

- Real Estate
- Structured Finance and Securitization

## Massachusetts Supreme Judicial Court Clarifies Foreclosure Requirements: *Eaton v. Federal National Mortgage Association*

### *Eaton* at a Glance:

- In order to exercise the statutory power of sale in Massachusetts, a mortgagee must either be the holder of the underlying promissory note or be acting under the authority of the note holder.
- Physical possession of the note is not necessary in order to foreclose.
- The *Eaton* holding is not retroactive; it applies only to mortgage foreclosure sales if the mandatory notice of sale has been given after June 22, 2012.
- Mortgagees should ensure the loan file clearly indicates their ownership of the promissory note at the time foreclosure is commenced in Massachusetts.
- Mortgagees should ensure the loan file clearly demonstrates their ownership of the mortgagee's interest in the mortgage. Best practice dictates the recordation of all mortgage assignments.
- Mortgagees in Massachusetts should be careful to properly document servicing arrangements to provide servicers the statutory authority to foreclose in Massachusetts.

*Association*,<sup>1</sup> rebuking a so-called “show the note” defense and holding that, in order to foreclose under Massachusetts law, a mortgagee must either be the holder of the promissory note or be able demonstrate that the mortgagee is acting under the authority of the note holder. This decision follows the court's widely reported rulings in *U.S. Bank Nat'l Ass'n v. Ibanez*<sup>2</sup> and *Bevilacqua v. Rodriguez*,<sup>3</sup> in which the Supreme Judicial Court upheld lower court decisions invalidating residential mortgage foreclosures due to the inadequacy of assignment documentation executed in connection with intervening transfers of the foreclosed mortgage loans.<sup>4</sup> Indeed, the legal questions raised in *Eaton* were of sufficient importance to garner the attention of the Federal Housing Finance Agency, which, in a rare move, submitted an *amicus* brief contending, among other things, that a retroactive application of the lower court's ruling would create “serious and widespread hardship

<sup>1</sup> SJC-11041, 2012 WL 2349008 (Mass. June 22, 2012).

<sup>2</sup> 458 Mass. 637 (2011).

<sup>3</sup> 460 Mass. 762 (2011).

<sup>4</sup> In *Ibanez*, the Supreme Judicial Court denied two securitization trustees' requests to quiet title with respect to a pair of foreclosed homes because the trustees were unable to document ownership of the mortgages at the time of foreclosure. In *Bevilacqua*, the Supreme Judicial Court extended the holding in *Ibanez* to a third party that had purchased real property from a lender which had previously taken ownership through a defective foreclosure process.

### Introduction

On June 22, 2012, the Massachusetts Supreme Judicial Court issued its much-anticipated ruling in *Eaton v. Federal National Mortgage*

among tens or even hundreds of thousands of Massachusetts citizens” and that the “resulting turmoil and hardship will adversely affect the housing markets, which continues to be in a fragile state.”<sup>5</sup>

This *DechertOnPoint* summarizes the *Eaton* decision, with a particular focus on issues pertinent to securitization lenders and servicers.

## Background

In 2007, a borrower borrowed a loan from BankUnited, FSB (BankUnited) to refinance debt on residential real property in Roslindale, Massachusetts. At closing, the borrower executed a promissory note in favor of BankUnited and a mortgage in favor of Mortgage Electronic Registration System (MERS).<sup>6</sup> After the loan was funded, BankUnited sold the loan to Fannie Mae, which retained Green Tree Servicing, Inc. (Green Tree) to service the loan. In connection with the loan sale, MERS assigned its interest as mortgagee to Green Tree pursuant to a recorded assignment. However, the note was indorsed in blank and did not clearly identify Fannie Mae as the assignee of the note. Subsequently, the borrower failed to make payments on the note and Green Tree instituted a foreclosure sale pursuant to the power of sale clause contained in the mortgage. Green Tree conducted a foreclosure auction and entered the winning bid. Green Tree later assigned its foreclosure bid to Fannie Mae, and a foreclosure deed was recorded reflecting Fannie Mae as the owner of the subject property. Fannie Mae subsequently commenced eviction proceedings against the borrower.

In response to the eviction proceeding, the borrower filed a complaint in Massachusetts Superior Court seeking both

injunctive relief from the eviction proceeding as well as a declaration that the foreclosure sale was invalid and, therefore, the borrower retained fee simple ownership of the property. The borrower asserted, *inter alia*, that the foreclosure sale was invalid because Green Tree was not the holder of the underlying note at the time of foreclosure and therefore lacked the statutory authority as a “mortgagee” to foreclose on the property under Massachusetts General Laws ch. 183, § 21 and Massachusetts General Laws ch. 244, § 14. The Superior Court granted the borrower’s preliminary injunction enjoining the eviction proceedings. A petition for interlocutory review was denied by the Massachusetts Appeals Court, however, because of the importance of the issues in question, the Supreme Judicial Court agreed to hear the appeal *sua sponte*.

## Common Law Interpretation and Massachusetts as “Title Theory” State

In weighing the arguments of the Appellants, the court first discussed the right of a mortgagee to foreclose under Massachusetts common law. The Commonwealth of Massachusetts is a “title theory” state. Thus, under Massachusetts law, when a mortgage is executed, bare legal title is vested in the mortgagee, defeasible by the mortgagor upon satisfaction of the underlying debt. In this way, the mortgage and the underlying promissory note are united; a mortgagee that does not hold the underlying promissory note is the holder of a “mere technical interest.”<sup>7</sup> The circumstance in which the holder of the mortgage is different than the holder of the promissory note was further discussed by the court in *Ibanez* which stated that “where a mortgage and note are separated, the holder of the mortgage holds the mortgage in trust for the purchaser of the note, who has an equitable right to obtain an assignment of the mortgage, which may be accomplished by filing an action in court and obtaining an equitable order of assignment.”<sup>8</sup> The *Eaton* court concluded that “a mortgagee possessing only the mortgage [and not the underlying note] was without authority to foreclose on his own behalf the mortgage’s equity of redemption or otherwise disturb the possessory interest of the mortgagor.”<sup>9</sup> This is a nuanced, but extremely important distinction, from the rule in many other jurisdic-

<sup>5</sup> Brief for Federal Housing Finance Agency as *Amicus Curiae* at 5, *Eaton v. Federal National Mortgage Association*, SJC-11041, 2012 WL 2349008 (Mass. June 22, 2012).

<sup>6</sup> The *Eaton* case states that MERS itself is not a lender or mortgage servicer. Rather, it is a centralized registration system where its members can track changes to mortgage servicing rights and beneficial ownership. MERS serves as the mortgagee of record on all mortgage loans registered on its electronic registration system, which allows electronic trading of servicing rights and beneficial ownership interests between members of MERS without public recording of each assignment. Instead of than recording each change in ownership, the MERS members indorse and deliver the note, and the transfer is only reflected in the MERS system. MERS continues as the mortgagee of record until the loan is transferred to a non-MERS member.

<sup>7</sup> *Eaton*, SJC-11041, 2012 WL 2349008 (Mass. June 22, 2012) (quoting *Wolcott v. Winchester*, 15 Gray 461, 465 (1860)).

<sup>8</sup> *Ibanez*, 458 Mass. at 652 (citing *Barnes v. Boardman*, 149 Mass. 106, 114 (1889)).

<sup>9</sup> *Eaton*, SJC-11041, 2012 WL 2349008 (Mass. June 22, 2012) (citing *Howe v. Wilder*, 11 Gray 267, 269-270 (1858)).

tions, where “the mortgage follows the note,” and of particular importance in the context of a securitization.

## Statutory Analysis Under M.G.L. ch. 244 § 14

The court then turned to the provisions of the relevant Massachusetts statute, Massachusetts General Laws ch. 244 § 14, and specifically the definition of the term “mortgagee” in the context of the statutory power of sale<sup>10</sup> and whether Massachusetts law required a “mortgagee” to hold both the mortgage and the underlying note. While noting some ambiguity in the use of the term “mortgagee” throughout the relevant statute, the court concluded that the term mortgagee “reflects a legislative understanding or assumption that the ‘mortgagee’ referred to also is the holder of the mortgage note.”<sup>11</sup>

## Rejection of “Show-the-Note” Defense and Prospective Application

While rejecting the Appellant’s broad statutory interpretation of the term “mortgagee,” the court did rule on two related points of significant importance to securitization lenders. First, the court rejected the lower court’s conclusion that a foreclosing mortgagee must be able to demonstrate physical possession of the underlying promissory note. Furthermore, the court found that the foreclosure statute must be read in light of ordinary principles of agency law and that the statute permitted a mortgagee acting as an authorized agent of a note holder to “stand in the shoes” of the note holder. In a footnote, the court stated that a mortgagee may be able to demonstrate that it is the note holder or authorized to act on behalf of the note holder through the filing of an affidavit in the appropriate registry of deeds. This statement may provide specific judicial authorization for servicers to foreclose on real property on behalf of securitization trusts.

Second, the court gave its opinion in *Eaton* only prospective effect. In so doing, the court recognized the ambiguity in the statute’s usage of the term “mortgagee” as well as the reasonable, if differing, prior interpretation of the statute by lenders, practitioners and title companies, and avoided casting the ownership of hundreds of thousands of foreclosed Massachusetts homes in question.

<sup>10</sup> Massachusetts law permits foreclosure by non-judicial power of sale. Mass. Gen. Laws ch. 183, § 21 (2012).

<sup>11</sup> *Eaton*, SJC-11041, 2012 WL 2349008 (Mass. June 22, 2012).

## Conclusion

The *Eaton* decision contains several important issues for mortgage lenders and servicers in Massachusetts. The court clarified that in order to foreclose the mortgagee must be the holder of the underlying note or acting under the authority of the note holder. In a footnote, the court further stated that authorization could be established through the filing of an affidavit. Importantly, the court enforced its opinion only prospectively, possibly closing the door on the possibility of some challenges to historical foreclosures where the mortgagee was neither the note holder nor acting under the note holder’s authority. The following key points should be considered by mortgage lenders and servicers when foreclosing on real property in Massachusetts:

- In order to exercise the statutory power of sale in Massachusetts, a mortgagee must either be the holder of the underlying promissory note or acting under the authority of the note holder. This requirement may be established through the filing of an affidavit with the appropriate registry of deeds;
- Physical possession of the note is not necessary in order to foreclose;
- The holder of a “naked mortgage” — where ownership of the mortgage has been separated from the ownership of the underlying note — does not have authority to foreclose in Massachusetts;
- The *Eaton* holding applies only to mortgage foreclosure sales for which the mandatory notice of sale has been given after June 22, 2012;
- Mortgagees should ensure the loan file clearly indicates their ownership of the promissory note at the time foreclosure is commenced in Massachusetts;
- As stated in *Ibanez*, as a transfer of title to real property, an assignment of mortgage in Massachusetts must be accomplished through a written instrument. Although the *Ibanez* decision tends to indicate that recordation is not vital, best practice dictates the recordation of the assigning instrument; and
- Mortgage lenders in Massachusetts should be careful to properly document servicing arrangements to provide servicers the authority to foreclose in Massachusetts.

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