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Battle Lines Forming in Clash Over Foreclosures

By [GRETCHEN MORGENSON](#) and [ANDREW MARTIN](#)

About a month after [Washington Mutual Bank](#) made a multimillion-dollar mortgage loan on a mountain home near Santa Barbara, Calif., a crucial piece of paperwork disappeared.

But bank officials were unperturbed. After conducting a “due and diligent search,” an assistant vice president simply drew up an affidavit stating that the paperwork — a promissory note committing the borrower to repay the mortgage — could not be found, according to court documents.

The handling of that lost note in 2006 was hardly unusual. Mortgage documents of all sorts were treated in an almost lackadaisical way during the dizzying mortgage lending spree from 2005 through 2007, according to court documents, analysts and interviews.

Now those missing and possibly fraudulent documents are at the center of a potentially seismic legal clash that pits big lenders against homeowners and their advocates concerned that the lenders’ rush to foreclose flouts private property rights.

That clash — expected to be played out in courtrooms across the country and scrutinized by law enforcement officials investigating possible wrongdoing by big lenders — leaped to the forefront of the mortgage crisis this week as big lenders began lifting their freezes on foreclosures and insisted the

worst was behind them.

Federal officials meeting in Washington on Wednesday indicated that a government review of the problems would not be complete until the end of the year.

In short, the legal disagreement amounts to whether banks can rely on flawed documentation to repossess homes.

While even critics of the big lenders acknowledge that the vast majority of foreclosures involve homeowners who have not paid their mortgages, they argue that the borrowers are entitled to due legal process.

Banks “have essentially sidestepped 400 years of property law in the United States,” said Rebel A. Cole, a professor of finance and real estate at [DePaul University](#). “There are so many questionable aspects to this thing it’s scary.”

Others are more sanguine about the dispute.

Joseph R. Mason, a finance professor who holds the Louisiana Bankers Association chair at Louisiana State University, said that concerns about proper foreclosure documentation were overblown. At the end of the day, he said, even if the banks botched the paperwork, homeowners who didn’t make their mortgage payments still needed to be held accountable.

“You borrowed money,” he said. “You are obligated to repay it.”

After freezing most foreclosures, [Bank of America](#), the largest consumer bank in the country, said this week that it would soon resume foreclosures in about half of the country because it was confident that the cases had been properly documented. [GMAC Mortgage](#) said it was also proceeding with foreclosures, on a case-by-case basis.

While some other banks have also suggested they can wrap up faulty foreclosures in a matter of weeks, some judges, lawyers for homeowners and real estate experts like Mr. Cole expect the courts to be

inundated with challenges to the banks' actions.

“This is ultimately going to have to be resolved by the 50 state supreme courts who have jurisdiction for property law,” Professor Cole predicted.

Defaulting homeowners in states like Florida, among the hardest hit by foreclosures, are already showing up in bigger numbers this week to challenge repossessions. And judges in some states have halted or delayed foreclosures because of improper documentation. Court cases are likely to hinge on whether judges believe that banks properly fulfilled their legal obligations during the mortgage boom — and in the subsequent rush to expedite foreclosures.

The country's mortgage lenders contend that any problems that might be identified are technical and will not change the fact that they have the right to foreclose en masse.

“We did a thorough review of the process, and we found the facts underlying the decision to foreclose have been accurate,” Barbara J. Desoer, president of Bank of America Home Loans, said earlier this week. “We paused while we were doing that, and now we're moving forward.”

Some analysts are not sure that banks can proceed so freely. Katherine M. Porter, a visiting law professor at [Harvard University](#) and an expert on consumer credit law, said that lenders were wrong to minimize problems with the legal documentation.

“The misbehavior is clear: they lied to the courts,” she said. “The fact that they are saying no one was harmed, they are missing the point. They did actual harm to the court system, to the rule of law. We don't say, ‘You can perjure yourself on the stand because the jury will come to the right verdict anyway.’ That's what they are saying.”

Robert Willens, a tax expert, said that documentation issues had created potentially severe tax problems for investors in mortgage securities and that “there is enough of a question here that the courts might well have to resolve the issue.”

As the legal system begins sorting through the competing claims, one thing is not in dispute: the pell-mell origination of mortgage loans during the real estate boom and the patchwork of financial machinery and documentation that supported it were created with speed and profits in mind, and with little attention to detail.

Once the foreclosure wheels started turning, said analysts, practices became even shoddier.

For example, the foreclosure business often got so busy at the Plantation, Fla., law offices of David J. Stern — and so many documents had to be signed so banks could evict people from their homes — that a supervisor sometimes was too tired to write her own name.

When that happened, Cheryl Samons, the supervisor at the firm, who typically signed about 1,000 documents a day, just let someone else sign for her, court papers show.

“Cheryl would give certain paralegals rights to sign her name, because most of the time she was very tired, exhausted from signing her name numerous times per day,” said Kelly Scott, a Stern employee, in a deposition that the Florida attorney general released on Monday. A lawyer representing the law firm said Ms. Samons would not comment.

[Bill McCollum](#), Florida’s attorney general, is investigating possible abuses at the Stern firm, a major foreclosure mill in the state, involving false or fabricated loan documents, calling into question the foreclosures the firm set in motion on behalf of banks.

That problem extends far beyond Florida.

As lenders and Wall Street firms bundled thousands of mortgage loans into securities so they could be sold quickly, efficiently and lucratively to legions of investors, slipshod practices took hold among lenders and their representatives, former employees of these operations say.

Banks routinely failed to record each link in the chain of documents that demonstrate ownership of a note and a property, according to court documents, analysts and interviews. When problems arose,

executives and managers at lenders and loan servicers sometimes patched such holes by issuing affidavits meant to prove control of a mortgage.

In Broward County, Fla., alone, more than 1,700 affidavits were filed in the last two years attesting to lost notes, according to Legalprise, a legal services company that tracks foreclosure data.

When many mortgage loans went bad in the last few years, lenders outsourced crucial tasks like verifying the amount a borrower owed or determining which institution had a right to foreclose.

Now investors who bought mortgage trusts — investment vehicles composed of mortgages — are wondering if the loans inside them were recorded properly. If not, tax advantages of the trusts could be wiped out, leaving mortgage securities investors with significant tax bills.

For years, lenders bringing foreclosure cases commonly did not have to demonstrate proof of ownership of the note. Consumer advocates and consumer lawyers have complained about the practice, to little avail.

But a decision in October 2007 by Judge Christopher A. Boyko of the Federal District Court in northern Ohio to toss out 14 foreclosure cases put lenders on notice. Judge Boyko ruled that the entities trying to seize properties had not proved that they actually owned the notes, and he blasted the banks for worrying “less about jurisdictional requirements and more about maximizing returns.”

He also said that lenders “seem to adopt the attitude that since they have been doing this for so long, unchallenged, this practice equates with legal compliance.” Now that their practices were “put to the test, their weak legal arguments compel the court to stop them at the gate,” the judge ruled.

Yet aside from the actions of a few random judges, little was done to force lenders to change their practices or slow things down. Since March 2009, more than 300,000 property owners a month have received foreclosure notices or lost their home in a foreclosure, according to RealtyTrac, which tracks foreclosure listings.

What finally prompted a re-examination of the foreclosure wave was the disclosure in court documents over the last several months of so-called robo-signers, employees like Ms. Samons of the Stern law firm in Florida who signed affidavits so quickly that they could not possibly have verified the information in the document under review.

Lenders and their representatives have sought to minimize the significance of robo-signing and, while acknowledging legal lapses in how they documented loans, have argued that foreclosures should proceed anyway. After all, the lenders say, the homeowners owe the money.

People who have worked at loan servicers for many years, who requested anonymity to protect their jobs, said robo-signing and other questionable foreclosure practices emanated from one goal: to increase efficiency and therefore profits. That rush, they say, allowed for the shoddy documentation that is expected to become evidence for homeowners in the coming court battles.

For example, years ago when banks made loans, they typically stored promissory notes in their vaults.

But the advent of securitization, in which loans are bundled and sold to investors, required that loan documents move quickly from one purchaser to another. Big banks servicing these loans began in 2002 to automate their systems, according to a former executive for a top servicer who requested anonymity because of a confidentiality agreement.

First to go was the use of actual people to determine who should be liable to a foreclosure action. They were replaced by computers that identified delinquent borrowers and automatically sent them letters saying they were in default. Inexperienced clerical workers often entered incorrect mortgage information into the computer programs, the former executive said, and borrowers rarely caught the errors.

Other record-keeping problems that are likely to become fodder for court battles involve endorsements, a process that occurs when notes are transferred and validated with a stamp to identify the institution that bought it. Eager to cut costs, most institutions left the notes blank, with no

endorsements at all.

Problems are also likely to arise in court involving whether those who signed documents required in foreclosures actually had the authority to do so — or if the documents themselves are even authentic.

For example, Frederick B. Tygart, a circuit court judge overseeing a foreclosure case in Duval County, Fla., recently ruled that agents representing [Deutsche Bank](#) relied on documents that “must have been counterfeited.” He stopped the foreclosure. Deutsche Bank had no comment on Wednesday.

Cynthia Veintemillas, the lawyer representing the borrower in the case, Patrick Jeffs, said the paperwork surrounding her client’s foreclosure was riddled with problems.

“Everybody knows the banks screwed up and loaned out money to people who couldn’t pay it back,” she said. “Why are people surprised that they don’t know what they are doing here either?”

Meanwhile, another judge on Wednesday indicated that the courts would not simply sign off on the banks’ documentation. [Jonathan Lippman](#), the chief judge of New York’s courts, ordered lawyers to verify the validity of all foreclosure paperwork.

“We cannot allow the courts in New York State to stand by idly and be party to what we now know is a deeply flawed process, especially when that process involves basic human needs — such as a family home — during this period of economic crisis,” Judge Lippman said in a statement.



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