REPORT: The Impacts of Toxic Foreclosure Documents

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TOXIC DOCUMENT FALLOUT

The toxic document crisis which some in the press now refer to as "Documentgate" has the potential to imperil the American banking system, foreclosure and secondary mortgage market operations and create a second potential financial catastrophe. The toxic document crisis which has resulted from the widespread manufacture by foreclosure mills of spurious documents required to foreclose on property in the event of default adversely impacts the following areas:

1. Title defects barring sale of REO properties acquired by foreclosure.
2. On-Going Foreclosure.
3. Liability to SEC and Investors.
4. Secondary mortgage market operations and future securitization.
5. Wrongful foreclosure class actions.
6. Non-Compliance with REMIC Regulations and Tax Evasion.
7. Public and Private Causes of Action under State Quit Tam or False Claims Act Authorities.

1. Title defects will not bar sale of REO properties acquired by foreclosure.

In a series of meetings between the major financial institutions and the leading title companies, a solution has been hammered out which will enable title companies to continue to insure the sale of REO even if the property was recovered by a bank in a foreclosure proceeding reliant upon toxic documents. The parties are creating a standard set of warranties to be given by a lender to the title company which will then issue a standard policy to the prospective homebuyer purchasing title insurance, The "warranties" essentially amount to a hold harmless, indemnification agreement in accordance with which the lender promises to repay the insurer any damages and other costs incurred by the insurer in the event a third party brings a legal challenge attacking the new purchaser's title to the property.

This accommodation does not cure any of the 16 types of toxic documents which I identified in an earlier memorandum. Instead, the arrangement is similar to what occurred in the bond rating system where AA ratings were given to higher risk mortgage portfolios. Title companies make money by collecting premiums for title insurance. No money is made by refusing to insure. Accordingly, the banks made an insurer an offer no businessman could refuse. Issue the policy,

collect and keep the premiums and the bank will pay the costs of any claim by any insured. What a deal!

The banks in return expect to be able to sell off REO with title insurance thereby averting a blockage which could slow the recovery of the economy from recession, impede the recovery of home values and restrain home resale and new construction.

Furthermore, the banks can continue to claim that the so-called toxic document crisis amounted to a tempest in a teapot-"full of sound and fury, signifying nothing." The defects were all minor technicalities and administrative problems, a glitch in the orderly flow of paperwork.

What has really happened? The banks have "monetarized" the problem. According to a friend of my daughter's, mostly any problem we face easily can be solved if we throw enough money at it. What the solution papers over is the distinction between "marketable" or "merchantable" and "insurable title.

"Merchantable or marketable title" is title to a piece of real estate that is reasonably free from risk of litigation over possible defects, and while it may not be perfect, it is free from plausible or reasonable objections, and is one that a court of law would order the buyer to accept. A seller under a contract of sale is required to deliver marketable title at final closing; this requirement is implicit in law and does not need to be stated in the contract. Usually the property buyer will engage a title insurance company to ensure that the seller has clear title to the real estate before entering into a purchase contract. This search generally is not ordered until financing has been secured. Once the title company has researched the history of ownership of the property and feels sure that the seller owns it, it will issue a title insurance policy. The seller is thus assured that he has a marketable title, which allows him to transfer ownership to the buyer.

"Insurable title" is title to a piece of real estate which a title company registered in the state where the property is situated will insure title at standard rates under a standard title policy. The insurance paid out by a title company depends upon the coverage purchased at settlement by the homebuyer. If mortgage financing is involved, the lender will require the buyer to purchase a lender's title insurance p [policy. The coverage only extends to the amount owed by the buyer to the lender. The buyer will also be offered an owner's title policy. This insures the down payment.

If the prior owner recovers the foreclosed home as a result of proving wrongful foreclosure, title insurance will only pay what has been described above. It will not reimburse payments made for interest, taxes, insurance and HOA fees. It will not pay for the costs of relocation and temporary housing.

Most standard Board of Realtor Forms require a seller to deliver merchantable title not insurable title. Each state has its own variation of what is specifically required to convey "merchantable"

title. According to the deal being worked out by the banks, what the banks plan to deliver and the title companies insure is “insurable title where most buyers of REO foreclosed properties will assume they are receiving marketable title.

Will Wall Street get away with this ploy? Probably! The financial institutions and title companies are relying upon an empirically verifiable phenomenon. Debtors do not defend. More than 90% of all cases of foreclosure are not defended. In those cases which are defended, the foreclosed borrower is rarely in a financial position to appeal an adverse decision by the trial court. No one anticipates that many foreclosed homeowners have either the appetite or the money to attempt to recover their properties through a suit for wrongful foreclosure. Where such a suit is brought, the banks will spare no resources in mounting a defense. If the foreclosure is overturned-as likely as a cold day in Hell- the banks will bury the problem by paying off in damages all concerned.

So there are no problems; the crisis really is over. I did not say that. First there is a legal problem for the title industry which is regulated in every state. They are selling insurance for merchantable title but only delivering insurable title. When a settlement is scheduled, any competent attorney will order a title report. A title report is not a commitment binder. A commitment binder is a unilateral agreement to issue title insurance subject to exceptions. A title report is what it says; it is a report of the condition of title noting all possible defects of record. Title reports are prepared for lawyers by title companies which provide the report or abstract often accompanied by exhibits showing the documents which adversely affect title. Arguably, title companies will be required to continue to search for and report the toxic documents which adversely affect title.

Title companies are free to insure subject to these defects. The title insurance policy only lists in a separate schedule those title defects excluded from coverage. It does not list title defects not excluded from coverage. There is thus a disparity between what the policy shows as defects excluded from coverage and title defects which need to be shown in the report of title.

This now creates a serious problem for an attorney conducting settlement. Does the attorney not have a legal obligation to disclose to the buyer the difference between insurable title and merchantable title? Given that standard contract forms call for the seller to deliver merchantable title, does not the attorney have the obligation to inform the buyer that the seller cannot deliver title as promise din the contract and that the buyer may object and cancel the sale and recover the deposit or sue the seller for breach of contract.

Is the settlement lawyer not subject to disciplinary proceedings and suit for malpractice if the attorney fails to inform the buyer or does not obtain a written agreement from the buyer that the buyer will accept insurable title and waive the requirement for marketable title?

Is this likely to be a serious problem? Probably not. Most lawyers need to earn a living, including those who specialize in real estate settlements. These lawyers have a strong financial incentive to overlook or otherwise ignore the problem. What about potential lawsuits and claims? These suits are only a reality on law school examinations not in the real word.

In the long run, it is my prediction that toxic documents will be treated like restrictive covenants. Either by decisional precedent or by enacted legislation, toxic documents will become inoperative as a barrier to either foreclosure or insurable title. As time goes by, the courts and American society in general will become less and less ready to see others who had nothing to do with the use of toxic documents being prevented from buying or selling their homes or being evicted by a prior owner.

Does this mean that the toxic document crisis is over? The problem of the cloud on title created by toxic documents restraining the resale REO obtained through alleged wrongful foreclosure has been successfully swept under the rug. However other toxic document problems remain unaddressed.

2. **On-Going Foreclosure may be forced to a halt.**

The one barrier to foreclosure which may, more than likely, force a nationwide moratorium is the inability to comply with legal requirements for a public auction of the foreclosed property on the court house steps because title to the auction property has been tainted by toxic documents so that a reasonable member of the public will not bid for a foreclosed property known to be uninsurable.

On October 13, Attorney General Bill McCollum sent letters to Bank of America, JP Morgan Chase, GMAC, PNC Financial Group and Litton Loan Servicing requesting meetings to discuss ways to promptly and effectively redeem the integrity of the foreclosure process. the letter states:

> I was distressed to learn from media reports that your company may have engaged in filing faulty affidavits in foreclosure cases in Florida courts with regard to ownership of promissory notes and affidavits that attested to personal knowledge of facts when, in fact, the affiant had no such personal knowledge. The net effect of these actions, among other things, has been to cast a shadow on the title to these properties which is of such proportions that at least one major title company is now refusing to write title insurance on foreclosed properties. Even more disturbing is that some of these foreclosed properties have already been sold and resold, and now their titles are in question, which may substantially slow the economic recovery for the citizens of Florida.

The toxic documents have tainted the title conveyed by sheriff's deed to the prevailing party at public auction of the foreclosed property. As of this moment, many lenders are entering into indemnification and hold harmless arrangements with title insurers for any REO property sold by

the institution. However, such an accommodation does not extend to properties at public auction which have tainted titles because the foreclosure proceeding relied upon toxic documents.

Accordingly, once courts realize that the official conducting the auction cannot conduct a legal auction because investors and others who usually bid on such property cannot obtain clear title such auctions will have to be delayed. The debtor is legally entitled to a fair auction of the property. Tainted title prevents this from occurring.

Secondly, the situation is analogous to bid rigging. In this case, first the lender who is foreclosing files toxic documents that taint the title. Then the lender is the only party at the auction, bids and takes the property back as REO. In this way, the lender even controls the amount of the deficiency between what is "paid" at auction and the amount of the debt.

This legal obstacle will preclude sales at the court house steps in judicial and non-judicial jurisdictions. The only foreclosures not affected are foreclosure of portfolio loans including purchase money mortgages held by the original seller of the property.

Until the attorneys general of the 50 states reach an accommodation agreement with title companies and lenders to spread the accommodation agreements to all affected foreclosure properties, foreclosure may have to grind to a halt. It only takes one brave attorney in a local jurisdiction to seek to enjoin all affected foreclosures until the title issue is remediated

Lenders took possession of a record 95,364 homes in August and issued foreclosure filings to 338,836 homeowners, or one of every 381 U.S. households, according to RealtyTrac Inc., an Irvine, California-based data vendor. The widespread use of toxic documents provides ample ammunition to delay foreclosure in contested cases. The lenders are relying upon the fact that most cases go to foreclosure without being contested so that the process of obtaining accelerated summary judgment by default will continue.

There is no evidence that the toxic document crisis has had an effect on debtor behavior. Most debtors confronted by foreclosure are amotivated and apathetic. So traumatic and overwhelming is the experience that the most common response-which is the one least beneficial to debtors- is to simply ignore the proceedings and await eviction. So long as this continues to be the case, debtors will not rely upon toxic documents to delay or overturn foreclosure.

It is likewise by no means clear that use of toxic documents is a necessary and sufficient condition to disallow foreclosure. Even where proved, a court may find that a greater harm is done by unjustly enriching the debtor. A court may reach a similar result by invalidating the enforcement of the mortgage but finding a constructive mortgage or equitable trust to have also been created which the court will enforce.

The stumbling blocks to foreclosure, however, may lie with the judges and judicial system. The problem legal propriety of auctions of tainted title property was noted above. In addition, so

extensive and widespread has been the perpetration of fraud and deceit upon the courts through the use of toxic documents, that the courts may adopt procedures such as document checks and enforced verification requirements so that the toxic documents may not be used to foreclose. The courts may well also start to impose fines and otherwise can sanction plaintiffs and their counsels who submit toxic documents. Finally judges may become concerned that continuing to ignore superficially obvious documentary improprieties may result in disciplinary action for the judges themselves or for liability for misprision of felony, misfeasance and violation of state ordinances and ethics codes.

Although previously disinclined in the extreme to do so, courts may start to police their dockets to prevent use of toxic documents. The current level of media attention may create a degree of awareness sufficient to generate a political climate where judicial systems feel constrained to act and begin to rectify meretricious and duplicitous misuse of the judicial system.

3. Liability to SEC and Investors.

Diane Olick of CNBC reported that "Josh Rosner, of Graham-Fisher, put the following out in a note today, claiming violations of pooling and servicing agreements on mortgages could dwarf the Lehman weekend:

Nearly all Pooling and Servicing Agreements require that "On the Closing Date, the Purchaser ***will assign to*** *the Trustee pursuant to the Pooling and Servicing Agreement all of its right, title and interest in and to the Mortgage Loans and its rights under this Agreement (to the extent set forth in Section 15),* ***and the Trustee shall succeed to such right, title and interest in and to the Mortgage Loans*** *and the Purchaser's rights under this Agreement (to the extent set forth in Section 15)". Also, an Assignment of Mortgage must accompany each note and this almost never happens.*

Here is another form of this requirement from a Deutsche Bank agreement filed with the SEC for a MBS trust:

e: Trust Agreement, dated as of April 1, 2006, between GS Mortgage Securities Corp. and Deutsche Bank National Trust Company

Ladies and Gentlemen:

In accordance with Section 2.02 of the above-captioned Trust Agreement (the "Trust Agreement"), the undersigned, as Trustee, hereby certifies that as to each Mortgage Loan listed in the Mortgage Loan Schedule (other than any Mortgage Loan paid in full or listed on the attached Document Exception Report) it has received:

(A) ***The original Mortgage Note, endorsed in the form provided in Section 2.01 of the Trust Agreement, with all intervening endorsements showing a complete chain of endorsement from the originator to the last endorsee.***

(B) ***The original recorded Mortgage or a certified copy thereof.***

(C) Except with respect to each MERS Designated Mortgage Loan, an executed Assignment of Mortgage endorsed in blank in the form provided in Section 2.01 of the Trust Agreement; or, if the Trustee has actual knowledge that the related Mortgage has not been returned from the applicable recording office, a copy of the Assignment of Mortgage (excluding information to be provided by the recording office).

(D) ***Except with respect to each MERS Designated Mortgage Loan, the original or duplicate original recorded assignment or assignments of the Mortgage endorsed in blank showing a complete chain of assignment from the originator to the last endorsee.***

(E) ***The original or duplicate original or certified copy lender's title policy and all riders thereto or, any one of an original title binder, an original preliminary title report or an original title commitment, or a copy thereof certified by the title company.***

The actual paper documents required to meet these requirements were never produced. Those documents which were deposited with MERS in lieu of satisfying these requirements or complying with the requirements of state law failed to create a legally sufficient conveyance of the mortgage sufficient to enable a holder to enforce the mortgage. Accordingly, the parties that organized, operated or underwrote the MBS trust engaged in repeated misrepresentations of fact and were negligent in protecting the assets and proprietary interest of the investors as beneficiaries of the trust. The toxic documents provide evidence of violation of SEC rules, misrepresentations to investors and endangering assets to create massive liability for the parties that organized, funded, administered, conveyed mortgages and underwrote securities.

Numerous big ticket, investor lawsuits may be anticipated in addition to those already filed.

4. <u>Secondary mortgage market operations and future securitization.</u>

The toxic document crisis was precipitated by an unanticipated wave of foreclosures necessitated by an exponential increase in the volume of loan defaults especially from 2005-2008. To proceed with foreclosure, it became necessary to retrieve documents which had never been produced-a near certain metaphysical impossibility. More than 80 % of mortgages had been sold to mortgage backed securities (MBS) trusts. Mortgages held by these trusts had to be replaced if and when an existing mortgage was prepaid, for example, when a borrower resold a home, paid off the mortgage and bought a new home. This greatly accelerated the trade in buying and selling mortgages or parts of mortgages on the secondary mortgage market.

The volume and velocity of the purchase and sale of mortgages as well as the sale of different, discrete sections ("tranches") of mortgage cash flow was only possible because of advances in IT and MIS. The securitization industry only existed because it was possible to digitize the origination, funding, servicing, purchase and sale and securitization of mortgages. New technology transformed primary and secondary mortgage market operations into a paperless system. The use of documents became redundant, obsolete, time wasting and expensive.

Laws in all 50 states governing foreclosure required all kinds of paper documents, a great many of which had to be notarized. The securitization industry had installed a paperless system without ever obtaining required enabling legislation from either the federal government or the individual states. The organizing documents of the MBS trust (Master Pooling and Servicing Agreement, Prospectus, etc.) required the trustee to foreclose upon debtors in default. Suddenly there was an unanticipated need for the paperwork that did not exist.

A new industry sprung up of law firms specializing in fixed fee foreclosure and document retrieval services which were ready, willing and able to produce and file in court documents as required for foreclosure. These companies were hired by lenders to foreclose loans in default. The lenders had to have known or have reason to have known that the documents being filed in court had never been produced. The toxic document crisis was spawned.

The question accordingly arises whether securitization from here on in can continue to be conducted upon the same paperless basis still lacking requisite enabling authority. Will the SEC register securities for a new MBS trust unable to show that new systems have been installed to produce legal documentation required for foreclosure, conveyancing and chain of mortgage title? Will purchasers on the secondary mortgage market continue to buy mortgages which they know or have reason to know lack authentic documents necessary to foreclose or convey title? Does the Federal Reserve or other federal agency have legal authority to buy toxic mortgages or REO conveyed with toxic documents in the chain of title?

Secondary mortgage market operations are necessary to liquidate existing mortgages to provide additional funds for future mortgage lending. Orderly secondary mortgage market operations are essential to the recovery of the economy and to provide mortgage money for the real estate market. Suffice it to say, measures so far taken by the securitization industry to circumvent cloud upon REO title do not address the concerns just raised. It is unclear how the toxic document crisis will adversely impact continuing secondary mortgage market operations.

5. Wrongful Foreclosure Class Action

From 2006-2010, the United States has experienced the worst avalanche of foreclosures since the Great Depression. Realty Trac estimates that during this period, which includes an estimate for 2010, more than 11,500,000 homes will have gone into foreclosure.

Approximately 80% of these foreclosures involve securitized mortgages. A mortgage becomes securitized when it has been bundled into a portfolio as collateral pledged to secure periodic payment to investors. About 8.5 million mortgages have been securitized. Half of these have been securitized by a quasi Federal entity such as FRMAC and FNMA. The other half has been securitized by the private sector.

Securitization of mortgages precipitates legal problems unaddressed and unresolved by legislation or judicial precedent. Foreclosure of securitized mortgages has taken place as a result of the evasion and avoidance of these issues by concealment, omission, deceit and fraud which practices are institutionalized and systemic. In plain English, each and every foreclosure of a securitized mortgage has been a wrongful foreclosure. If the damages resulting from a wrongful foreclosure are monetarily compensable, then a homeowner who has lost a home as a result of the wrongful foreclosure of a securitized mortgage can recover such damages after foreclosure.

If the damages suffered as a result of a foreclosure is $50,000. per mortgage, the total amount of damages caused by wrongful foreclosure of securitized mortgages from 2006-2010 is $425 billion. That is the treasure trove resulting from “toxic foreclosures” awaiting successful litigants for wrongful foreclosure of securitized mortgages.

Usually, when litigating violation of consumer protection authorities, it is necessary to prove the facts and figures which are specific to each case. Such transgressions are not generic. It is difficult to group acts specific to each case as injuries done to an entire class. Forcing counsel to prove the specific injuries and damages of each client instead of all the clients as a class creates what one attorney refers to as the “death by a thousand cuts.” When it comes to toxic foreclosure, as stated above, the wrongful acts committed are institutionalized and systemic. Each complainant has been wronged by being tarred with tar from the same brush. Each has been gored by the same ox. The violations do not vary from case to case.

The violations which create the toxic foreclosure have been repeated again and again by the same tort feasor and often in concert with the same cast of co-tort feasors. Moreover the malefactors typically consist of foreclosure mills and the largest financial institutions in the country with the deepest pockets which hired these mills.

The evidence of malefaction has been preserved in the public record, protected at public expense. Every time, a false affidavit is recorded, it is preserved as a public record in the land records of the jurisdiction where the foreclosure took place. Every time a spurious document or incomplete pleading is filed in the docket of a court, the document becomes a public record in the jurisdiction where the foreclosure has taken place. Without using the tools of discovery, a damning case of misconduct can be established by having a title company do a search of documents of record. These documents also name the and identify the persons who need to be deposed regarding the authenticity and propriety of the subject document. The cast of characters, which includes the richest and most sophisticated, well healed financial institutions in this country, were so arrogant and myopic in effecting predatory foreclosure that they forgot to destroy the evidence and rub out the witnesses.

Finally, the evidence will also, in many cases, support an indictment by public authorities for criminal fraud and many other violations of criminal law, both state and federal. It is of course illegal to extort a civil settlement by threatening a defendant with blackmail (Unless you settle,

the information obtained will be disclosed to public authorities.). Such a threat need not be made. The mere existence of the evidence collected enshrined in the public record available upon request to any member of the public or the local prosecutor will impel many defendants to settle upon condition that the record of the case be sequestered. Given the damning evidence uncovered, a victory for the defense runs a high risk of being a pyrrhic victory. In other words, the victorious defendants do not have to pay compensation to the plaintiffs; only their officers and principals have to go to jail.

Toxic foreclosure is the next accident waiting to happen to Wall Street in the mortgage meltdown. Those attorneys who blaze the trail to obtain monetary damages for individuals and families wrongfully driven from their home stands to make a fortune; they will do very well by doing good.

6. REMIC Tax Evasion.

MBS trusts are organized as one or a series of REMICs. Real Estate Mortgage Investment Conduits, or "REMICs," are a type of special purpose vehicle used for the pooling of mortgage loans and issuance of mortgage-backed securities. They are defined under the United States Internal Revenue Code (Tax Reform Act of 1986, as amended), and are the typical vehicle of choice for the securitization of residential mortgages in the US. As REMICs are typically exempt from tax at the entity level, they may invest only in qualified mortgages and permitted investments, including single family or multifamily mortgages, commercial mortgages, second mortgages, mortgage participations, and federal agency pass-through securities.

A “qualified mortgage” includes any of the following:

- “An obligation (including MBS) that is secured by an interest in real property and is:

▪ Contributed to the REMIC on the startup day in exchange for regular or residual interests.

▪ Purchased by the REMIC within the first three months beginning on the startup day (with certain exceptions provided in the regulations).

- A qualified replacement mortgage. A qualified replacement mortgage is an obligation that meets qualified mortgage requirements, but is received for:

▪ Another obligation within the three month period beginning on the startup day.

▪ A defective obligation within the two year period beginning on the startup day.

- A regular interest in another REMIC contributed to the REMIC on the startup day in exchange for regular or residual interests in the REMIC, and …”.

The use of paperless technology to “acquire” a mortgage may not satisfy the requirement to have “purchased” the asset within 90 days of the startup date. Without proper conveyance by a paper document, the purchase may remain as a promise to perform rather than a finalized purchase. The use of paperless technology may imperil the REMIC tax exemption resulting in billions o dollars of tax liability to the REMICS and investors including recapture of taxes, interest and penalties by the IRS.

7. Qui Tam/False Claims Act Public and Private Causes of Action.

The False Claims Act, as amended, (31 U.S.C. § 3729–3733 also called the "Lincoln Law") is a federal law that allows people who are not affiliated with the government to file actions against federal contractors they accuse of committing claims fraud against the government. The act of filing such actions is informally called "whistleblowing". Persons filing under the Act stand to receive a portion (usually about 15–25 percent) of any recovered damages. Several states have also created False Claims Act statutes to protect their public-funded programs against fraud by including qui tam provisions, enabling them to recover money at the state level. Many of these laws mirror the federal False Claims Act and simply apply it to the state's jurisdiction. Michigan and Tennessee have specifically limited their False Claims Acts to merely protect their Medicaid systems.

The Attorneys General of California and Ohio have each filed a class action suit seeking billions of dollars to recover penalties for filing false documents and to recover recording fees wrongfully withheld from the state by the failure to record assignments of mortgages and similar documents. Such lawsuits may also be field by private citizens. States which provide for both public and private recovery of payments under the False Claims Act of a state are listed below.

State False Claims Act Cases Citations * = Medicaid only False Claims Act ✓ = Qualified for Increased Share Under Deficit Reduction Act
California ✓
Colorado*
Connecticut *
Delaware

District of Columbia
Florida
Georgia * ✓
Hawaii ✓
Illinois ✓ (PDF, amended 2010)
Indiana ✓
Louisiana *
Maryland *
Massachusetts ✓
Michigan * ✓
Minnesota
Montana
Nevada ✓
New Hampshire
New Jersey
New Mexico
New York ✓
North Carolina
Oklahoma
Rhode Island ✓
Tennessee ✓
Texas * ✓

Virginia ✓
Wisconsin * ✓

CONCLUSION

1. Title defects barring sale of REO properties acquired by foreclosure.

   The financial institutions will sweep the defects under the carpet. Overturned foreclosures will be few and far between. In those instances, the financial institutions will pay off the claimants.

2. On-Going Foreclosure.

If the courts find that a lawful foreclosure cannot be conducted where title to the foreclosed property sold at auction is tainted by toxic documents, foreclosure will be postponed until the problem is resolved. This would result in a national moratorium on foreclosure. The only way such a situation will be avoided is if no defendant in foreclosure raises objection to the conditions of the auction.

3. Liability to SEC and Investors.

The toxic documents pave the highway to a car wreck waiting to happen as investors will try to recoup losses. Investor lawsuits and class actions have already been filed with more on the way. The toxic documents provide evidence to fuel the investor's fire. It remains a question to what degree the SEC will enforce its regulations. Other than verbal bombast, the Administration has gone out of its way to protect the interests of Wall Street. It is as if Obama trails the footsteps of Charlie Wilson of what's good for Wall Street (the U.S. now owns GM), is good the USA.

4. Secondary mortgage market operations and future securitization.

Here is the question: will market forces on Wall Street or regulatory authorities compel compliance with traditional document production requirements in primary and secondary mortgage market operation, until enabling authorities are enacted to paperless operation with electronic systems. It depends upon how the current crisis de jour plays out. If the story has traction. If the media keeps on investigating, if the political parties jump into the debate, if the Congress investigates, the financial industry will not be able to continue operation as usual. If its next week, next story and everyone moves on, the industry will revert to conducting paperless transactions without legal authority. If paperwork production nis required and enforced, designing and impolkementing new document producing systems will delay mortgage financing

and secondary market operations. Wall Street would be best advised to jump on this matter now in advance of possibly being forced to comply.

5. Wrongful foreclosure class actions.

Call me crazy but here is the pot of gold at the end of the rainbow for millions of American families. It is only a question of time until those who litigate class actions understand that the lenders can no longer rely upon “the death of a thousand cuts” to defend against a class action recovery. Most attorneys believe that the lender misconduct depends upon facts and claims specific to each case, that there are no generic, cross cutting acts to serve as the proximate cause for damages. Once lawyers start to study securitization and identify common, generic acts of misconduct that injure everyone in the class, the tanks will start to roll.

So extensive is the financial exposure of the financial institutions for mortgage fraud and wrongful foreclosure that one may anticipate Congressional intervention. Ultimately, the major participants in the secutization industry will need to enter a consent decree where each and every person wrongfully displaced by foreclosure using toxic documents will receive the same damages award, tax free. Such an award might be $20,000. for each owner and $10,000. for each non-resident occupant. In return, the major participants, in their corporate and individual capacities, would receive immunity from criminal prosecution and civil liability.

6. Non-Compliance with REMIC Regulations and Tax Evasion.

Someone somewhere will file a whistleblower complaint with the IRS pursuant to its new procedures to compensate insider reporting of tax evasion and other tax related misconduct. The financial institutions will spare no effort or expense to block further investigation of treasury action. Ultimately the industry will obtain a revenue ruling that electronic filing suffices to comply with IRS regulations. The political will and consensus does not exist to compel the REMIC trusts to funds because of non-compliance with the REMIC tax exemption requirements.

7. Public and Private Causes of Action under State Quit Tam or False Claims Act Authorities.

This is a sleeper that may become a major problem for Wall Street. States do not commit extortion. Far be it from me to suggest such an idea despite the facts that most states are having severe budget balancing difficulties. The foregoing discussion amply demonstrates the myriad likely violations of law committed through the use of toxic documents to obtain foreclosure. What if one standard term of any qui tam consent decree would provide immunity from state prosecution for criminal acts? It is only a question. Would the public ever dream of electing to a higher office any state attorney general who forced the banks to accept an offer they could not refuse to pay damages to families displaced by foreclosure?

The one barrier to foreclosure which may, more than likely, force a nationwide moratorium is the inability to comply with legal requirements for a public auction of the foreclosed property on the court house steps because title to the auction property has been tainted by toxic documents so that a reasonable member of the public will not bid for a foreclosed property known to be uninsurable.

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There are three reasons why foreclosure auctions, both in judicial and non-judicial jurisdictions, cannot go forward:

1. <u>The foreclosure proceedings have allowed toxic documents to taint title and driven away buyers who otherwise are ready, willing and able to bid upon and buy at a foreclosure sale.</u>

The toxic documents have tainted the title conveyed by sheriff's deed to the prevailing party at public auction of the foreclosed property. As of this moment, many lenders are entering into indemnification and hold harmless arrangements with title insurers for any REO property sold by the institution. However, such an accommodation does not extend to properties at public auction which have tainted titles because the foreclosure proceeding relied upon toxic documents.

Usually, a property is not withheld from public auction because of title defects. Normally a sheriff's deed need not and often does not convey clear title. This case is different. In this case, it is the judicially conducted foreclosure proceeding itself which precipitated the title defect through the admission of toxic documents. Next, it is the creditor seeking foreclosure who fouled the nest be filing toxic documents. As a court of equity which has a legal obligation to do equity, the defendant can object that the foreclosure itself has driven away otherwise ready, willing and able buyers such as investors and homebuyers from the public auction.

2. The plaintiff who seeks to foreclose has tainted title with toxic documents and arranged for title insurance for tainted title REO there rigging the bidding at public auction sop that only the plaintiff will bid for the property and take it back as REO.

Secondly, the situation is analogous to bid rigging. In this case, first the lender who is foreclosing files toxic documents that taint the title. Then the lender is the only party at the auction, bids and takes the property back as REO. In this way, the lender even controls the amount of the deficiency between what is "paid" at auction and the amount of the debt.

This legal obstacle will preclude sales at the court house steps in judicial and non-judicial jurisdictions. The only foreclosures not affected are foreclosure of portfolio loans including purchase money mortgages held by the original seller of the property.

Until the attorneys general of the 50 states reach an accommodation agreement with title companies and lenders to spread the accommodation agreements to all affected foreclosure properties, foreclosure will have to grind to a halt. It only takes one brave attorney in a local jurisdiction to seek to enjoin all affected foreclosures until the title issue is remediated.

3. **By auctioning the foreclosed property the court would aid and abet monopolization and conspiracy to monopolize, a violation of the Sherman Antitrust Act.**

The agreements being reached between lenders and title insurers create a bid rigging scheme so that only the lender as secured creditor will bid at public auction. Such an arrangement violates the Sherman Antitrust Act and will likely receive the scrutiny of the Antitrust Division of the Justice Department and the Attorney General.

RECOMMENDATIONS

1. **Title tainted by Toxic Documents on foreclosed properties.**

Problem:

REO and properties which have gone through foreclosure with titles from foreclosures tainted by toxic documents filed in the foreclosure proceedings.

Solution:

Any financial institution will issue a blanket warranty to each title insurer registered to issue title policies in a state the financial institution will indemnify and hold a title insurer harmless from any cost or liability resulting from insuring title on property foreclosed by the lender. This undertaking will extend to subsidiaries, affiliates agents or parties otherwise under the control of the financial institution.

2. **<u>Title to Properties in Foreclosure</u>**

Problem:

The conduct of a public auction as required for execution of a judgment of foreclosure is barred by inability to conform to legal and equitable requirement:

(a) Plaintiff wrongfully misused foreclosure to file toxic documents to slander defendant's title to the property being foreclosed thereby wrongfully tainting title and damaging the value of the property at foreclosure sale.
(b) The arrangement between the plaintiff financial institution and the title company to only insure the banks REO constitutes bid rigging which is illegal.
(c) The same bid rigging arrangement violates the Sherman Antitrust Act as monopolizing or attempting to monopolize per se. It likely also violates the Fair Trade Act, the Fair Debt Collection Practices Act and the Racketeer Influenced and Corrupt Organizations Act (commonly referred to as RICO Act or RICO), federal and state versions.

Therer may also be liability to purchasers of tainted titles against the plaintiff who foreclosed for slander of title.

Solution:

Extend the hold harmless and indemnification blanket undertaking to all properties foreclosed by the institution. By indemnifying all titles to foreclosed properties, the problems become moot. Moreover, very few borrowers contest foreclosure. It may be anticipated that even fewer borrowers will seek to recover the property by moving to set aside the sale or a subsequent action for wrongful foreclosure. Accordingly the liability of the banks resulting in actual payment of damages will be limited and not financially significant. Even though some awards in specific cases may be large enough to attract media attention, the frequency of such successful litigation outcomes will prove few and far between.

3. **<u>Liability to Wrongfully Foreclosed Homeowners.</u>**

Problem

Homeowners have lost their homes as a result of tortuous acts by the plaintiff and other parties in conducting foreclosure upon the home:

(a) The filing of toxic documents which tainted title constituted abuse of process and malicious prosecution of defendant making the mortgage unenforceable in an equitable proceeding.
(b) Wrongful foreclosure by foreclosing upon a property without being the lawful holder of the mortgage note or to collect debt on behalf of an unsecured general creditor.
(c) Mortgage fraud by making loan where a lender in the business of making a loan knows or has reason to know that the borrower cannot repay the loan. State, Federal and personal cause of action under Fair Debt Collection Practices Act and other consumer protection authorities.

Solution

The filing of toxic documents has created a treasure trove of recovery remedies against financial institutions. These remedies may be pursued through individual or class actions. The difficulty of bringing such litigation has been a lack of financial resources. Individuals do not have the means to withstand the counterattack of a defending financial institution with virtually unlimited finances. Class actions have been constrained by the lack of funding as well as fear that each plaintiff can only demonstrate case specific wrongful conduct by the lender. The belief exists that there are no generic, cross cutting misdeeds where the same violative conduct demonstrably appears in one case after the next.

It may well be that removal of restrictions against barratry and maintenance in 37 states will permit hedge funds and other investors to "invest" in foreclosure class actions for a percentage of judgment awarded to a successful class. Moreover, the toxic document crisis will provide generic offenses suitable for class action adjudication as more and more attorneys become familiar with the arcane, recondite subject of securitization.

Finally, the financial institutions which created the toxic document crisis ignored the "Tony Soprano Rule. Make the witnesses and incriminating evidence disappear. Instead, the financial institutions caused toxic documents which constitute evidence of crime to be filed in the public records in a court docket or in land records offices thereby preserving the evidence in perpetuity at the expense of local taxpayers. The voluminous accumulation and use of such evidence to conduct a class action will pose irresistible pressure upon the defendant financial institution to settle and sequester the record. This situation does not amount to extortion but for litigators representing wronged borrowers, it is the next best thing.

If one out of five wrongful foreclosures winds up in a successful class action and if the average jury award per home foreclosed is $50,000., an exposure of $30 billion will result. It is but a question of time until the litigating bar gets a whiff of this windfall. This impending liability will direct Wall Street to reform securitization practice and to petition government to provide necessary enabling authorities and protection from liability.

The only alternative to exposure to the aforementioned liability is Federal intervention which is further discussed in paragraph 5.

4. Liability to Investors and Insurers.

Problem:

Approximately 10 trillion dollars was invested worldwide in American MBSTs. Half went to Federally chartered corporation such as FNMA and FRMAC. These entities have now been taken over by the Federal Government to enable the new regulators to shore up the value of securities secured by mortgages and forestall financial chaos. The remaining $5 trillion was securitized by the private sector.

The toxic documents together with recent depositions of employees of financial institutions, document recovery firms and foreclosure mills suggest two major areas of concern. The first is that the parties administering a MBST did not take the proper, necessary steps to assemble and transfer mortgages as promised in the prospectus and master pooling and servicing agreement. Second the parties administering

the trust did not properly exercise the fiduciary duty to investors to manage the property, foreclose and replace and redeem mortgages in default, as promised in the Prospectus and Pooling Agreement. Branch Hill Capital and Manal Mehta issued an August 2010 predicting that liability of Bank of America on repurchase and redemption agreements and warranties and representation would result in a liability sufficient to cut its current share price in half.

In addition to the redemption and repurchase agreements, insurers who provided financial guarantees or guarantee insurance are demanding redemption of defaulted mortgages under subrogation of claims the insurers paid off.

There may also be substantial third party beneficiary liability from rating companies to investors for deceit, misrepresentation and willful and wantonly reckless disregard of the facts.

Solution:

The Federal Government has already taken over FNMA and FRMAC to limit investor losses. Many of the victims are themselves financial institutions and large pension funds with the resources to go to court and hold the parties responsible accountable. Nonetheless, the Obama Administration may under the guise of protecting pension funds and pensioners intervene to limit liability. Such a suggestion was made by David Fasber on CNBC. It remains an open question whether those concerned and the politicians under their influence would prefer to leave it to private ordering where those on Wall Street settle their own scores. Here is a situation where I suggest Main Street, in payback is hell fashion, will placidly ignore the problems on Wall Street.

5. **Criminal and Administrative Liability to Federal and State Authorities.**

Problem:

The financial institutions which organized and administered MBSTs engaged in systemic and systematic criminal acts under state and federal law, including fraud, racketeering, illegal conversion of someone else's property and perjury, as evidenced by the ubiquity of toxic documents.

Solution:

The initial response of affected companies is to "jump in the river" known as "denial". What happened never happened. The second line of defense is that what happened did happen but was due to clerical error and technical oversight. It is the sort of complaint which aggravates pedantic lawyers but does not due injury to anyone else. When this line of defense is exhausted, the companies next turn to blaming the borrowers for the crimes committed by the lender. They owed us money; they made us do it. This defense did not work for O.J. Simpson who languishes in jail because he tried to take back his own property through the use of illegal means. As more than one commentator has noted, two wrongs do not make a right, just two wrongs.

OI am awaiting the last line of defense. The one that has consistently worked, The bully argument: If the companies who engaged are held accountable the entire financial system will collapse. This is the "chicken little defense". It has worked so far. The Special Inspector General for TARP in his June report

to the Congress noted that $4.3 Trillion dollars had been expended by the government to rescue Wall Street.

Essentially the issue is a political one. The chicken little defense has worked but will it work again or will the public demand that the lenders and other involved finally be held accountable and pay for their misconduct. I do not know what will happen. I do believe this is an angry electorate out there.

Will the Obama Administration facing a reelection in 2010 continue to stand between the pitchforks and the banks or will the Administration throw Wall Street under the bus to get reelected? I do not believe it can afford to do so. Instead, I believe the Congress and Administration will enact legislation along the lines previously used for the tobacco settlement. The Tobacco Master Settlement Agreement (MSA) was an agreement entered into in November 1998, originally between the four largest US tobacco companies and the Attorneys General of 46 states. The states settled their Medicaid lawsuits against the tobacco industry for recovery of their tobacco-related health care costs, and also exempted the companies from private tort liability regarding harm caused by tobacco use.[1]:25 In exchange, the companies agreed to curtail or cease certain tobacco marketing practices, as well as to pay, in perpetuity, various annual payments to the states to compensate them for some of the medical costs of caring for persons with smoking-related illnesses.

It may well be that Congress will have to enact legislation providing enabling authority for reconciliation of wrongful foreclosure and amnesty to:

(a) Confer immunity upon companies engaged in organizing and administering securtization from Federal prosecution in exchange for payments to an amnesty fund. Establish procedures, criteria and limits for calculation and payment of compensation to victims and states. Payments can be made through the IRS or Social Security Administration. Victims entitled to compensation can be tracked by social security identification number.
(b) Establish procedures, criteria and limits for calculation of payments to the amnesty fund and payment of compensation to victims and states. Payments can be made through the IRS or Social Security Administration. Victims entitled to compensation can be tracked by social security identification number.
(c) Require a committee representing the states attorneys general together with the Uniform Commercial Code Association, the Treasury, the Federal Reserve and the newly organized Department of Consumer affairs to create a UCC chapter for securitized transactions which includes requirements and procedures for electronic conveyance of mortgages and digitized, electronic transactions.
(d) Prosecute any company engaged in criminal activities in connection with securitization which has not enrolled itself in the amnesty program.
(e) Treat financial payments made for compensation of victims as a business expense and payments to victims are tax free.

If compensation of $10,000. were paid to the estimated three million homeowners who lost homes as a result of wrongful foreclosure, $30 billion would be expended. If an equal sum were paid to the states, the bill would come to 60 billion. That is where I think we are heading. Although Wall Street does not know it yet, the victims and states are about to be added to next year's executive compensation bonus list.

6. **Qui Tam and False Claims Act Liability at the State level.**

Problem: In Ohio and California, the state Attorney General has brought a class action against sponsors of securitization for violating state statutes through the use of toxic documents and failure to record assignments thereby wrongfully withholding payment to the local land records recording office for recording fees. In most states such a class action claim to recover repayment of monies owed to the state may be brought under the state's version of the False Claims Act which replaces the common law qui tam proceeding to recover improperly paid public funds. Most state causes of actions can be brought by the state's attorney general or by a private citizen

Solution: In these cases, the plaintiff has the burden of proving that the defendant was legally obligated to record assignments of mortgages and similar instruments. I am unfamiliar with ant state authorities, enacted or decisional, which makes document recordation mandatory. If industry members do negotiate a blanket reconciliation and amnesty agreemen, false claims payment obligations should be included in the agreement.

7. **Plaintiff in foreclosure actions that cannot produce authentic documents to substantiate the chain of title cannot enforece the mortgare.**

Problem: A substantial number of mortgage defense attorneys have argued that the purported holder of the note, if different from the named mortgagee in the mortgage, must produce a chain of title using authentic documents. If the p[laintiff is unable to do so, plaintiff cannot demonstrate that plaintiff is the lawful successor in interest to the oprioginal mortgagee and accordingly cannot foreclose.

Solution: Some plaintiffs have argued that no chain of title is required where the plaintiff holds a bearer note. Such a legal assertion begs the question whether title to a mortgage can be conveyed by a bearer note, If the mortgage, as the agreement to secure the repayment of the loan with the property, requires idcnetification of the mnortgageee, how can the successor be an unidentifiable bearer It may well be that the bearer of a negotiable note is entitled to payment; it may also be the bearer is not entitled to be an unidentified successor in interest to the original mortgagee. Asx interesting as this argument may be academically, the court mauy well allow the plianitff to prove ownership opf the nmote by alternate means.