regulations were necessary for the property market to work well in the first place.

2. HOW TO FIX THEM

2.1. Institutional design principles

2.1.1. Property and the rule of law

WHAT LESSONS CAN WE LEARN from the subprime crisis about the institution of private property? The most fundamental lesson is that property cannot work without regulation. Since another name for "regulation" is the "rule of law," we can say that the infrastructure of our property system includes laws establishing and clarifying property rights. While those rules impose costs on market actors, property cannot exist without them. And the benefits of the institution of private property outweigh its costs.

The banks looked at the costs of formalizing and recording mortgages and wanted to reduce them. There is nothing wrong with the impetus to reduce costs and improve efficiencies. New technology has allowed faster, cheaper ways of disaggregating, formalizing, and exchanging property rights and the mortgage industry was right to take advantage of it. But the mortgage industry was entranced by the technology and by the idea of cost reduction and assumed that things that *could* be done *should* be done. By establishing MERS, they went gangbusters into new technological and institutional frameworks for mortgage law without adequate consideration for whether they were complying with existing real property law rules or what the effects might be on the infrastructure of property. They assumed that costs to them were costs to society; they did not understand that the benefits associated with property law rules might outweigh their costs, not only to society but to the banks themselves.

The banks also forgot that while securities markets are global, property law is (mostly) local. It is not clear that the banks sought or received high quality advice from real estate lawyers about the legality of MERS or its practices. The banks' failure to assess correctly state property law rules designed to protect homeowners and ensure clear title – or to understand their purpose and importance – has meant that the banks' technological and institutional innovations have not only failed to achieve their purposes but have had

potentially devastating consequences on the security, alienability, and publicity of land titles in the United States. The mess they have left us with suggests either that we renew compliance with traditional legal forms and principles or that we figure out how to modify those forms to take advantage of new technologies while preserving the benefits of traditional regulations.

Americans have a deep instinct to see government regulation as an interference with our freedom to do what we please. This value underlies the norm of freedom of contract and it can blind us to the benefits of the rule of law, otherwise known as "regulation." We cherish the freedom to use markets to redefine and exchange new forms of property, through securitization or other means. At the same time, we must not forget that neither markets nor property can exist without a legal framework. We have legal rules governing the creation, transfer, recording, and enforcement of property rights because without these rules, property cannot exist as an institution. Neither the statute of frauds nor state recording acts are pointless technicalities nor regulatory impediments to freedom or efficiency. Rather, they are part of the infrastructure that allows property to exist, and rules that clarify title and protect the core rights of owners and are the foundation on which markets operate.

2.1.2. Consumer protection

The subprime crisis could have been avoided (or mitigated) if the banks had not saddled homeowners with unaffordable loans and if the government had promoted home ownership through viable and appropriate means rather than deregulation and promotion of subprime mortgages. This suggests that a fundamental principle guiding a just and efficient property system is protecting consumers from unfair or deceptive practices.[77] Indeed, every state has a consumer protection statute that prohibits such business practices.[78] The Federal Trade Commission Act similarly prohibits "unfair or

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[77] *See* Peterson, *Predatory Structured Finance, supra* note —, at 2190 (consumer protection law must be updated to address the problems associated with predatory lending and finance).

[78] Singer, *Subprime, supra* note —, at 155 n.45 (collecting statutes).

deceptive acts or practices in or affecting commerce."[79] Consumer protection law not only promotes the values of treating people with respect and dignity but provides a useful barrier against schemes that can spin out of control and undermine the infrastructure of the economic system. Unfair or deceptive property transactions effectively defraud consumers out of their hard-earned wealth and make them worse off than before while causing enormous negative externalities that have the potential to undermine the world economy. We protect consumers from unjust business practices (1) to protect them from fraud; (2) to protect them from unfair arrangements; (3) to protect innocent third parties and to prevent harms from undue systemic risk.

First, deceptive practices induce people to enter agreements they would not make if they had adequate information. They are a species of fraud and the opposite of the principle of freedom of contract. We are free to make contracts with others but we are also free *not* to make contracts. Agreements make both parties better off than they were before the agreement because each is getting something they want and giving up something they are willing to exchange for what they get. Deception in the contracting process induces agreements that are not in the best interests of both parties. Both fraud (lying about a material fact to induce agreement) and deception (making misleading statements or failing to reveal information the other side would want to know) undermine any sense that contract enforcement promotes the will of both parties. It is akin to diverting someone's attention so you can pick their pocket. Deception is a form of theft. It not only contravenes freedom of contract norms but violates the property rights of the victim.

There was a lot of deception in the subprime mortgage market. Borrowers were often misled about the interest rates they would be paying. It was common for them to be surprised by sudden rises in mortgage payments. This happened because the mortgage documents are so complicated and because the mortgage brokers failed to explain clearly what the borrowers were getting into. If the borrowers had clearly understood what the real interest rate was,

[79] 15 U.S.C. §45.

some would not have agreed to the loan at all. As Federal Reserve Board Governor Ned Gramlich noted, "Why are the most risky loan products sold to the least sophisticated borrowers? The question answers itself. The least sophisticated borrowers are probably duped into taking these products."[80] Mortgage brokers who did explain the intricacies of adjustable rate mortgages assured borrowers that they could refinance when the interest rates increased. They did not explain, however, that this ability to refinance would disappear if housing prices stalled or plummeted. They induced borrowers to ignore such real concerns. Similarly, banks misled investors in securitized mortgages by giving AAA ratings to subprime mortgages held by people who could not afford to pay them back if housing prices decreased.

We could of course debate how much deception there was or what forms of market practice are acceptable. One could argue that borrowers and investors made free choices to invest in risky purchases, that they made high returns for taking those risks, and that the downside is a risk they voluntarily take on themselves. If all this is true, borrowers and investors have no one to blame but themselves for their misfortune. They assumed the risk and we have no good reason to depart from the traditional doctrine of *caveat emptor*. This argument has some merit, but it does require distinguishing between acceptable and unacceptable business practices. The law not only prohibits outright fraud; it also prohibits "deceptive" practices. The federal securities laws that protect shareholders who invest in stocks prohibit not only misleading statements but omissions that convey a false impression about facts investors would want to know in deciding whether to invest in a company's stock.[81] One could argue for repealing state consumer

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[80] Edward M. Gramlich, *Booms and Busts: The Case of Subprime Mortgages,* THE URBAN INSTITUTE, 2007, http://www.urban.org/ UploadedPDF/411542_Gramlich_final.pdf.

[81] *Securities and Exchange Act,* 15 U.S.C. §78j (unlawful to use any "manipulative or deceptive device or contrivance" in connection with the sale of any security); 17 C.F.R. §240.10b-5 (unlawful, in connection with the sale of any security, to "defraud" or "to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading").

protection laws and federal trade and securities regulation but the truth is that both consumers and sophisticated investors *want* protection from deceptive practices. These laws do not interfere with freedom of contact; rather *they ensure that people get what they want when they buy or invest.*[82] In so doing, they also protect private property by ensuring that businesses cannot take your money on false or misleading pretenses.

Second, in addition to preventing fraud or deception, consumer protection laws promote *fairness* in market transactions. Or at least they prohibit "unfair" transactions. This principle protects consumers from being taken advantage of; it requires businesses to treat customers with dignity. While the prohibition on deception focuses on giving the consumer what she wants, fairness requires more than this; it holds businesses to minimum standards in market relationships to protect the justified expectations of those with whom it does business.

Libertarians and some economists criticize minimum wage and other regulatory laws because they increase the costs of doing business and hurt those at the bottom of the economic ladder. While it is true that regulations increase the costs of providing consumer goods and services, we do not help the poor by eliminating regulations that the rest of us need to ensure that we get what we pay for. We could lower the costs of housing by eliminating all building code regulations and allowing people to live in shacks. That would decrease the costs of housing but would deprive everyone of the security of living in safe housing. No, we ensure that market transactions provide consumers with what they have a right to expect and we protect the poor in ways other than removing regulations that protect the rest of us.

We have minimum standards legislation not only to ensure that people get what they want out of market transactions but to ensure that people are treated with minimum levels of respect. The Supreme Judicial Court of the Commonwealth of Massachusetts held that it constitutes an "unfair practice" in violation of the state's consumer protection statute to grant a mortgage to a borrower who cannot pay

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[82] Singer, *Subprime, supra* note —, at 157.

it back if it is structured in a manner that would make it impossible to refinance if housing values fell.[83] This is at least true when it is clear that housing values are starting to level off or fall. In such a case, it is not true that it is better to have owned and lost than never to have owned at all — and the bank knows it.[84] Selling a loan to such a buyer is the moral equivalent of picking the consumer's pocket. And if you doubt this principle, consider whether you would be happy if the bank sold such a mortgage to your son or daughter.

Consumers are not making a mistake when they trust businesses to treat them fairly. They are entitled to believe that businesses like banks know what they are doing and that the products they sell will operate as advertised. Trusting customers are doing nothing wrong. The banks who take advantage of mixed messages or who sell products designed to impoverish the customer are not engaged in free commerce; they are picking our pockets. We have consumer protection laws not because people are stupid or foolish; we have such laws because pressures to pursue profits can induce businesses to sell what they should not sell. In such cases, it is the sellers, not the buyers, who are morally responsible for unfair outcomes. We do not after all blame people when thieves pick their pockets; we do not say "shame on you for carrying money around on your person." No, we blame the thief.

Banks understandably may wish to be free of vague obligations to consumers and investors. They want clear rules and the power to "walk the line" offering products and services as long as they are not clearly prohibited. But our consumer protection laws and our securities laws do not give banks the right to be complacent. We want banks to engage in moral reflection before they act. We want them to imagine whether they can convince a judge or a jury that their conduct was lawful and appropriate. We want them to imagine

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[83] Commonwealth v. Fremont Investment & Loan, 897 N.E.2d 548, 558–559 (Mass. 2008); Joseph William Singer, *Property Law as the Infrastructure of Democracy* [The Fourth in the Wolf Family Lecture Series on the American Law of Real Property], 11-1 Powell on Real Property (2011); Singer, *Subprime, supra* note —, at 159.

[84] ENGEL & MCCOY, *supra* note —, at 41 ("Without a doubt, most borrowers with subprime loans would have been better off with loans on better terms or with no loans at all").

whether they could justify what they did to someone burned by it. We want them to consider whether they would sell such a loan, on such terms, to their daughter or their son. And if the answer is no, if the question gives them pause, then perhaps they should not have sold such a loan to someone else's child.

To achieve these goals, we may need to abolish or modify the holder-in-due-course doctrine that immunizes note holders from fraud claims based on acts by note originators. That doctrine promotes negotiability of loans while also promoting fraud; Christopher Peterson argues for extending the FTC "holder-notice rule" to home mortgages so as to preserve consumer claims and defenses when notes are transferred.[85] Such a law reform will not hamper negotiability as long as banks refrain from deceptive practices – something they should not be doing anyway. Indeed, the holder-in-due-course doctrine never protected the transferee of a note where there was "fraud in the factum."[86] That exists where the fraud induced the consumer to sign the agreement, the signer did not know the "character" or "essential terms" of the instrument and lacked a reasonable opportunity to obtain this knowledge.[87] Fraud in the factum may exist where oral representations were made that diverge from the written terms of the agreement and the signer reasonably relied on those oral representations, something that was common in subprime mortgage transactions.[88]

Third, the sale of loans to people who could not pay them back and of mortgage-backed securities to investors who thought they were AAA safe had the side effect of causing a worldwide recession in 2008, the effects of which are still much in evidence now in 2013. The third party effects were both enormous and unfair. Banks made

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[85] ENGEL & MCCOY, *supra* note —, at 235; Peterson, *Predatory Structured Finance, supra* note —, at 2257, 2274 (arguing for such a change). *See* JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE §15-1, at 690, §15-9, at 723–733 (6th ed. 2010) (noting that the Federal Trade Commission, abolished the holder in due course doctrine for most consumer credit transactions, see 16 CFR 433.1–.3,, and, contrary to some fears, this has not substantially restricted the flow of credit to consumers. The FTC rule does not extend to mortgage transactions. *Id.*, §15-9, at 726

[86] U.C.C. §3-305(a)(1).

[87] WHITE & SUMMERS, *supra* note —, §15-10, at 736–737.

[88] U.C.C. §3-305 cmt. 1.

money in a manner that imposed undeserved losses on innocent third parties. Those losses included lost jobs, diminished pension and college funds, lower stock prices, depressed public services, and lower property values resulting from millions of foreclosures combined with a stalled housing market and a depressed economy. Even if one believes that subprime borrowers got what was coming to them, innocent third parties had no part in causing the harms they suffered.

We must protect people from avoidable losses associated with conduct that creates unreasonable systemic risk. Never again will it be difficult for me to explain to my property law students why we regulate the packages of property rights you are allowed to create. All I have to do is utter the words "subprime crisis" to remind them that property rights impose externalities on others and some of those externalities have the potential to go so far as to wreck the world economy. We need to set minimum standards for market transactions, not only to ensure that people are treated fairly, but to protect the general public from the negative effects of unduly risky schemes.

Now that the banks have become landlords and neighbors by taking properties in foreclosure and keeping them until they can be profitably resold on the market, they cannot complain when they find that they are subject to the same rules governing other landlords. They may have skirted the statute of frauds, the recording acts, and the foreclosure laws, but that does not mean they are entitled to ignore housing codes, zoning laws, or landlord-tenant law. Both tenants and neighbors have a right to be treated with human dignity and that entails compliance with minimum standards for housing and real estate construction and maintenance. If you want your neighbors to maintain their houses so that neighborhood values are preserved, you cannot claim a right to violate those regulations yourself.

Finally, we must protect housing consumers first and foremost by making sure that they have clear title to their property. Without such clarity, they can neither use their property nor sell it. To ensure clear title we have ancient rules that require real estate transactions, including mortgages, to be reduced to a clear writing and publicly

recorded. Such rules protect homeowners by enabling them to use and sell their property; they promote purchase as well by ensuring buyers they will get what they think they are purchasing. The formality and publicity rules skirted by the banks were not archaic relics of a primitive society; they are the foundation of our property system and can be avoided only when doing so is necessary to avoid systemic risk or substantial injustice. The banks must learn from the past as well as the lawsuits complaining of misrepresentation, robo-signing, and sloppy record keeping.[89]

2.1.3. Two principles for mortgage law

Mortgage law should be guided by the master principle of consumer protection. This principle embodies several norms which are in tension with each other. One way to protect consumers is to give them the freedom to engage in transactions they view as beneficial to themselves. But another, potentially contradictory way to protect consumers, is to regulate transactions to protect consumers from agreements they are likely to regret and which they would not enter if they had better information. And a third norm is to ensure that the infrastructure of the market and property system is maintained so that transactions can continue in the future and work to achieve their intended results.[90]

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[89] Chris Isidore, *Bank of America sued for alleged mortgage fraud,* @CNNMoney, Oct. 24, 2012, http://money.cnn.com/2012/10/24/news/companies/bank-of-america-lawsuit/index.html; Jessica Silver-Greenberg, *2 Banks to Settle Case for $417 Million,* N.Y. TIMES, Nov. 16, 2012; Jessica Silver-Greenberg, *Banks face wave of new mortgage-securities suits,* BOSTON GLOBE, Dec. 10, 2012.

[90] "First, the nonjudicial foreclosure process should remain efficient and inexpensive. Second, the process should provide an adequate opportunity for interested parties to prevent wrongful foreclosure. Third, the process should promote the stability of land titles." Bain v. Metropolitan Mortgage Group, Inc., 285 P.3d 34, 38 (Wash. 2012). *See also* Mortgage Finance Working Group, Sponsored by the Center for American Progress, *Comments on the Federal Housing Finance Agency's Plan for "Building a New Infrastructure for the Secondary Mortgage Market,"* Dec. 3, 2012, http://www.americanprogress.org/issues/housing/news/2012/12/05/47073/building-a-new-infrastructure-for-the-secondary-mortgage-market/ (identifying principles for the mortgage market that center on liquidity, stability, transparency and standardization, affordability and access, and consumer protection).

These norms suggest two master principles for mortgage law. First, protect homeowners, and second, promote housing transactions. The norm of protecting homeowners means (1) protecting homeowners from unfair or deceptive practices; (2) ensuring a well-functioning and public system of title protection; and (3) protecting homeowners from unreasonable systemic risk. The norm of promoting housing transactions requires promoting desirable forms of housing finance and allowing appropriate disaggregation of property rights. These two principles are stated in order of lexical priority. The second principle (promote housing transactions) is subordinate to the first (protect homeowners). As with Rawls's two basic principles of justice,[91] these two principles of mortgage law ensure that people have freedom to act within boundaries designed to preserve their freedom to act and to ensure they get what they are entitled to get when they enter market transactions. What are the implications of these principles for mortgage law? What do they tell us about how to handle the current foreclosure crisis?

2.2. Protect homeowners

2.2.1. By disclosure and qualification

The first principle of mortgage law is to protect the homeowner. And the first and most important way to do that is for banks to protect consumers from unduly burdensome mortgages by not granting mortgages to people who cannot pay them back. This is so obvious now that banks are refraining from giving mortgages to people who cannot pay them back. One way to achieve this goal is to enact better *disclosure* requirements, so that borrowers understand what they are committing themselves to when they take out a loan.[92] Luckily, the

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[91] JOHN RAWLS, JUSTICE AS FAIRNESS: A RESTATEMENT §13, at 42–50 (2001) (Erin Kelly ed.)
[92] *See* Oren Bar-Gill, *The Law, Economics and Psychology of Subprime Mortgage Contracts*, 94 CORNELL L. REV. 1073, 1084–1085, 1147–1150 (2009) (advocating better disclosure requirements).

new Consumer Financial Protection Bureau (CFPB) has been created to enact regulations of this sort.[93]

At the same time, better disclosure requirements will not completely solve the problem.[94] It is sometimes thought that all we have to do is to ensure that consumers have proper information and then let them make whatever decisions they want to make on the ground that stopping them from doing so constitutes inappropriate paternalistic interference with their autonomy. It is sometimes thought, on the other hand, that we need regulation of consumer contracts because consumers are either not smart enough to understand the contracts they are signing or that they are irrational and psychologically incapable of appreciating the real risks involved in the arrangement.[95]

In truth, we regulate consumer contracts not because consumers are stupid or irrational but because *sellers* are too easily drawn in to money-making schemes that cannot be defended from a moral point of view. Banks are in the business of lending money to people who need it and can pay it back with reasonable security from assets they own. Banks should not lend to those who cannot pay back the loan because they should not be in the business of selling mortgages for

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[93] www.consumerfinance.gov.

[94] *See* Jean Braucher, *Form and Substance in Consumer Financial Protection,* 7 BROOKLYN J. OF CORPORATE, FINANCIAL & COMMERCIAL L. — (2013, forthcoming) (Arizona Legal Studies Discussion Paper No. 12-25), available at SSRN: http://ssrn.com/abstract=2126859 or http://dx.doi.org/10.2139/ssrn.2126859 (explaining forthcoming regulations of the Consumer Financial Protection Bureau (CFPB) to go beyond disclosure requirements to preventing abusive practices); Peterson, *Structured Predatory Finance, supra* note — (discussing the various changes in consumer protection law that may be needed to fully protect homeowners from predatory finance); Dee Pridgen, *Putting Some Teeth in TILA: From Disclosure to Substantive Regulation in the Mortgage Reform and Anti-Predatory Lending Act of 2010,* 24 LOY. CONSUMER L. REV. 615, 616, 627-639 (2012)(explaining why disclosure is insufficient to protect consumers).

[95] *See* Bar-Gill, *supra* note —, at 1075 ("the problem is that lenders hid these high prices and borrowers underappreciated them"); *id.* at 1079 ("Myopic borrowers unduly focus on the short-term dimensions of the loan contract and pay insufficient attention to the long-term dimensions.").

the sole purpose of stripping the owner's equity from the home.[96] As Joseph Stiglitz explained: "There was no point of putting someone in a home for a few months and then tossing him out after having stripped him of his life savings. But that was what the banks were doing."[97] We have consumer protection statutes that prohibit unfair or deceptive practices not because consumers are irrational but to ensure that businesses treat their customers like customers rather than marks who can be easily parted from their wallets. Consumer protection laws are not paternalistic interferences with freedom of contract; *they protect the property rights of consumers.*

Banks and mortgage brokers need to develop a better appreciation that they are not legally entitled to defraud or mislead borrowers about the transactions they are entering. Nor are they entitled to hook borrowers into arrangements that they are very likely to regret. The subprime crisis has, to some extent, brought banks to their senses. The old-fashioned practice of determining whether someone *qualifies* for a mortgage has returned. The trauma associated with the subprime crisis might have led us to imagine that no new regulations might be needed to go back to this practice. At the same time, history shows that the temptation to bleed the vulnerable may require appropriate regulations at either the federal or state level to ensure that people who cannot afford mortgages are steered to obtaining housing in other, more appropriate ways. Recent applications of consumer protection and securities regulation laws are a step in this direction.[98] Their injunction to avoid "unfair" as well as "deceptive" practices goes beyond common law fraud and puts banks on notice that they neither have—nor are entitled to—a safe harbor when they sell products they cannot defend to a judge or jury. Importantly, the *Mortgage Reform and Anti-Prediatory Lending Act of 2010,* passed as one part of the *Dodd-Frank Wall Street Reform and*

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[96] Braucher, *supra* note —, at 11–12 ("The essence of predatory lending is extending credit to those who can be expected to default, and creditors who fail to evaluate creditworthiness know that they are setting up some of their customers for a fall.").

[97] JOSEPH STIGLITZ, FREEFALL: AMERICA, FREE MARKETS, AND THE SINKING OF THE WORLD ECONOMY 11 (2010).

[98] Comm. v. Fremont Inv. & Loan, 897 N.E.2d 548, 556–561 (Mass. 2008)(loan that the borrower cannot repay is "unfair").

Consumer Protection Act, makes ability to repay a condition for granting a residential mortgage.[99] Final regulations have now been issued that prevent granting high-priced mortgages to those who cannot afford them and provide presumptive protection for "qualified mortgages" that meet certain affordability criteria.[100] At the same time, those regulations leave in place state and federal laws that prohibit "unfair and deceptive practices" in the mortgage industry.

2.2.2. By title formalities and clear public records

The second major way to protect the homeowner is to ensure that we have clear, public records of title to property. That includes written records of all encumbrances on the land, such as easements, covenants, liens, mortgages, and court judgments. People cannot use or develop their property if ownership is unclear and their property cannot be marketed if it is unclear whether the property is subject to an outstanding mortgage and who the identity of the mortgagee is. There are desirable exceptions to this principle but they are exceptions.[101] Knowing who owns property and what mortgages validly attach to it not only makes property alienable but protects consumer interests in avoiding double payment or liability and knowing with whom to negotiate in the event of default.[102]

The banks tried to save money by creating a national, electronic database for mortgages. In so doing, they tried to obtain the benefits of a unified national system while (feebly) attempting to comply with

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100 12 C.F.R. §1026 (amending Regulation Z, implementing the Truth in Lending Act (TILA), 15 U.S.C. §§1639c, which itself implements the Mortgage Reform and Anti-Predatory Lending Act which comprised Title XIV of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, H.R. 4173, July 21, 2010, at §§1411-1412). *See* Ability to Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z), http://www.consumerfinance.gov/regulations/ability-to-repay-and-qualified-mortgage-standards-under-the-truth-in-lending-act-regulation-z/; https://www.federalregister.gov/articles/2013/01/30/2013-00736/ability-to-repay-and-qualified-mortgage-standards-under-the-truth-in-lending-act-regulation-z.

101 Singer, *Rule of Reason, supra* note —.

102 Robinson, *Case Against MERS, supra* note —, at 1635–1636; White, *Losing the Paper, supra* note —, at 494–496.

the regulatory statutes of the more than fifty jurisdictions that regulate real property in the United States. Their efforts highlight the necessary tension between local and national regulation of the economy and of real property. On one hand, property owners might benefit from uniform national standards and they might save money by enacting a national registration system for real property titles. On the other hand, property has traditionally been governed by state law and there are significant variations in how the states regulate both mortgages and foreclosures. Having a national takeover of mortgage law would deprive the states of the ability to protect their citizens in the manner they deem best. For example, some states like California ban deficiency judgments; California is willing to live with the higher costs of mortgages that this may entail.[103] Some states require judicial foreclosure while others are more interested in the lower costs of nonjudicial foreclosure procedures.[104]

Clearly this is not a topic with an easy resolution. We could stay with the current system that grants states the power to regulate negotiable instruments, mortgages and foreclosures while complying with certain federal statutes that impose minimum standards on mortgage markets and federal regulation of securities. We could seek greater uniformity among states by drafting uniform mortgage laws that actually get passed by state legislatures.[105] Or we could seek

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[103] *But see* Bar-Gill, *supra* note —, at 1113 (arguing that deficiency actions often cost more than they would achieve, giving little protection to lenders and therefore in theory should not affect the interest rate charged to borrowers); Grant S. Nelson & Dale A. Whitman, *Reforming Foreclosure: The Uniform Nonjudicial Foreclosure Act,* 53 DUKE L. J. 1399, 1429 (2004) (deficiency judgments are rare).

[104] Frank S. Alexander, Dan Immergluck, Katie Balthop, Philip Schaeffing, Jesse Clark, *Legislative Responses to the Foreclosure Crisis in Nonjudicial Foreclosure States,* 31 REV. BANKING & FIN. L. 341, 343–349 (2011) (explaining the difference between judicial and nonjudicial foreclosure); Dana, *Mortgage "Formalities," supra* note —, at 107–108; Elizabeth Renuart, *Toward a More Equitable Balance: Homeowner and Purchaser Tensions in Non-Judicial Foreclosure States,* 24 LOY. CONSUMER L. REV. 562, 564–567 (2012) (explaining potential flaws in the nonjudicial foreclosure process); White, *Losing the Paper, supra* note —, at 489–493 (explaining the important procedural and substantive differences between judicial and nonjudicial foreclosure).

[105] *Compare* Helen Mason, *No One Saw It Coming* – Again, *Systemic Risk and State Foreclosure Proceedings: Why a National Uniform Foreclosure Law Is Necessary,* 67 U. Miami L. Rev. 41 (2012) (arguing for a federal foreclosure statute that preempts state

greater national unity by federal legislation that either sets minimum standards for state law or by drastic and unprecedented legislation that preempts the field and makes real property law a national rather than a local enterprise.[106]

It is hard to identify clear value valences that emerge from the choice between the federal and state regulation. It seems that people often push for one or the other based not on the superior competence of that level of government but on their views of whether it is more or less likely to regulate in the way one favors. Libertarians who generally prefer "state's rights" sometimes argue for federal preemption if they believe the Congress will pass laws that increase "market freedoms" and toss away state regulations thought to be oppressive. Liberals who generally prefer federal preemption change their mind when they see that states often pass more protective consumer protection laws than those enacted by the Congress and the President.

The choice is really between uniformity and diversity. And we cannot make this choice wholly separate from our views about the substance of proposed regulations. Uniform federal regulation may reduce costs for businesses and homeowners because banks would not have to comply with the varying legal standards of many jurisdictions. On the other hand, if the United States enacts a regulatory law that prohibits practices that banks want to engage in, they may find that they prefer local regulation that allows them freedom to engage in market practices they favor in the states that allow them. Conversely, consumers may favor either state or federal regulation depending on which gives them the freedoms they want and the protections they seek.

Tradition suggests that property law will continue to be local and that means that banks must do business in a manner that complies

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law) *with* Grant S. Nelson & Dale A. Whitman, *Reforming Foreclosure: The Uniform Nonjudicial Foreclosure Act,* 53 DUKE L.J. 1399 (2004) (arguing for adoption of a uniform nonjudicial foreclosure law).

[106] Nelson & Whitman, *supra* note —, at 1509–1513 (arguing for federal foreclosure legislation); Woolley & Herzog, *supra* note —, at 368 (because there is no federal law governing private property rights, "a federal system of title (electronic or otherwise) is not feasible"); *id.* at 397.

with the property law regimes of the various states. It is not impossible to do this. There is no dispute that if you want to build a house in Cambridge, Massachusetts that you have to comply with the state housing code and local zoning law and building regulations. It should not be surprising to banks that the rules governing mortgage transactions are also local in nature. The bottom line is that states generally want formalized property transactions. They also provide a public recording system for those who want to protect their property rights from other claims. The banks would be wise to figure out what those regulations are and how to comply with them. Neither of these obligations is onerous. When mortgages are assigned, the banks will want a record of the assignment in any event. It was pure carelessness that led to mistakes in keeping track of mortgage assignments. Banks deal in numbers all the time; they are supposed to not make mistakes. It is not unreasonable to expect them to keep clear records of mortgage transactions.

The bottom line is that property titles must be sufficiently *clear* and *public*. There are various ways to achieve these goals. To some extent, the clarity issue is likely to be improved in the future by the banks exercising greater care in documenting mortgage transactions. They have experienced first hand the problems that ensue when they cannot prove they have a right to foreclose on property. Not only does this affect their ability to enforce their rights but it has the potential to affect the banks' capital requirements and poses a risk to the bank's solvency. So, as with qualification, it may be the case that no law reforms will be necessary, at least in the short term, to induce banks to go back to careful creation of written records for mortgage assignments. At the same time, states should consider adopting the Michigan approach to nonjudicial foreclosures by requiring proof of the "record chain of title ... prior to the date of sale ... evidencing the assignment of the mortgage to the party foreclosing the mortgage."[107] State laws may also need to be updated not only to make electronic records more easily available but to ensure their authenticity.

[107] MICH. COMP. LAWS §600.3204(3); Timothy A. Froehle, *Standing In the Wake of the Foreclosure Crisis: Why Procedural Requirements Are Necessary to Prevent Further Loss to Homeowners,* 96 IOWA L. REV. 1719, 1740 (2011)(recommending adoption of this requirement by other states).

Given the existence of MERS, one law reform that is definitely needed to restore the publicity of land titles. If we are not going to abolish MERS or replace it with a different registration system, MERS should at least be *required to make its records public*.[108] The state recording systems were created to create incentives to induce buyers and lenders to record deeds and mortgages in a public office. This lets any potential buyer determine who owns the property and what encumbrances or restrictions are attached to it. The MERS system privatizes this information. And because the banks were so careless with their records of mortgage assignments, and because there is evidence that MERS records are often inaccurate, there is no reason to trust the MERS records. The only way to regain trust is to induce banks to be more careful about mortgage assignments and to make the chain of title accessible to potential buyers. As Alan White argues, "a better system design would incorporate transparent and authoritative registration of mortgage loan ownership throughout the life of the loan, and not just at the point foreclosure is initiated."[109] Property will not be alienable if buyers cannot trust that they will actually own the property they think they are buying. If that property is possibly subject to outstanding liens of which they are unaware, they will be discouraged from buying the land. If MERS is going to be our repository of information about mortgage transactions, there is no way to achieve these goals without forcing MERS records to become accessible to the public.

The traditional recording system worked well because banks had a huge economic incentive to record their mortgages. The MERS system removed that incentive by suggesting that it was not necessary to protect the banks from inconsistent claims. Because the courts have not fully accepted the MERS system, we have a renewed

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[108] White, *Losing the Paper, supra* note —, at 497 (advocating full disclosure of agency relationships and transfer history); Zacks, *Standing, supra* note —, at 607–608 (arguing for greater public transparency in MERS records). Note that the Truth in Lending Act (TILA) was amended to require homeowners to be notified of changes in beneficial ownership of loans. Zacks, *Standing, supra* note —, at 593–594 (*citing* Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, § 404, 123 Stat 1632, 1658 (2009); 15 U.S.C. §1641).

[109] White, *Losing the Paper, supra* note —, at 497.

incentive for banks to notify MERS about mortgage transfers. At the same time, if many courts allow the current mortgagee to foreclose simply by showing an assignment of the mortgage from MERS, we may need to establish a *requirement that banks record mortgages* for them to be valid, either by recording them in public recording offices or by notifying MERS of the transfer. If MERS cannot be reformed to recreate clear, public mortgage records of the full chain of mortgage assignments, then a *federal public agency* could be created to take its place. Such an agency could insist on appropriate regulations of mortgage transfers while preserving the accessible, public notice of mortgage liens.

Changes are definitely needed to the UCC and state foreclosure statutes to clarify the relationship between negotiable instruments law and mortgage law. Because it may be useful for one party to hold the note and another to hold the mortgage, we need clearer answers to the question of which party is the principal and which is the agent. We also need clarification of how mortgage transfers occur. Do they occur by endorsement of the note and if so can it be done in blank? Do they occur by transfer of the mortgage and if so what are the rights of the note holder? Can rights to deficiency judgments under the note be separated from rights to foreclose on the mortgage? In some sense, it does not matter how these questions are answered, just that the answer be clear. And if the states agree on the underlying principles, then state law could be made uniform to effectuate the shared norms. In general, the courts assume that the mortgage serve the interests of the note holder; it is security for the loan. They differ on whether the transfer of the mortgage brings the note with it or whether the mortgage holder holds it for the benefit of the note holder. They also differ on what acts are sufficient to prove who is an agent for another principal. The courts are wrestling with these issues now and they are among the issues that were not completely clear before the subprime crisis. Both clarity and uniformity would be desirable in this area.

Various approaches could achieve these goals. Back in 2002, Dale Whitman argued for a uniform electronic recording act.[110] Adam Levitin has argued for a national registry of mortgage notes while Alan White has argued that we should merge the note and the mortgage into a single document that could be more easily tracked.[111] Dustin Zacks has suggested that MERS should be "forc[ed] to store actual electronic documents that were previously recorded at the local recording level, such as mortgages and assignments."[112] And Tanya Marsh has argued for nationalizing the title registration system, effectively replacing both state recording offices and MERS with a public federal system of title and mortgage registration.[113] Rather than choose among these proposals, I simply want to applaud them for suggesting ways to achieve the ultimate goal: to restore our system of clear, public titles that the banks have destroyed.

How should courts handle foreclosures still in the pipeline? What should they do when the chain of title is broken, the statute of frauds violated, and no clear written evidence that the foreclosing bank has a right to foreclose? In some cases, no law reform is needed. After all, the homeowner has an interest in clearing title. If the bank cannot foreclose, this does not free the homeowner from the recorded mortgage in MERS's name. Potential buyers may be discouraged from buying if they cannot identify which bank holds the mortgage. That means that homeowners have an interest in negotiating with the bank to clear the title. The bank, of course, has an interest either in renegotiating the mortgage or in foreclosing or arranging a short sale or engaging in some other way to obtain value out of the mortgage it purchased. As between the bank and the homeowner, a deal could be struck in the absence of transaction costs.

But of course, there are transaction costs galore and many banks have refused to negotiate with homeowners. That is why many states have passed laws that prohibit foreclosure unless the parties can

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[110] Dale A. Whitman, *Are We There Yet? The Case for a Uniform Electronic Recording Act,* 24 W. N. ENG. L. REV. 245 (2002).

[111] Levitin, *Paper Chase, supra* note —; White, *Losing the Paper, supra* note —, at 498.

[112] Zacks, *Standing*, *supra* note —, at 554.

[113] Marsh, *supra* note —, at 24–26. David Waks has similarly advocated for the creation of an independent federal agency to fulfill this role. Waks, *supra* note —, at 32.

show they engaged in good faith negotiations, usually through mediation.[114] One proposal, partially and temporarily adopted in California, is that banks be forced to use a mathematical formula to calculate and then reveal the relative costs and benefits of renegotiation and foreclosure before proceeding to foreclosure.[115] A federal law passed in 2009, the Home Affordable Mortgage Program (HAMP), created incentives for banks to modify loans for borrowers who were paying more than 31% of their income toward housing costs when modification was economically more advantageous to the lender than foreclosure.[116] These laws place obligations on banks that may increase their costs of doing business but they may also save banks money in the long run. In any event, they protect homeowners by inducing the parties to come to the negotiating table when it is apparent that many banks were reluctant to do so.

From the standpoint of potential buyers, the answer may be to purchase title insurance. There have been few disputes among banks as to which banks "owns" the mortgage. The problem has been that banks could not show that they complied with the statute of frauds.

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[114] ORE. REV. STAT. § 86.735 (as amended by 2012 ORE. LAWS ch. 112, §§1-13); Pasillas v. HSBC Bank USA, 255 P.3d 1281 (Nev. 2011)(bank cannot foreclose if it fails to act in good faith to participate in state-mandated mediation with the borrower as required by state law, NEV. REV. STAT. §107.086). *See also Foreclosure Fairness Act,* WASH. REV. CODE § 61.24.030, §61.24.163 (foreclosure notice must tell homeowner about state-provided mediation services); Alexander, *Legislative Responses, supra* note —, at 364–409; Salsich, *supra* note —, at 59–64; Alan White, *State Foreclosure Mediation Laws: Examples and Research for a Uniform Statute,* May 11, 2012, http://www.uniformlaws.org/shared/docs/mortgage%20foreclosure/4_2012may11_RREMFFP_State%20Foreclosure%20Mediation%20Laws%20memo_White.pdf.

[115] Alexander, *Legislative Responses, supra* note —., at 370 (explaining the recommendation by the Center for Responsible Lending for mandatory loss mitigation); *id.* at 388 (explaining the California Foreclosure Prevention Act of 2009, CAL. CIV. CODE §§2923.52 to .53 (now repealed), which temporarily imposed a 90-day delay for foreclosure unless the bank modified the loan when the "expected recovery from modification was greater than the expected recovery from foreclosure). A bill mandating negotiations has been proposed in Massachusetts. Paul McMorrow, *Foreclosures are climbing rapidly when they should be slowing,* BOSTON GLOBE, June 26, 2012, at A-11.

[116] ENGEL & MCCOY, *supra* note —, at 128–129; Daniel P. Lindsey, *The Subprime Mortgage Mess: A Chicago Perspective,* 24 LOY. CONSUMER L. REV. 455, 460 (2012); Salsich, *supra* note —, at 45–49.

The risk of another bank coming in to sweep the title away is low if the parties contract out of the problem. Title insurance companies may provide insurance because consumers want it and it restores the alienability of the property, and the risks of title problems may be relatively low in such cases. At the same time, their willingness to sell insurance may depend on the legal vulnerability they face and that is something is that is not completely known given the ongoing litigation about the effects of MERS on property titles.[117] There is some evidence title insurance companies are not willing to insure clouded subprime titles.[118] Even if such insurance is available, it will increase the cost of buying and financing real property.

To clear title and make it marketable, the courts may need to accept affidavits from banks that show why they reasonably believe that they are entitled to foreclose on the property. The banks cannot be allowed to "robo-sign" affidavits without any investigation or presentation of evidence that backs up their claim to own the mortgage. But if the bank can produce reliable evidence of their ownership of the mortgage, then it is not unfair to hold borrowers to the contracts they made, unless the borrower can show that the entire agreement violated the consumer protection statute because it was based on unfair or deceptive practices. In such a case, it would be appropriate for courts to promote renegotiation of the loan terms to approximate the terms the parties would have agreed to if they had not been unfair.

2.2.3. By protecting the homeowner's equity

We should remember that the historical origin of mortgage regulation is designed to achieve the dual goals of ensuring repayment of the loan while protecting the homeowner's equity. The abolition of strict foreclosure ensured that the lender got back its loan with agreed-upon interest upon foreclosure but that any excess value

[117] Woolley & Herzog, *supra* note —, at 394–396 (title insurance may not be available for properties with clouded titles).
[118] Woolley & Herzog, *supra* note —, at 395–396.

in the real property, *e.g.*, the "equity," belonged to the homeowner.[119] This homeowner equity principle takes a back seat in times like ours when property values have plummeted and we are beset by "underwater" mortgages that exceed the current value of the mortgaged property. At the same time, homeowner protection underlies the multiple efforts over the last five years to limit foreclosures by both federal and state officials.[120]

One way we can protect the equity of homeowners in a time of decreasing property values is to ensure that foreclosures only occur when they are the best way to protect the banks' financial interest in recouping its loan. Many banks adopted general policies not to negotiate with homeowners to extend the term of the loan or change the payment schedule; they assumed that such a blanket policy would save the transaction costs of case-by-case evaluation of loans and allow them to clear their books of bad loans. In addition, there are many barriers to renegotiation, including transaction costs, incentive structures for loan servicers, and the terms of the contracts between servicers and the trusts holding the mortgage-backed securities, as well as the contract obligations of of those trusts to the purchasers of the securities they issue.[121] In many instances, renegotiation of the loan repayment terms would be economically superior for both all parties than foreclosure.[122] The principle of protecting the homeowner's equity, as well as avoiding the individual and social harms caused by widespread displacement from one's home, is part of what accounts for the various state laws requiring mediation between the bank and the homeowner before foreclosure can occur.[123] In some cases, renegotiation may be a win-win solution to the problem. But mediation is easier to implement in judicial foreclosure states than in the majority that allow nonjudicial

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[119] Burkhart, *supra* note —, at 270–271 (noting the abolition of strict foreclosure in the U.S.).
[120] Alexander, *Legislative Responses, supra* note —.
[121] *See* ENGEL & MCCOY, *supra* note —, at 131; Levitin, *Resolving the Foreclosure Crisis, supra* note —, at 624.
[122] On the various barriers to negotiation, see Levitin, *Resolving the Foreclosure Crisis, supra* note —, at 576.
[123] *See* Alexander, *Legislative Responses, supra* note —.

foreclosure.[124] At the same time, a few nonjudicial foreclosure states have experimented with programs to promote mediation.[125]

A second way to protect homeowner equity is to ensure that foreclosures only occur when the foreclosing party can prove its legal right to foreclose. Courts have begun to insist on better proof that the foreclosing bank actually owns the mortgage encumbering the property. They have done so by renewed insistence on the formalities that give the best evidence of title. The banks have lost the trust of many courts by failing to adequately formalize mortgage transfers and by adopting the MERS system that privatizes this information. Banks argue that formalities are technicalities; they effectively seek to reverse the burden of proof, allowing foreclosures to happen unless homeowners cannot prove the bank is not the current mortgage holder. But the loss of trust in the title system the banks created has led some courts to insist on a showing of chain of title of mortgage assignments.

Even if the banks cannot make this showing, they at least should be able to present enough evidence to show why they believe they are lawful, current assignee of mortgage rights in the property. The records may be incomplete; they may not satisfy the statute of frauds. But the evidence must show, at least by a preponderance of the evidence, that the bank is the current lawful assignee of the original mortgage. A bank that cannot make this showing has no right to foreclose. We protect the homeowners equity, not just because it represents wealth, but because of the harmful consequences of displacing a family from its home.[126] In judicial foreclosure states, this means that the foreclosure process has heightened (or restored) the burden of proof on the foreclosing bank to prove its legal rights by written evidence sufficient to satisfy the statute of frauds. In the majority of states that allow nonjudicial foreclosure, it means that

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[124] Alexander, *Legislative Responses, supra* note —, at 346-347.
[125] Alexander, *Legislative Responses, supra* note —, at 367–369 (analyzing the programs in California and Nevada); *id.* at 355 (noting that the federal Home Affordable Modification Program [HAMP] implemented a procedure for evaluating borrower claims for loan modifications and that the state laws piggy-backed on those standards).
[126] Levitin, *Resolving the Foreclosure Crisis, supra* note —, at 568–570.

homeowners may be able to resist eviction after foreclosure if the foreclosing bank cannot satisfy the court that it had the legal right to foreclose. While this may increase the costs of nonjudicial foreclosure,[127] it is justified because banks that cannot make this showing by convincing evidence have no right to make a family homeless.[128]

While some banks refuse to negotiate with homeowners to modify the terms of existing loans, others may have an incentive *not* to foreclose on underwater properties, hanging onto them until property values rise again. Foreclosure is costly and banks typically lose a large percentage of the value of the loan in the process.[129] If banks do this, they can delay the moment when they have to record a loss of value on their books. But because such homeowners cannot refinance their mortgages (because the property is worth less than the outstanding loan), they cannot sell or move. This drag on the real estate market also inhibits the movement of labor among states; this may not only further depress property values and prevent the housing recovery but have a broader dampening effect on the whole economy. Underwater mortgages thus pose a systemic problem for the larger economy a well as inhibiting individual autonomy.[130]

The most obvious solution to this problem is to alter the current law regarding mortgages in bankruptcy. As is, first mortgages on family homes are among the few debts that cannot be modified through bankruptcy.[131] Senator Durbin introduced a bill, called the "*cramdown*" provision, that would have allowed bankruptcy courts to

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[127] Levitin, *Resolving the Foreclosure Crisis, supra* note —, at 600, *citing* Karen M. Pence, *Foreclosing on Opportunity: State Laws and Mortgage Credit,* 88 REV. OF ECON. & STAT. 177, 180 (2006), available at www.mitpresjournal.org/doi/pdf/10.1162/rest.2006.88.1.177?cookieSet=1 (noting that mortgage credit may be more available in states that allow nonjudicial foreclosure)

[128] Dana, *Mortgage "Formalities," supra* note —, at 102-105 (explaining why "formalities" serve the substantive purpose of protecting stable access to one's home).

[129] Levitin, *Resolving the Foreclosure Crisis, supra* note —, at 603-606.

[130] *Cf.* Brent T. White, *Underwater and Not Walking Away: Shame, Fear, and the Social Management of the Houisng Crisis,* 45 WAKE FOREST L. REV. 971 (2010) (underwater mortgagors should "walk away" from their mortgages).

[131] 11 U.S.C. §§ 1322(b)(2) & 1123(b)(5); Levitin, *Resolving the Foreclosure Crisis, supra* note —, at 570-571.

reduce the principal debt to the current fair market value of the property – a proposal for underwater properties that might in some cases make loan payments affordable and allow the family to stay in its home.[132] The provision was controversial because it might reduce the willingness of banks to give mortgages by making their repayment and mortgage rights contingent on the overall movement of housing values. However, it is hard to see how this argument differs from arguments about bankruptcy generally.[133] Credit is provided even though creditors know debts can be discharged in bankruptcy. Lenders provide such credit because they only loan to people they think can pay the loans back — a principle I have argued should have been a bedrock principle for mortgage lenders in the first place and one that might have avoided some of the current problems we are facing. Cramdown is also unlikely to have a significant effect either on interest rates or willingness to grant mortgages.[134] And even if it translates into a small increase in interest rates charged for mortgages, the benefits to homeowners and to society outweigh the cost.[135] That, after all, is the argument for mortgage and foreclosure regulation in the first place. We could reduce the cost of mortgages by reintroducing strict foreclosure, but no one wants to do that precisely because we have a strong policy to protect homeowners from losing their homes unless all else fails.

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[132] Alexander, *Legislative Responses, supra* note —, at 355–356; Adam Levitin, *Resolving the Foreclosure Crisis: Modification of Mortgages in Bankruptcy,* 2009 Wis. L. Rev. 565.

[133] Joshua Goodman & Adam J. Levitin, *Bankruptcy Law and the Cost of Credit: The Impact of Cramdown on Mortgage Interest Rates* (Aug. 1, 2012) (HKS Working Paper No. RWP12-037; Georgetown Law and Economics Research Paper No. 12-036), available at SSRN: http://ssrn.com/abstract=2128841 or http://dx.doi.org/10.2139/ssrn.2128841; Alex Ulam, *Why a Mortgage Cramdown Bill Is Still the Best Bet to Save the Economy,* THE NATION, Oct. 20, 2011, http://www.thenation.com/article/164096/why-mortgage-cramdown-bill-still-best-bet-save-economy#.

[134] Levitin, *Resolving the Foreclosure Crisis, supra* note —.

[135] Goodman & Levitin, *supra* note —; Levitin, *Resolving the Foreclosure Crisis, supra* note —. *See also* Salsich, *supra* note —, at 57–59 (discussing "loss mitigation" for mortgages). *But see* Brent T. White, *Underwater and Not Walking Away: Shame, Fear, and the Social Management of the Housing Crisis,* 45 WAKE FOREST L. REV. 971, 1018–1020 (2010) (arguing that, instead of cramdown, underwater mortgagors should be encouraged to "walk away" from their mortgages and lenders disabled from using that to affect their credit scores).

Cramdown is also effectively the law in states like California that prohibit deficiency judgments; in such states, the only recourse for banks is foreclosure and if the market value of the property goes down, that is all the lender can get out of the debtor. Deficiency judgments are rare even in states that allow them because borrowers generally do not have other assets to repay the loan. It is therefore not clear how different cramdown in bankruptcy would be from current economic realities from the banks' perspective.[136] But cramdown might make a huge difference to homeowners who might get to stay in their homes. It would, in other words, change the identity of *who* occupies the home – an irrelevant fact to the bank but far from irrelevant to the homeowner.

Because the cramdown provision went nowhere in Congress, another way out of this problem is for municipalities to take underwater mortgages by *eminent domain* and transfer them at their (depressed) current fair market value to a new lender who will offer a new loan to the homeowner at that current value that is affordable.[137] In effect, such eminent domain procedures would force a renegotiation that could or should have happened anyway but that is not happening either because the banks don't want to write down losses at this point (undermining their capital position) or because of a collective action problem whereby all banks are waiting for property values to rise when this collective waiting may be part of what is stopping those values from rising.[138] Of course, this may

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[136] *But see* Levitin, *Resolving the Foreclosure Crisis, supra* note —, at 600, *citing* Mark Meador, *The Effects of Mortgage Laws on Home Mortgage Rates,* 34 J. ECON. & BUS. 143, 146 (1982) (interest rates may be slightly higher in states with antideficiency laws).

[137] Robert Hockett, *Breaking the Mortgage Debt Impass: Municipal Condemnation Proceedings and Public/Private Partnerships for Mortgage Loan Modification, Value Preservation, and Local Economic Recovery,* http://www.lawschool.cornell.edu/spotlights/upload/Memorandum-of-Law-and-Finance-21-April-Municipal-Plan.pdf; Hockett, *Paying Paul and Robbing No One, supra* note —.

[138] While this proposal has been criticized on various legal grounds, *see* Walter Dellinger, Jonathan Hacker & Matthew Close, *Memo on San Bernadino Eminent Domain Proposal,* July 16, 2012, http://www.sifma.org/uploadedfiles/issues/capital_markets/securitization/eminent_domain/memorandumfromo'melvenymyerstosifmaresanbernardinoeminentdomainproposal071612.pdf, none of them is definitive and they rest on faulty assumptions

result in losses on the banks' books and decrease loans they could be giving out, further dampening economic growth. In some ways, this is a chicken and egg problem that can only be solved by looking at the magnitude of the different problems and the relative economic effects of bank write-downs versus persistent underwater mortgages.

2.2.4. By mitigating systemic risk

It goes without saying that the securitization process needs to be better regulated to protect all of us from the systemic risks associated with subprime mortgages. Even if investors are willing to take great risks, they are not entitled to impose those risks on the rest of us. And the biggest risk they are not entitled to impose on society is the risk of undermining the foundations of the property system itself. As I have explained, regulations designed to clarify ownership are preconditions to markets. They are the way we ensure that we have both freedom and prosperity. That is why the principle of promoting housing transactions is subordinate to the principle of protecting the homeowner. Fair treatment of consumers and adequate formalization and publicity of titles are the bedrock on which housing exchange and finance sit. These foundational protections make property markets possible.

2.3. Promote housing transactions

Despite the subprime crisis, it is important to remember that securitization is a good thing. Done correctly, it can spread risk, lower the costs of housing finance, and widen access to housing ownership. In general, it is desirable to allow property rights to be disaggregated and repackaged to suit human purposes. However, this "freedom of contract" principle works only if it is kept within

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about the nature of the rights in question. Space limitations prevent a full analysis of the legal pros and cons of the eminent domain strategy. Suffice it to say that states have traditionally regulated local property rights, that we have a long tradition of regulating mortgages to protect the homeowner's equity, and that the public interest is furthered by overcoming collective action problems that prevent the housing market from working to serve the interests of homeowners and the public alike.

regulatory boundaries that preserve the infrastructure of the property and market system. That infrastructure ensures that transactions are mutually beneficial rather than vehicles for committing fraud and it manages transactions to mitigate systemic risk.

Just as we have consumer protection in place for mortgage borrowers, we have securities regulations to protect investors in mortgage-backed bonds. But existing protections were either insufficient or insufficiently appreciated by securitizers. Banks misled investors about the characteristics of the bonds they were marketing. Litigation is proceeding now against various banks for their marketing practices.[139] In addition, the rating system for mortgages is broken. The rating agencies turned out to work for the banks marketing the mortgages instead of acting as professionals expressing objective opinions that investors could trust. The conflict of interest between rating agencies and investors means that the ratings no longer fulfill the function they were intended to play.

These problems could be fixed in a number of ways. One solution is better disclosure. The banks should not be misleading investors about the quality of the mortgages contained in mortgage-backed securities. And it should be clear what ratings issued by rating agencies mean. If a AAA rating means that the mortgages in the securitized package are what the seller says they are, rather than that this is a relatively safe investment, then that should be crystal clear to investors. If a AAA rating does not mean that the investment is safe, the rating agencies should explain that in no uncertain terms. An alternative is to recreate the goodwill the rating agencies squandered, either by changing the way they are compensated and by turning them into independent professionals or by replacing them with public agencies whose mission is to protect investors and other consumers of mortgage-backed securities. The current system puts the rating agencies in the pocket of the securitizing banks and gives them incentives to mislead investors. It would be better if incentives

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[139] Chris Isidore, *Bank of America sued for alleged mortgage fraud*, @CNNMoney, Oct. 24, 2012, http://money.cnn.com/2012/10/24/news/companies/bank-of-america-lawsuit/index.html; Jessica Silver-Greenberg, *Banks face wave of new mortgage-securities suits,* N.Y. TIMES, Dec. 10, 2012.

could be changed to put the rating agencies on the side of the consumers rather than the sellers of securities. And if that is not possible, then they should be replaced by a professional, expert public agency.

While securitization should be promoted, it must be better regulated to protect all of us from the systemic risks associated with subprime mortgages. Even if investors are willing to take great risks, they are not entitled to impose those risks on the rest of us. And the biggest risk they are not entitled to impose on society is the risk of undermining the foundations of the property system itself. Regulations designed to clarify ownership are preconditions to markets. They are the way we ensure that we have both freedom and prosperity. That is why the principle of promoting housing transactions is subordinate to the principle of protecting the homeowner. Fair treatment of consumers and adequate formalization and publicity of titles are the bedrock on which housing exchange and finance sit. These foundational protections make property markets possible and securitization exists on top of that foundation, not despite it.

Finally, there are many ways to promote home ownership for low and moderate income families that work.[140] The subprime market was not one of them. To the extent that the idea of spreading home ownership was a justification for subprime mortgages, we should learn from experience and move back to other strategies to achieve this purpose. Many nonprofit organizations provide affordable housing ownership in a manner that led to few defaults.[141] Low income housing ownership was not the problem; subprime mortgages were. And we should realize that many people are better

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[140] David Abromowitz & Janneke Ratcliffe, *Homeownership Done Right: What Experience and Research Teaches Us,* Center for American Progress, Apr. 2010, http://www.americanprogress.org/wp-content/uploads/issues/2010/04/pdf/homeownership_done_right.pdf.

[141] David M. Abromowitz & Janneke Ratcliffe, *Homeownership Done Right: What Experience and Research Teaches Us,* Center for American Progress, Apr. 2010, http://www.americanprogress.org/wp-content/uploads/issues/2010/04/pdf/homeownership_done_right.pdf.

off renting than owning.[142] That, in turn, requires better enforcement of landlord-tenant law, especially promoting housing code enforcement and preventing invidious discrimination.

3. CONCLUSION

THE SUBPRIME CRISIS HAPPENED because banks sold mortgages to people who should not have bought them. Some of those people took honest risks but others had to be convinced that the deals were in their best interest. Some banks did this by engaging in unfair and deceptive consumer practices. The effects of the subprime mortgages they marketed were magnified when the banks evaded traditional procedures for formalizing property titles. The banks sought to evade regulatory requirements they considered costly and archaic while assuming that the courts would trust them to manage housing finance as they saw fit. But nothing turned out as the banks imagined it would. Borrowers defaulted, the housing bubble burst, borrowers could neither refinance nor sell, and banks had trouble foreclosing when they could not prove they had a right to do so, making titles unmarketable. Not only did banks treat many homeowners unfairly and deceptively but they similarly misled investors in mortgage-backed securities and created a market designed to fail, causing a worldwide recession. Worse still — and almost hard to believe — they broke a well-functioning recording system that had, for three hundred years, provided a basis for clear public property titles in the United States.

The banks' failures cannot be corrected by a simple admonition to adhere to the traditional rules. For one thing, while banks seek "safe harbors" that let them sell financial products without fear of legal

[142] On government policies needed to increase the availability of affordable rental housing, see David M. Abromowitz, *The Housing Market Is Not Only for Homeowners: Policymakers Need to Focus on Renters to Facilitate a True "Housing Recovery,"* Center for American Progress, Dec. 10, 2012, http://www.americanprogress.org/issues/housing/report/2012/12/10/47408/the-housing-market-is-not-only-for-homeowners/; Salsich, *supra* note —, at 67 ("One of the clear lessons of the foreclosure crisis is that not all households have the emotional and financial resources to discharge the responsibilities associated with homeownership.").

problems, we have "fuzzy" consumer protection laws regulating "unfair and deceptive practices" because no set of clear rules could be complete enough to catch all the ways businesses can trick consumers and investors into products they should not be buying. For another thing, the pervasiveness of MERS in the mortgage market requires it to be either formally recognized and regulated by state property legislation or replaced by a better structure. Moreover, strict enforcement of the statute of frauds would be unfair to homeowners and would leave them and us with clouded, unmarketable titles. To protect both homeowners and the general public, the statute of frauds must be relaxed to promote negotiation in foreclosure cases to enable transactions that can allow the parties, and society itself, to move forward. Or we must allow affidavits based on sufficient evidence to enable banks to foreclose when negotiations fail and the banks cannot otherwise prove that they have a right to obtain possession of the premises. We must also renew our commitment to consumer protection and regulation of systemic risk. That means that we should promote computerization of land records and securitization of mortgages only within a consumer protection framework that improves disclosure, ensures both the clarity and publicity of land titles, and protects consumers and investors from unfair or deceptive practices.

Jewish law about the marketplace is built on the biblical injunction against "plac[ing] a stumbling block before the blind."[143] This principle prohibits any market transaction whose purpose or effect is to leave the consumer worse than before. It does not matter that the consumer valiantly "assumes the risk." You should not sell a mortgage to someone if you would not sell it to your loved ones. Nor should you structure the transaction in a way that undermines the very product you are trying to convince the consumer is a good deal. The banks evaded necessary regulations designed to clarify and publicize property titles and while it may seem like poetic justice to hoist them on their own petards, we cannot do so without harming homeowners even more. Our only alternatives are to muddle through by promoting negotiation between mortgagors and mortgagees in

[143] Leviticus (Vayikra) 19:14.

foreclosure and to promote regulations designed both to avoid unfair and deceptive practices in the future and to ensure that we have a viable infrastructure for our housing transfer and financing system.

The bottom line is that we are entitled to expect bankers to act responsibly. You cannot build a house without a foundation and you cannot operate a market without a legal infrastructure. Of course bankers are in business to make money but we expect them to do so without undermining the framework that makes our housing market function. A house of straw will not withstand the wind. There are many ways to make money honorably, but deceiving consumers and investors is not one of them. There are many ways to improve the efficiency of our property title system but privatizing title records and carelessly recording them is not one of them. There are many ways to improve our housing markets, but undermining their legal infrastructure is not one of them. Property law must be interpreted or changed to vindicate these norms and business ethics must evolve to internalize them.