MODERNIZING MORTGAGE LAW*

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Modern mortgage law is designed for a world that no longer exists. The residential mortgage transaction of today looks nothing like it did during the formative period when the property laws governing mortgages were developed. What was once a local dealing between two individuals and largely for commercial or quasi-commercial purposes has now become a housing-centric financial transaction-turned-asset between multiple distant and often invisible parties that operate as part of a national market. Yet, although the mortgage transaction has changed, mortgage law has not. Property law rules that once balanced the rights of mortgagors and mortgagees now completely fail to furnish aggrieved homeowners with meaningful relief when faced with wrongs that stem from the complexities of the securitization of mortgage loans and the acts of intermediaries. The result is that consumers suffer wrongs at the hands of mortgage creditors and their contractors but have no remedies to right them. This is particularly true in light of the economic fallout from the COVID-19 pandemic and the threat of a coming wave of foreclosures that, if the 2008 financial crisis is any indication, promise to leave households vulnerable and completely at the mercy of the mortgage finance machine. This Article shows why an overhaul to residential mortgage law's most basic doctrines is long overdue.

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INTRODUCTION

It's hard to overstate the significance of the modern *mortgage transaction*. It's also hard to overstate the obsolesce of modern *mortgage law*.

The financial transaction itself drives so much. Mortgage finance allows families to purchase homes, fuels a tremendous portion of the economy, and has even been the cause of a global financial crisis. Even as this paper is being written, many Americans wait in constant fear for the eviction and foreclosure aftermath of the COVID-19 pandemic. Indeed, mortgage lending is at the heart of the American dream—homeownership—and it can also be the cause of a household's greatest pain—foreclosure and housing insecurity.

All this makes the following truth even more astounding: for all the importance and vibrancy of the mortgage *transaction*, mortgage *law* has been fairly lifeless for about a century.

This is not to say that mortgages are lawless. On the contrary, there is quite a bit of law built around the mortgage transaction. There are procedural rules governing mortgage creation, maintenance, and foreclosure, which can vary between judicial and nonjudicial regimes. There are substantive commercial and contract law rules that facilitate the creation and enforcement of the underlying obligation to pay the mortgaged debt. And there is an ocean of statutory rules and regulations that govern the financial institutions that make up the architecture of the mortgage finance system.

But mortgage law—the organic source of the security device itself comprising the inherent common law rules that underpin its operation—is so simple and outmoded that modern courts and scholars, with some notable exceptions,[1] barely give this area much thought. And more importantly,

1. *See, e.g.*, Ann M. Burkhart, *Freeing Mortgages of Merger*, 40 VAND. L. REV. 283 (1987) [hereinafter Burkhart, *Freeing Mortgages*]; Ann M. Burkhart, *Real Estate Practice in the Twenty-First Century*, 72 MO. L. REV. 1031 (2007); Ann M. Burkhart, *Third Party Defenses to Mortgages*, 1998 BYU L. REV. 1003; Ann M. Burkhart, *Fixing Foreclosure*, 36 YALE L. & POL'Y REV. 315 (2018); Ann M. Burkhart, *Lenders and Land*, 64 MO. L. REV. 249 (1999) [hereinafter Burkhart, *Lenders and Land*]; R. Wilson Freyermuth, *Of Hotel Revenues, Rents, and Formalism in the Bankruptcy Courts: Implications for Reforming Commercial Real Estate Finance*, 40 UCLA L. REV. 1461 (1993); R. Wilson Freyermuth & Dale A. Whitman, *The New Model Negotiated Alternative to the Foreclosure Act*, 32 PROB. & PROP. 36 (2018); R. Wilson Freyermuth & Dale A. Whitman, *Residential Mortgage Default and the Constraints of Junior Liens*, 57 U. LOUISVILLE L. REV. 207 (2019); Julia Patterson Forrester, *Fannie Mae/Freddie Mac Uniform Mortgage Instruments: The Forgotten Benefit to Homeowners*, 72 MO. L. REV. 1077 (2007); Joseph William Singer, *Foreclosure and the Failures of Formality, or Subprime Mortgage Conundrums and How To Fix Them*, 46 CONN. L. REV. 497 (2013); JOSEPH WILLIAM SINGER, NO FREEDOM WITHOUT REGULATION: THE HIDDEN LESSON OF THE SUBPRIME CRISIS (2015); Gregory M. Stein, *Mortgage Law in China: Comparing Theory and Practice*, 72 MO. L. REV. 1315 (2007); Gregory M. Stein, *The Scope of the Borrower's Liability in a Nonrecourse Real Estate Loan*, 55 WASH. & LEE L. REV. 1207 (1998); Andrea Boyack & Robert Berger, *Bankruptcy Weapons To Terminate a Zombie Mortgage*, 54 WASHBURN L.J. 451 (2015); Grant S. Nelson & Dale A. Whitman, *Rethinking Future Advance Mortgages: A Brief for the Restatement Approach*, 44 DUKE L.J. 657 (1995); Dale A. Whitman & Drew Milner, *Foreclosing on Nothing: The Curious Problem of the Deed of Trust Foreclosure Without Entitlement To Enforce the Note*, 66

mortgage law offers little to no protection to homeowners when they suffer wrongs at the hands of overbearing and even abusive mortgage creditors.

The primary reason for mortgage law's datedness involves its origin story. Mortgage law, as a distinct subset of the broader law of property, arose and developed in a time when the mortgage transaction looked nothing like it does today. Historically, most mortgage deals were for business or agricultural purposes—not for buying homes.[2] The transaction was fairly simple, with there being only a debtor and a creditor.[3] To that end, the creditor was an individual—a neighbor, most likely—rather than a financial institution.[4] Perhaps most importantly, mortgages were intensely local affairs between individuals who lived in the same geographic area.[5] And of course, there was no national market of which to speak.[6] Credit was local and stayed local.[7] This also meant that the terms of mortgage transactions were not standardized but instead varied widely.[8]

These characteristics were true of both the mortgage transaction in England and in the early United States. The most noted historian of pre-twentieth century U.S. mortgage law observed "that in [late 1800s] America the making of a mortgage loan is essentially a local transaction."[9] And it was within these historical parameters that mortgage law itself developed. The norms, jurisprudence, theories, and resulting rules that eventually grew to be the body we know today as mortgage law evolved to fit this very simple, very local, very bespoke, and very commercially oriented transaction.

Of course, such a transaction setting seems quaint today. Starting in the 1930s, after the Great Depression, the mortgage finance market was transformed completely. By the twenty-first century, mortgage transactions

ARK. L. REV. 21 (2013); Dale A. Whitman, *How Negotiability Has Fouled Up the Secondary Mortgage Market, and What To Do About It*, 37 PEPP. L. REV. 737 (2010); Dale A. Whitman, *Transferring Nonnegotiable Mortgage Notes*, 11 FLA. A & M U. L. REV. 63 (2015); Dale A. Whitman, *Mortgage Prepayment Clauses: An Economic and Legal Analysis*, 40 UCLA L. REV. 851 (1993); Grant S. Nelson & Dale A. Whitman, *Reforming Foreclosure: The Uniform Nonjudicial Foreclosure Act*, 53 DUKE L.J. 1399 (2004); Grant S. Nelson, *The Foreclosure Purchase by the Equity of Redemption Holder or Other Junior Interests: When Should Principles of Fairness and Morality Trump Normal Priority Rules?*, 72 MO. L. REV. 1259 (2007); Grant S. Nelson, *The Contract for Deed As a Mortgage: The Case for the* Restatement *Approach*, 1998 BYU L. REV. 1111; Alan M. White, *Deleveraging the American Homeowner: The Failure of 2008 Voluntary Mortgage Contract Modifications*, 41 CONN. L. REV. 1107 (2009); Alan M. White, *Losing the Paper – Mortgage Assignments, Note Transfers and Consumer Protection*, 24 LOY. CONSUMER L. REV. 468 (2012).

2. *See infra* Section I.A.
3. *See infra* Section I.A.
4. *See infra* Section I.A.
5. *See infra* Section I.A.
6. *See infra* Section I.A.
7. *See infra* Section I.A.
8. *See infra* Section I.A.
9. D.M. Frederiksen, *Mortgage Banking in America*, 2 J. POL. ECON. 203, 209 (1894).

were centered on housing; were fueled by a national credit market with significant standardization in terms and form; were administered by a wide variety of distant and disinterested financial intermediaries; were insured or guaranteed by an alphabet soup of federal government agencies; were originated only by banks and lending institutions; and, most importantly, were aggressively financialized. And all of this remains true today.

One would assume, then, that if the mortgage finance market has changed so drastically, then mortgage law (meaning here the common law of mortgages) would have progressed as well—in order to meet the realities of the modern mortgage transaction. If the assumptions that underpin the rules no longer apply, then the law of mortgage, as developed primarily by judges, should have evolved as well. But it has not.

Mortgage law, far from developing to meet modern demands, remains relatively the same as it was at the turn of the twentieth century. The market changed, but the law did not. Financial regulations bloomed, many of which were intertwined with mortgage law. But the law of mortgages itself stopped developing. Indeed, with few exceptions, scholars of property law also lost interest in this area. Where there were once a number of authoritative treatises and a healthy scholarly discourse, now one mostly finds an occasional law review article and a short discussion of the topic in first-year property law casebooks.

Perhaps the stagnation of mortgage law would not be so lamentable if it did not have such real and dire consequences. As the financial crisis of 2008 and its aftermath taught us, the financialization of mortgages created significant harms for families in financial distress, particularly when it came to avoiding foreclosure and managing loan modification negotiations.[10] Litigation abounded where homeowners tried to seek recourse for harms related to these issues but were largely rebuffed at every turn.[11] For negligence claims, courts held that financial institutions do not owe a duty to borrowers.[12] For pre-foreclosure trespass claims, courts held that homeowners bargained away their possessory rights when they signed standard form mortgages.[13] When homeowners brought breach of contract claims for mortgage companies' failure to follow appropriate servicing guidelines, courts held that a lack of privity prevented recovery.[14] More fundamentally, courts didn't even know how to classify or treat the various financial intermediaries involved in a modern mortgage transaction.[15]

But why is this the case? Why does mortgage law so woefully fail to balance the rights between mortgage creditors and debtors? In a 2013 decision,

10. *See infra* Section II.D.
11. *See infra* Section II.D.
12. *See infra* Section II.D.2.
13. *See infra* Section II.C.
14. *See infra* Section II.D.4.
15. *See infra* Section II.A.

the Rhode Island Supreme Court said it best: "[W]e are confronted with the same problem with which many courts before us have struggled—the 'difficulty of attempting to shoehorn a modern innovative instrument of commerce into nomenclature and legal categories which stem essentially from the medieval English land law.'"[16] Put simply, our archaic *mortgage law* does not align with our modern *mortgage market*.

I argue in this Article that although mortgage law—specifically, residential mortgage law—has become obsolete, it does not have to remain that way. Now is the time for courts (and hopefully legislatures soon after) to breathe new life into mortgage law—to make it meet the demands of today and actually reflect the financialized structure of modern transactions. We need a mortgage law revolution, not unlike the landlord-tenant revolution of the 1970s. It is time to modernize mortgage law.

To show how to get there, this Article proceeds in three parts. First, Part I takes us back to the origin story of mortgage law and shows how it developed in early England and the United States. In doing so, I explain how even in the context of much simpler transactional incarnations, courts and scholars greatly contested the nature of the mortgage and particularly the powers that could be given to a mortgage creditor. At each turn, creditor overreach was met with courts in equity rebalancing the power dynamic. This part also explains how residential mortgage finance was transformed and financialized starting in the 1930s—coming to be unrecognizable to its forebearers. Part II then shows how mortgage law as a body of rules has failed to police wrongdoing in the modern residential mortgage transaction. Courts are unsure as to the relationship of the various parties in a mortgage securitization, and they routinely reject the notion that mortgage creditors owe any kind of duty of reasonable care to borrowers. And when tort-based paths of recourse are cut off, courts also foreclose contract remedies. Indeed, amid all the many players involved, courts are unsure who the *mortgagee* even is or what that the term means anymore.

Having set the stage and explained the problems, I turn in Part III to the solution: a reinvigoration of residential mortgage law. This part advocates that courts, as the guardians of mortgage law, take up the same reins that were held by earlier courts and fashion new and modern equitable principles to police the mortgage relationship—ones that do not lean exclusively on areas like tort law or contract law, but instead draw broadly on *property law*.[17] I advocate that this be done through the recognition of a doctrine of *equitable privity of estate* in

16. Bucci v. Lehman Bros. Bank, FSB, 68 A.3d 1069, 1086 (R.I. 2013) (quoting Mortg. Elec. Registration Sys., Inc. v. Revoredo, 955 So. 2d 33, 34 (Fla. Dist. Ct. App. 2007)).

17. I note here again that mortgage law is but a subset of property law. *See* SHELDON F. KURTZ, HERBERT HOVENKAMP, CAROL NECOLE BROWN & CHRISTOPHER K. ODINET, CASES AND MATERIALS ON AMERICAN PROPERTY LAW vii–ix (7th ed. 2019). Other areas of property law include landlord-tenant law, estates in land, and conveyancing. *Id.*

modern residential mortgage transactions. In doing so, I draw on other areas, such as the debtor-secured creditor property repossession rules in commercial law, the real covenants law from property, and the residential landlord-tenant relationship in lease law, to show how such equitable principals could be fashioned and how, in fact, doing so would accord with the historical development of property law.

I conclude this Article with a warning—the foreclosure crisis that followed 2008 and the harms that it caused homeowners showed us the weaknesses in mortgage law. The fallout from COVID-19 will likely, in large part, also be a story of housing in crisis. If mortgage law does not rise to meet the challenge, history is likely to repeat itself—with disastrous consequences for homeowners, particularly the most marginalized.

I. THE FINANCIALIZATION OF MORTGAGE CREDIT

To see where mortgage law fails and why, one must first see where this body of law came from. This means knowing how and under what circumstances it developed, what kind of economic conditions it was responding to, and the transactional context in which it operated. Against this backdrop, the development of the rules, which today largely fail to meet the demands of justice, can be explained as responses to the problems of a time that no longer exists. The section below sketches the development of early mortgage law and shows how what was once a completely local and rather quaint transaction involving two individuals has been transformed into a goliath, completely divorced from its roots, that operates on a nationwide basis and is underpinned almost entirely by the standardizing hands of government actors and private intermediaries. Starting in the 1930s, mortgage credit was financialized and would never be the same again. Yet, somewhere along the way, the role of equity and the courts in policing the mortgage transactions went dormant.

A. *The History of the Mortgage Relationship*

To set the stage for the present complexity, this section explains the two oft-proclaimed theories that are said to be largely responsible for how mortgage law currently operates. Having done so, this section then explains how mortgage law, both in England and in the early United States, was hardly orderly. Rather than being neatly aligned into categories, scholars and jurists contested mortgage law—specifically as to the nature of the relationship between the mortgagor and mortgagee—from the very beginning. This section ends by explaining the two things that remained relatively constant throughout this early period—the nature of the mortgage transaction as being both commercial in nature and fairly simplistic in structure.

1. The Two Theories

The conventional wisdom in modern times is that the theory of mortgage law can be generally organized into two categories. First there is the title theory,[18] which is the notion that when a property owner grants a mortgage over land to a creditor, the creditor actually takes title to the property.[19] The owner-debtor no longer has legal title in fee simple; that now rests with the creditor. Only upon fulfillment of the obligation that the mortgage secures (usually repayment of a loan) could the owner-debtor force the property to be reconveyed and thereby reacquire title.[20]

Second is the lien theory.[21] Here, the granting of a mortgage merely conveys to the creditor a lien—something far less than fee simple.[22] Rather than legal title, the mortgage is merely a right in the property that allows the creditor to have the property seized and sold, with the proceeds from the sale being used to repay the loan.[23]

There is also a hybrid theory, whereby the granting of a mortgage merely creates a lien but, upon the owner-debtor's failure to pay the debt, the mortgage becomes a conveyance such that the creditor now holds legal title to the property.[24] The owner-debtor is "deemed to have legal title until default occurs; after default, legal title passes to the mortgagee."[25] This additional, mixed theory has received some attention by scholars and courts, but is rarely seen as a true third legal frame.

Leading property law texts routinely recite these theories as being fairly straightforward.[26] Indeed, courts also explain the history of mortgage law as

18. *See* RESTATEMENT (THIRD) OF PROP.: MORTGS. § 4.1 cmt. a(1) (AM. L. INST. 1997).

19. *See id.*

20. *See id.*

21. *See id.* § 4.1 cmt. a(2).

22. *See id.*

23. *See id.*

24. *See id.* § 4.1 cmt. a(3).

25. *Id.*

26. Malloy and Smith observe that "[b]y the fourteenth century, the English mortgage had assumed a settled form that has endured as part of the common law." ROBIN PAUL MALLOY & JAMES CHARLES SMITH, REAL ESTATE TRANSACTIONS: PROBLEMS, CASES, AND MATERIALS 413 (5th ed. 2017); *see also* ANN M. BURKHART, R. WILSON FREYERMUTH, CHRISTOPHER K. ODINET, GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE TRANSFER, FINANCE, AND DEVELOPMENT 348–50 (10th ed. 2021). Under this theory, explain Dukeminier, Krier, Alexander, Schill, and Strahilevitz, "the mortgagee takes legal title to the land." JESSE DUKEMINIER, JAMES E. KRIER, GREGORY S. ALEXANDER, MICHAEL H. SCHILL & LIOR JACOB STRAHILEVITZ, PROPERTY: CONCISE EDITION 399 (2d. ed. 2017). "Under the traditional form of mortgage," they continue, "the mortgagee takes legal title to the land[;] [t]his approach is called the 'title theory.'" *Id.* On the other hand, "[m]ost states subscribe to the 'lien theory,' which disregards the form and holds that . . . the mortgagee has only a lien on the property." *Id.*; *see also* KURTZ ET AL., *supra* note 17, at 1296–97. Similarly, Nelson, Whitman, Medill, and Saxer explain that "[i]n form, [the common law mortgage] was essentially a conveyance of fee simple ownership . . . ." GRANT S. NELSON, DALE A. WHITMAN, COLLEEN E. MEDILL & SHELLEY ROSS SAXER, CONTEMPORARY PROPERTY 643 (4th ed. 2013); *see also* JOSEPH WILLIAM

falling into these discrete boxes. In 1861, the California Supreme Court noted: "At common law, a mortgage was regarded as a conveyance of a conditional estate, which became absolute upon breach of its conditions."[27] Further, in 1908, the New York Court of Appeals declared that "contrary to the common law, a mortgage creates no estate in the land, but is merely a lien on the mortgaged premises."[28]

Courts and scholars often use these theories to talk about mortgage law. In truth, however, the history and nature of the mortgage in property law is anything but easy to categorize. As the next section describes, all the way back to its roots, the law has been both muddied and often contradictory, representing a constant struggle between transactional form and equitable considerations.

2. In England

In the United States, we generally accept that the mortgage of England is the mortgage that arrived on these shores.[29] Economic historian Andra Ghent notes that "[u]ntil the 19th century, it seems the mortgage in the American states followed the same legal theory (title) and procedure as the United Kingdom."[30] In the late 1880s, the Supreme Court of South Carolina also observed that "[t]he phrases, 'foreclosure of a mortgage,' and 'equity of redemption,' were imported here from England along with the body of the common law . . . ."[31]

Yet, one of the most prominent scholars of mortgage law in the nineteenth century, Judge Leonard Augustus Jones, noted that it is far from clear whether

SINGER, BETHANY R. BERGER, NESTOR M. DAVIDSON & EDUARDO MOISÉS PEÑALVER, PROPERTY LAW: RULES, POLICIES, AND PRACTICES 966 (2014) (stating the same proposition). Sprankling and Coletta, in turn, note that "[w]hile some states still use the title theory of mortgages, today most states follow a different approach called the lien theory." JOHN G. SPRANKLING & RAYMOND R. COLETTA, PROPERTY: A CONTEMPORARY APPROACH 588–89 (3d ed. 2015). Similarly, the Restatement (Third) of Property: Mortgages expounds: "American courts have traditionally recognized one of three theories of mortgage law" and "[t]hese three mortgage law theories are the product of several centuries of English and American legal history." § 4.1 cmt. a(1) (AM. L. INST. 1997); *see also id.* § 4.1 cmt. a(3) (mentioning the hybrid theory as the third).

27. Fogarty v. Sawyer, 17 Cal. 589, 589 (1861).

28. Becker v. McCrea, 86 N.E. 463, 464 (N.Y. 1908).

29. *See* Esker v. Heffernan, 41 N.E. 1113, 1114 (Ill. 1895) ("Under the rule of this court the mortgagee is held, as in England, in law, the owner of the fee, having the jus in rem as well as the jus ad rem.").

30. ANDRA GHENT, RSCH. INST. FOR HOUS. AM., THE HISTORICAL ORIGINS OF AMERICA'S MORTGAGE LAWS 13 (2012), https://www.mba.org/news-research-and-resources/research-and-economics/research-institute-for-housing-america/published-reports/2014-2012/the-historical-origins-of-americas-mortgage-laws [https://perma.cc/6XBP-TCL9 (staff-uploaded archive)].

31. Anderson v. Pilgram, 9 S.E. 587, 588 (S.C. 1889) (noting that since then the terms have acquired different meanings over time); *see also* Isaac Bell, Inc. v. Sec. Ins. Co. of New Haven, 139 So. 524, 526 (La. Ct. App.), *aff'd as amended*, 143 So. 705 (La. 1932) (same).

the early English mortgage itself actually came from the idea of a conveyance subject to a condition (specifically, a title theory), or if, instead, it was derived from the Roman law concept of *hypotheca*.[32] The *hypotheca*, a device much more akin to the modern-day lien theory mortgage, was a "right given to a creditor over a thing belonging to another, in order to secure the payment of a debt," provided that "the thing remained in the hands of the debtor."[33] Jones notes that since England was under the dominion of the Romans for three and a half centuries,[34] Roman law almost certainly had some impact on the English mortgage.[35]

Some of the earliest historical sources from the Anglo-Saxon period (between AD 410–1066) indicate that real property was pledged to secure a debt and the mortgagee took possession and could even convey away the land thereafter.[36] This tracks, in theory, the idea that title was conveyed to the creditor when a mortgage was granted, but it is hardly conclusive. There are nearly no historical records that exist to truly give us an accurate picture of the mortgage during this period. After the Norman Conquest, when restraints on alienation of interests in land became widespread, historians largely believe the mortgage or anything like it disappeared for the next two hundred years.[37]

When alienation restrictions loosened and the use of the mortgage took hold again around 1325, the focus turned to the question of whether nonpayment of the debt by the date agreed upon between the debtor and creditor actually resulted in the debtor being unable to revendicate the property.[38] This was considered to be "an unsettled question" during the Elizabethan period, thereby calling into question the title theory's solidity.[39]

Soon thereafter, equitable considerations came to bear on the mortgage. In the first part of the seventeenth century, during the reign of James I, the equitable right of redemption was born.[40] This judge-made right allowed the debtor to pay the debt and thereby retrieve the property even after the court-designated date had passed. By the reign of Charles I, and particularly with the

32. 1 LEONARD A. JONES, A TREATISE ON THE LAW OF MORTGAGES OF REAL PROPERTY 2–3 (6th ed. 1904).

33. THOMAS COLLETT SANDARS, THE INSTITUTES OF JUSTINIAN 135 (1922).

34. *See generally* DAVID MATTINGLY, AN IMPERIAL POSSESSION: BRITAIN IN THE ROMAN EMPIRE, 54 BC–AD 409 (2008) (providing a history of Britain under Roman rule). England was governed by the Romans from AD 43 to approximately AD 410. *Id* at 47.

35. JONES, *supra* note 32, at 2.

36. *Id.* at 1–2.

37. *Id.* at 5.

38. *Id.*

39. *Id.*

40. *Id.* at 6–7.

1626 decision of *Emmanuel College v. Evans*,[41] the concept had been firmly recognized by the courts of equity.[42]

This began the formal split between how mortgages were treated in the courts of law and how they were treated in the courts of equity. Conventional wisdom understands that the courts of law viewed the mortgage as a conditional conveyance, whereas the courts of equity viewed the mortgage as merely a granting of a limited right for purposes of security. In other words, a mere *lien*.

Yet, in a very real sense, this was not viewed by some English scholars as a split between law and equity so much as an overtaking.[43] In their view, it was not that the English mortgage had one meaning in one legal sphere and a different meaning in another. Rather, among a number of prominent jurists, the belief was that the mortgage was merely a security right *in all cases*. Even Lord Mansfield, the Lord Chief Justice of the King's Bench during the second half of the 1700s and considered to be one of England's greatest judges,[44] declared in *The King v. St. Michael's*[45] that "it is an affront to common sense to say the mortgagor is not the real owner."[46] The mortgage creditor, "notwithstanding the form, has but a chattel, and the mortgage is only a security."[47] This of course does much more than merely conceive of the mortgage as a conveyance in one context and as security in other—it envisions the English mortgage as *never* constituting a conveyance.

Adding to the perplexity, the English scholar Sheldon Amos,[48] writing a century later in the late 1880s, returned to the title theory and hypothesized in his work *A Systemic View of the Science of Jurisprudence* that the relationship between mortgagor and mortgagee was that of a trust.[49] Yet, even in this description, he believed that "the mortgagee takes the place of the mortgagor as owner of the land" with a "subsequent repayment of the money and reconveyance of the land" to come thereafter.[50] Yet, the mortgagee, despite holding legal title, "is treated as the mere trustee of the land for the benefit of

41. (1626) 21 Eng. Rep. 494.

42. *See id.* at 495; JONES, *supra* note 32, at 5.

43. JONES, *supra* note 32, at 7.

44. *See generally* NORMAN S. POSER, LORD MANSFIELD: JUSTICE IN THE AGE OF REASON (2013) (offering a detailed political biography of Lord Mansfield and describing his influence on the law).

45. (1781) 99 Eng. Rep. 399.

46. *Id.* at 400.

47. *Id.*

48. Amos was a Professor of Jurisprudence at University College, London from 1869 to 1879. *Sheldon Amos*, CAMBRIDGE ALUMNI DATABASE, https://venn.lib.cam.ac.uk/cgi-bin/search-2018.pl?sur=&suro=w&fir=&firo=c&cit=&cito=c&c=all&z=all&tex=AMS853S&sye=&eye=&col=all&maxcount=50 [https://perma.cc/V4WJ-HTCF]. He later became a judge of the Egyptian High Court of Appeal in 1883. *Id.*

49. SHELDON AMOS, A SYSTEMATIC VIEW OF THE SCIENCE OF JURISPRUDENCE 269–70 (1872).

50. *Id.* at 270.

the Mortgagor and his Heir."[51] The contradiction continued as courts and commentators engaged in an effort to provide a theoretical basis for what a mortgage actually did.

Indeed, far from being neatly ordered, English property law struggled to come to terms with the very nature of the relationship between a mortgagor and a mortgagee. Lord Denman perhaps said it best in the 1840 case of *Higginbotham v. Barton*[52] when he declared that "it is very dangerous to attempt to define the precise relationship in which mortgagor and mortgagee stand to each other, in any other terms than by those very words."[53]

Thus, the status of the English mortgage as being based in a conveyance of title was quite uncertain before and after it passed to the United States. The reason was largely due to the fact that courts in equity and legal scholars were trying to mold and fashion rules that would protect the rights of both creditor and debtor. English judge Lord James Parke opined on what the nature of a mortgagor was in 1840, contending "[h]e can be described only by saying he is a mortgagor."[54]

3. In the United States

American law inherited the disorder of English mortgage law. And, over time, U.S. courts, commentators, and legislatures only added to the confusion as to what the relationship between a mortgagor and mortgagee actually embodied.

By the end of the 1800s and the beginning of the 1900s, the noted mortgage law scholar Leonard Jones declared that the older U.S. states followed the title theory and the newer states (a majority of the whole) followed the then-novel lien theory.[55] Yet, even then it was uncertain whether this was actually true and, more so, what it meant to be a lien-theory or a title-theory state at all.

Take New York—certainly one of the original colonies—as an example.[56] This state followed Lord Mansfield's approach and, as early as 1836, regarded a mortgage as merely creating a lien over property.[57] A court in Pennsylvania,

51. *Id.*

52. (1840) 113 Eng. Rep. 432; II Ad. & El. 307.

53. *Id.* For an admiring biography of Lord Denman, see generally JOSEPH ARNOULD, LIFE OF THOMAS, FIRST LORD DENMAN, FORMERLY LORD CHIEF JUSTICE OF ENGLAND (1874).

54. JONES, *supra* note 32, at 15 (quoting Litchfield v. Ready (1850) 155 Eng. Rep. 409; 5 Ex. 939).

55. *See id.* at 16. For a discussion of each state, see *id.* at 16–36.

56. The area was first settled by the Dutch in 1624 but was then taken over by the English in 1664. *See New York*, HISTORY (Mar. 15, 2019), https://www.history.com/topics/us-states/new-york [https://perma.cc/EM8U-AC4Q].

57. Phyfe v. Riley, 15 Wend. 248, 250 (N.Y. Sup. Ct. 1836) ("A mortgage is a mere lien."); *see also* Becker v. McCrea, 86 N.E. 463, 463 (N.Y. 1908).

also one of the original thirteen colonies,[58] stated as early as 1785 that, by act of the legislature: "In Pennsylvania, . . . the land mortgaged never ceases to be a pledge; a legal estate never vests in the mortgagee."[59] Again in 1824, the Pennsylvania Supreme Court stated that: "A mortgage is but a security[] for the payment of the debt."[60] Yet, in an 1870 U.S. Supreme Court case applying Pennsylvania's mortgage law, the Court noted that "courts [of law] have always regarded the legal title to be in the mortgagee until redemption . . . . And such is the law of Pennsylvania."[61]

Jones thought *possession* was the central concept that separated the two theories. He described the title theory as entitling a mortgagee to immediate possession of the mortgaged property, regardless of default.[62] Moreover, even with a provision that granted possession to the mortgagor, once a default occurred the mortgagee was entitled to possession.[63] On the other hand, the lien theory, because it granted only a security right to the mortgagee, did not automatically allow for possession.[64] Absent such agreement, foreclosure was the only method of taking possession from the mortgagor.[65] Jones concluded that "[t]his is the great difference resulting from these different theories."[66] In essence, the difference was *possession*.

Yet, Jones also readily noted that despite this theoretical division, it was possible, in large part, to contract around the barrier. In a title-theory state, a court would enforce an agreement between the mortgagor and mortgagee that allowed the mortgagor to remain in possession.[67] Alternatively, Jones also observed that in a lien-theory state the right to possession could be given to the mortgagee by the mortgagor as long as there was an "express contract."[68] This created the so-called *mortgagee-in-possession*.[69]

58. The English King Charles II signed the Charter of Pennsylvania on March 4, 1681, and it was officially proclaimed on April 2 of that year. *See The Charter: The Story of Pennsylvania's "Birth Certificate*,*"* ST. MUSEUM PA. (Mar. 1, 2016), http://statemuseumpa.org/charter-pennsylvania-birth-certificate/ [https://perma.cc/ALB6-48CK].

59. Dorrow v. Kelly, 1 U.S. (1 Dall.) 142, 143 (Pa. Com. Pl. 1785).

60. Anderson v. Neff, 11 Serg. & Rawle 208, 223 (Pa. 1824).

61. Brobst v. Brock, 77 U.S. 519, 530 (1870). Notably, the Court does not cite any Pennsylvania cases for this proposition. *Id.*

62. JONES, *supra* note 32, at 14.

63. *Id.* at 15.

64. *Id.*

65. *Id.*

66. *Id.*

67. *Id.*

68. *Id.*

69. *See, e.g.*, Seckler v. Delfs, 25 Kan. 159, 165 (1881) (explaining that "[i]n this state a real-estate mortgage conveys no estate or title," but rather "creates only a lien upon the mortgaged property"); Cullen v. Foote, 61 N.W. 818, 819 (Minn. 1895) (allowing such an agreement subsequent to the mortgage being made); Fogarty v. Sawyer, 17 Cal. 589, 589 (1861) ("[California law] takes from the mortgagee all right to the possession, either before or after condition broken, and makes the mortgage

Just as in England, the nature of the mortgage during this early American period was contested. Regardless of freedom of contract, commentators of the nineteenth century viewed the equitable precepts underlying mortgage law as superior. In 1830, the noted American legal scholar and jurist James Kent wrote in his commentaries that the law of "mortgages is one of the most splendid instances in the history of our jurisprudence of the triumph of equitable principles over technical rules" and, in turn, "the homage which those principles have received by their adoption in the courts of law."[70]

4. Essentially Commercial

One unique feature of mortgages remained constant throughout these legal debates taking place among scholars and in the courts during the early period. Early mortgage transactions, both in England and in the United States, were for agricultural and other business-related purposes—in other words, they were essentially commercial in nature.

The earliest written evidence of a mortgage-like device during the Anglo-Saxon period, as described above, was called the *vivum vadium*.[71] The debtor gave possession of the land to the creditor in exchange for a loan of money, and the creditor would obtain repayment from the rents and profits of the land.[72] Only once repayment was made could the debtor demand a return of possession (including through court action).[73] This form of mortgage was favored because it was viewed as a curb against usury and promoted good morals, rather than a mortgage that allowed the debtor to remain in possession and repay out of his or her own funds.[74] Implicit here was that the mortgaged land was income producing. The rents served as the source of repayment of the funds.

Even as the mortgage developed into a device that did not require the mortgagee to take possession, case law evidences that the transactions remained largely, to one degree or another, business-related. In the 1786 case of *Birch v. Wright*,[75] the court noted that "[t]he mortgagee has the right to the actual possession whenever he pleases; he may bring his ejectment at any moment that he will, and he is entitled to the estate as it is, *with all the crops on it*."[76]

a mere lien; *but this section does not prevent the owner from making an independent contract for the possession* . . . ." (emphasis added)).

70. 4 JAMES KENT, COMMENTARIES ON AMERICAN LAW 151–52 (1830).

71. JONES, *supra* note 32, at 3.

72. *Id.*

73. *Id.*

74. 1 GARRARD GLENN, MORTGAGES: DEEDS OF TRUST, AND OTHER SECURITY DEVICES AS TO LAND 9 (1943).

75. 99 Eng. Rep. 1148; 1 T.R. 378.

76. *Id.* at 1152.

The focus on crops here is no surprise because mortgage credit was "widely linked to productivity growth in agriculture."[77] Loans secured by mortgages were used not to buy homes, as is largely the case today, but rather for "either upscaling by creating larger units of arable land, or investments in agricultural techniques, or both."[78] Historian Juliet Gayton explains that certain rural tenant farmers (called copyholders)[79] in 1600s Hampshire, England, borrowed money using their landed interests as collateral in order to take advantage of business opportunities, usually by investing in other pieces of real estate or in equipment.[80] The loaned funds were often also used to refurbish a building or to fund a business venture.[81]

Early mortgage transactions in the United States were similarly agricultural and commercial in nature. Although there is little written about the early American mortgage market, available sources indicate that it was decidedly not residentially focused. Economic historian Jonathan Snowden notes that farm mortgaging was the earliest form of mortgage credit in the United States, growing particularly strong in roughly the 1870s with the explosive growth of farming in the West.[82] Professor Claire Priest has chronicled the agricultural purposes of mortgage loans in connection with the development needs of the Southern planter class, largely through the mortgaging of both staple crops and slaves.[83] In his famed commentaries, Justice Joseph Story notes that the growth in land-based lending during these early decades was in furtherance of colonial pursuits, such as new settlements and plantations.[84] More recently Professor K-Sue Park summed up these historical

77. Chris Briggs & Jaco Zuijderduijn, *Introduction: Mortgages and Annuities in Historical Perspective*, *in* LAND AND CREDIT: MORTGAGES AND ANNUITIES IN THE MEDIEVAL AND EARLY MODERN EUROPEAN COUNTRYSIDE 7 (Chris Briggs & Jaco Zuijderduijn eds., 2018).

78. *Id.*

79. Juliet Gayton, *Mortgages Raised by Rural English Copyhold Tenants 1605–1735*, *in* LAND AND CREDIT: MORTGAGES AND ANNUITIES IN THE MEDIEVAL AND EARLY MODERN EUROPEAN COUNTRYSIDE, *supra* note 77, at 48.

80. *Id.* at 58.

81. *Id.* at 58; *see also* Rowel v. Walley (1662) 21 Eng. Rep. 555; 1 Ch. R. 218 (discussing non-purchase money mortgage); Baylie v. Taylor (1601) 78 Eng. Rep. 1122; Cro. Eliz. 899; Corsellis v. Corsellis (1678) 23 Eng. Rep. 192; Rep. Temp. Finch 351 (discussing property mortgaged in order to pay other preexisting debts).

82. KENNETH A. SNOWDEN, MORTGAGE BANKING IN THE UNITED STATES, 1870–1940, at 3 (2014), https://www.mba.org/news-research-and-resources/research-and-economics/research-institute-for-housing-america/published-reports/2014-2012/mortgage-banking-in-the-united-states-1870-1940 [https://perma.cc/4PEM-6S46].

83. Claire Priest, *Creating an American Property Law: Alienability and Its Limits in American History*, 120 HARV. L. REV. 385, 418 (2006); *see also* CLAIRE PRIEST, CREDIT NATION: PROPERTY LAWS AND INSTITUTIONS IN EARLY AMERICA 15 (2021) [hereinafter PRIEST, CREDIT NATION].

84. *See* 1 JOSEPH STORY, COMMENTARIES ON THE CONSTITUTION OF THE UNITED STATES 128 (1833).

land transactions, and the accompanying development of mortgage law, as being "in the service of English economic expansion."[85]

As some scholars have noted, it is important to observe that even in these most early periods in American history, the mortgage had roots in marginalization. It was used as a tool for subjugation by literally turning people into collateral through the institution of slavery,[86] and later by facilitating a devastating decline in even the meager wealth accumulated by the descendants of its former victims.[87] The mortgage developed in the United States was not only to commodify real property in order to grease the wheels of capital but also to raise capital on the backs of people.[88] These early mortgage loans of the colonial period, set in time at a great distance from the predatory mortgage lending practices of the early 2000s that so extensively devastated marginalized communities, cast a long shadow. Reckoning from its origins in this country, it should be no surprise that the legal device that is the mortgage has never benefited Black individuals, much less broader communities of color. And as noted below, in the wake of the pandemic, it maintains its marginalizing slant even today.

As a more specific example, in 1795, Connecticut sold roughly three million acres it had stolen from the native people living there (the area being called the Connecticut Western Reserve) to a group of investors.[89] The money that was generated from the sale was used to create the Connecticut School Fund, which was used to make mortgage loans in New Haven, with the interest on those loans going to benefit the public schools.[90] Borrowers from the fund, however, constituted the most elite, including a founder of Yale Law School and a U.S. senator.[91] While loan data from the time is scarce, a number of records indicate these funds were used for business investments (such as an 1834 loan to John Calhoun in exchange for the mortgaging of his factory).[92]

85. K-Sue Park, *Money, Mortgages, and the Conquest of America*, 41 LAW & SOC. INQUIRY 1006, 1012 (2016).

86. *See generally* RICHARD HOLCOMBE KILBOURNE, JR., DEBT, INVESTMENT, SLAVES: CREDIT RELATIONS IN EAST FELICIANA PARISH, LOUISIANA, 1825–1885 (2014) (describing the use of enslaved people as mortgaged collateral in antebellum Louisiana).

87. SARAH BURD-SHARPS & REBECCA RASCH, SOC. SCI. RSCH. COUNCIL, IMPACT OF THE US HOUSING CRISIS ON THE RACIAL WEALTH GAP ACROSS GENERATIONS 1–4 (2015), https://www.aclu.org/sites/default/files/field_document/discrimlend_final.pdf [https://perma.cc/Y7S7-BPXU]; *see also* Gilian B. White, *The Recession's Racial Slant*, ATLANTIC (June 24, 2015), https://www.theatlantic.com/business/archive/2015/06/black-recession-housing-race/396725/ [https://perma.cc/2RNE-HYXK (dark archive)].

88. *See* PRIEST, CREDIT NATION, *supra* note 83, at 57–89.

89. Steven J. Kochevar, *The Rise of Institutional Mortgage Lending in Early Nineteenth-Century New Haven*, 124 YALE L.J. 158, 180–81 (2014).

90. *Id.* at 181–82.

91. *Id.* at 183.

92. *Id.*

Investments in more urban areas—such as for new dwellings, jobs, and production facilities—would arise later in the 1890s.[93] However, even as residential mortgage credit grew, it was not robust. In 1890, the percentage of nonfarm homes with a mortgage was only 27.7%.[94] Commercial mortgage debt, on the other hand, comprised about 40% of nonfarm mortgage debt.[95] In sum, during the late nineteenth century, the mortgage transaction was a business affair. And, as such, the law developed to meet largely business-related demands.

B. *The Financialization of Mortgage Credit*

Although much of the foundational concepts in mortgage law were crystalized by the beginning of the 1900s, there would be a sea change in housing finance in the century that followed. And, in numerous ways, these changes in the mortgage finance market would fundamentally upend the vision of mortgage law that had persisted for hundreds of years prior—one that reflected a fairly simple but nonstandardized transaction between two people in a local market that was driven largely by business motives.

1. The Pre-New Deal Market

The period that is generally viewed by scholars as being pivotal in the development of modern U.S. mortgage finance is the New Deal.[96] Before the enactment of the New Deal legislation, the American housing market was largely unrecognizable compared to its current form.[97] Yet, despite what little information is available, Adam Levitin and Susan Wachter marshal the available data to show that the most salient feature from this period was "a substantially lower homeownership rate than today."[98] Only roughly 48% of American households owned their home in 1890[99] compared to 67.4% in

93. SNOWDEN, *supra* note 82, at 52.

94. *Id.* at 54 tbl.17.

95. *Id.* at 53 tbl.16.

96. *See, e.g.*, ADAM J. LEVITIN & SUSAN M. WACHTER, THE GREAT AMERICAN HOUSING BUBBLE: WHAT WENT WRONG AND HOW WE CAN PROTECT OURSELVES IN THE FUTURE 16 (2020). The New Deal was the name given to President Roosevelt's response to the Great Depression. *See generally* WILLIAM E. LEUCHTENBURG, FRANKLIN D. ROOSEVELT AND THE NEW DEAL: 1932–1940 (2009) (providing an overview of the New Deal and its many programs).

97. *See* ALEX F. SCHWARTZ, HOUSING POLICY IN THE UNITED STATES 69–70 (3d ed. 2015); CHRISTOPHER K. ODINET, FORECLOSED: MORTGAGE SERVICING AND THE HIDDEN ARCHITECTURE OF HOMEOWNERSHIP IN AMERICA 65 (2019) [hereinafter ODINET, FORECLOSED]. *See generally* Adam Gordon, *The Creation of Homeownership: How New Deal Changes in Banking Regulation Simultaneously Made Homeownership Accessible to Whites and Out of Reach for Blacks*, 115 YALE L.J. 186 (2005) (explaining how New Deal reforms "transformed homeownership in America").

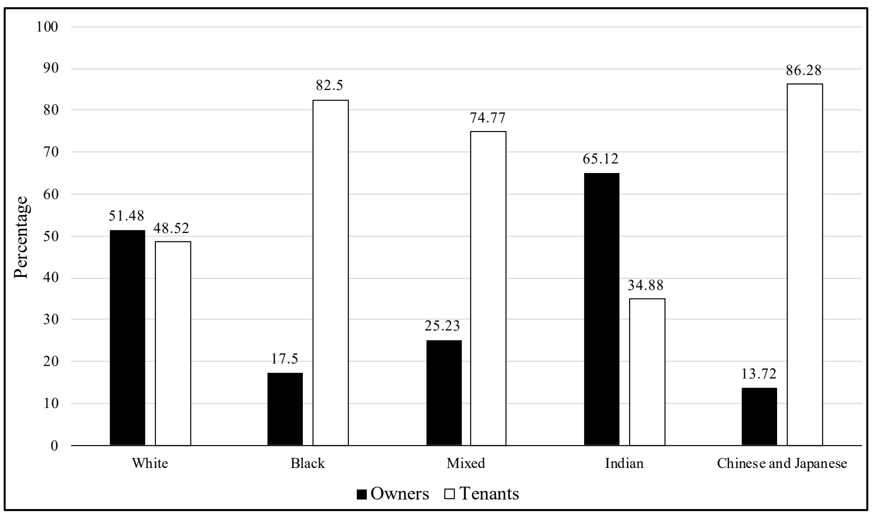
98. LEVITIN & WACHTER, *supra* note 96, at 17.

99. *Id.*

October 2020.[100] Moreover, home ownership rates at the time reflected the fact that the mortgage was designed for white families—racially discriminatory practices that would grow all the more robust in the next century underpinned the development of mortgage law in the United States. The early rates of homeownership bear this out.

Within that 48%, there was great variation. States like Louisiana had a little over 29% homeownership while states like Iowa enjoyed a 63% homeownership rate.[101] White households accounted for 51% of homeowners, while only 17% of Black households owned their homes.[102] Perhaps most importantly, of the 48% of Americans who owned their homes in 1890, only 13% had a mortgage.[103] Figure 1 shows the demographic breakdown between owners and tenants, as expressed in the 1890 census data.[104]

Figure 1. Percentage of Two Classes of Farm and Home Proprietors of All Farm and Home Families by 1890 U.S. Census Demographics



Additionally, not only were homeownership and mortgage loan rates substantially lower than today, the terms of mortgage loans were quite different

100. U.S. CENSUS BUREAU, QUARTERLY RESIDENTIAL VACANCIES AND HOMEOWNERSHIP, THIRD QUARTER 2021, at 1 (2020), https://www.census.gov/housing/hvs/files/currenthvspress.pdf [https://perma.cc/9YPU-HFB9].

101. GEORGE K. HOLMES & JOHN S. LORD, DEP'T OF THE INTERIOR, CENSUS DIV., REPORT ON FARMS AND HOMES: PROPRIETORSHIP AND INDEBTEDNESS IN THE UNITED STATES AT THE ELEVENTH CENSUS: 1890, at 35–36 tbl.14 (1896).

102. *Id.* at 168 diagram 21.

103. LEVITIN & WACHTER, *supra* note 96, at 17.

104. HOLMES & LORD, *supra* note 101, at 168 diagram 21.

as well.[105] Loan terms were five years on average and involved monthly interest-only payments, with a large balloon or bullet payment due at the end of the five-year period.[106] The interest rates on these loans were often adjustable, meaning that they changed over the life of the loan.[107] As most individuals could not pay such a large amount all at once, they would obtain a new loan and refinance the existing one before the balloon became due, thereby rolling over the first loan into a second and eventually into a third and so on.[108]

Down-payment requirements were also quite high, with some lenders requiring 50% equity in the property.[109] As most households could not come up with such a large down payment, a second mortgage loan was often made to aid in reaching the required loan-to-value ratio on the first loan.[110] This of course, in the aggregate of both loans, left the new homeowner with very little—if any—real equity.

One of the most noteworthy aspects of the pre-New Deal mortgage market was who made mortgage loans and how their business models operated. First, mortgage lending, very much like the prevailing vision of mortgage law, was extremely local. Second, the sources of mortgage loan funds were quite different from today. Unlike modern mortgage lending, individuals, such as wealthy persons or private businesses, were often the lenders.[111] Around 1903, about half of all mortgage loans were made by individuals—an occurrence that is virtually unheard of today—with second mortgage loans being seller-financed.[112] And considering that this period coincides with the end of Reconstruction and the beginning of the Jim Crow Era, it is almost certain that Black families were never, or hardly ever, offered these friendly seller-financed terms.[113]

105. LEVITIN & WACHTER, *supra* note 96, at 19–20.

106. *Id.* at 22.

107. *Id.*

108. *See id.* at 19–21; ODINET, FORECLOSED, *supra* note 97, at 66.

109. LEVITIN & WACHTER, *supra* note 96, at 19–21; *see also* Frederiksen, *supra* note 9, at 210 (stating that in some parts of the country the average loan-to-value ratio was between 35–40%).

110. LEVITIN & WACHTER, *supra* note 96, at 21.

111. Frederiksen, *supra* note 9, at 209 ("The resident persons holding mortgages, themselves usually also the mortgagees, form the largest class of mortgage investors, and this fact is essentially characteristic of the American way of making mortgage loans."); *see also* LEVITIN & WACHTER, *supra* note 96, at 23–24.

112. LEVITIN & WACHTER, *supra* note 96, at 24.

113. Mehrsa Baradaran, *Jim Crow Credit*, 9 U.C. IRVINE L. REV. 887, 900 (2019) (describing how New Deal credit reforms "created a wealth-producing credit market for whites and an inescapable debt trap for blacks"); *see also* Shennette Garrett-Scott, *Banking*, *in* THE WORLD OF JIM CROW AMERICA: A DAILY LIFE ENCYCLOPEDIA. 74–76 (Steven A. Reich ed., 2019); Ta-Nehisi Coates, *The Case for Reparations*, ATLANTIC (Jun. 2014), https://www.theatlantic.com/magazine/archive/2014/06/the-case-for-reparations/361631/ [https://perma.cc/D2W6-9S8Q (dark archive)] (chronicling post-Civil War abuses of Black Americans, such as sharecropper abuse).

The other half of mortgage loans were made by institutional lenders, largely consisting of local insurance companies and savings institutions.[114] And as the financial sector was a willing participant in the Jim Crow laws that excluded Black Americans from virtually all paths to economic prosperity, we can easily surmise that these loans were most certainly for white families only.[115] Very little of mortgage lending prior to the New Deal was done by commercial banks and nonbank mortgage lenders—both of which would later come to dominate the market by the beginning of the next century.[116]

The fact that individuals and a number of specialized financial institutions comprised the vast majority of mortgage lenders reinforced the local nature of the market.[117] Individuals tended to only lend funds to borrowers that were located nearby, and the types of institutional lenders mentioned above, due to then-existing legal restrictions on real estate-related lending, were also constrained to local markets.[118]

Lastly and most importantly, the mortgage lending relationship during this period was fairly static. As the legal historian D.M. Frederiksen described, this meant that the vast majority of mortgage lenders held the loans on their own books and awaited repayment[119] (sometimes known as *portfolio lending* because the lender kept its loans in its own portfolio).[120] There was no real secondary mortgage market whereby lenders made loans and then sold them to third parties who would take up the task of collecting from the borrower.[121] This meant that, to quote Levitin and Wachter, "housing was not financialized."[122]

In sum, the limited rate of homeownership and even more limited rate of mortgage lending resulted from the confluence of the limited number of sources

114. LEVITIN & WACHTER, *supra* note 96, at 24–25. A so-called "savings bank" is a type of thrift company that is organized "to promote prosperity of persons of small means and limited opportunities, wherein earnings may be gained on aggregate small deposits, which, after deducting necessary expenses and a reserve for depositors' security, are divided among the depositors." Bulakowski v. Philadelphia Sav. Fund Soc., 113 A. 553, 554 (Pa. 1921). Unlike a private corporation, however, there are stock and stockholders; "it is not a bank in the commercial sense of that word." *Id.* Rather, it is "a charitable society." *Id.*

115. *See generally* BRANDON K. WINFORD, JOHN HERVEY WHEELER, BLACK BANKING, AND THE ECONOMIC STRUGGLE FOR CIVIL RIGHTS (2019) (describing the banking sector during the Jim Crow period).

116. *See* LEVITIN & WACHTER, *supra* note 96, at 24–25; *see also* Frederiksen, *supra* note 9, at 212 (describing the relatively minor role played by mortgage banks during this period).

117. Frederiksen, *supra* note 9, at 208–09; *see also* LEVITIN & WACHTER, *supra* note 96, at 24–25.

118. LEVITIN & WACHTER, *supra* note 96, at 24–25; *see also* Frederiksen, *supra* note 9, at 210 (describing the small capital base of mortgage banks, resulting in them having little money to deploy in making mortgage loans to a large volume of borrowers). National banks at this time were not permitted to engage in any mortgage lending at all. Frederiksen, *supra* note 9, at 225.

119. Frederiksen, *supra* note 9, at 210 (comparing the market for mortgage bonds at the time to that of railroad bonds).

120. *See* ODINET, FORECLOSED, *supra* note 97, at 6.

121. Frederiksen, *supra* note 9, at 221.

122. *See* LEVITIN & WACHTER, *supra* note 96, at 26.

of mortgage lending and the business model whereby lenders kept the loans they made throughout the life of the credit relationship.[123] Lenders were cautious about making loans because they bore the entirety of the risk that a borrower would default.[124] Also, because there was no national market from which to draw mortgage funds, lenders had a limited pool to pull from in the business of further lending money.[125] Individual lenders only had their private funds from which to draw and the few institutional lenders in the market either had a limited number of deposits (in the case of banks) or premiums (in the case of insurance companies) from which to draw—all local.[126] In sum, for borrowers, mortgage lending was "expensive and inconvenient," and for lenders and investors, it involved "considerable expense and trouble."[127]

2. Public Insurance and the Secondary Market

The Great Depression spurred a seismic shift in federal housing finance policy.[128] Along with a general downturn in the financial markets and the broader economy, the Great Depression also brought about a housing crisis.[129] As countless Americans found themselves unemployed, mortgage defaults and sinking housing prices followed.[130] At the time, President Herbert Hoover noted that there were "thousands of heart-breaking instances of the inability of working people to attain renewal of expiring mortgages on favorable terms," which of course resulted in "the consequent loss of their homes."[131] Around 1933, somewhere between 40–50% of all mortgage loans were in default.[132]

In order to combat economic decline, and in an effort to reinvigorate the residential housing and related construction sector, the federal government intervened. The scope of this intervention was massive and would fundamentally change the way mortgage finance operated—everything from the types of loans that were made to the source of those loans and more. And notably, this intervention was for white families struggling to stay in their homes—while not explicit, the structuring of these foundations did and would continue to shut out Black families for decades to come.[133] For our purposes, a

123. Frederiksen, *supra* note 9, at 227–28.

124. *See id.* at 222.

125. *See id.* at 209 ("Under an ideal system of mortgage banking, the capital available for permanent investment would be distributed where most needed. But the actual facts are different, and there is considerable friction impeding the free movement of such capital.").

126. *See id.* at 221 ("[C]apital flows from place to place with great difficulty.").

127. *Id.* at 221, 223.

128. *See* SCHWARTZ, *supra* note 97, at 69–70.

129. *See* ODINET, FORECLOSED, *supra* note 97, at 65–66.

130. *Id.*; LEVITIN & WACHTER, *supra* note 96, at 39.

131. ODINET, FORECLOSED, *supra* note 97, at 66.

132. *Id.*

133. *See generally* MEHRSA BARADARAN, THE COLOR OF MONEY: BLACK BANKS AND THE RACIAL WEALTH GAP (2017) (providing extensive detail of the ways the government and the market

complete retelling is not necessary.[134] Instead, I will focus on the most salient points for the story of how property law—mortgage law to be more specific—started to diverge from mortgage finance.

First, Congress created a funding mechanism for thrift institutions, such as the savings banks mentioned above, through the formation of the Federal Home Loan Bank Board.[135] This helped solve the problem of savings banks having very limited and very tenuous access to funding for the making of new mortgage loans.[136]

Second, the Home Owners' Loan Corporation was created for the purpose of buying defaulted mortgage loans from both institutional and individual mortgage lenders and then restructuring those loans so that they became affordable for homeowners in financial distress.[137]

Third, Congress created the Federal Housing Administration ("FHA"), the purpose of which was to make mortgage loans more liquid.[138] The FHA's job was to provide a guarantee or insurance on mortgage loans.[139] Essentially, if a lender would agree to make a mortgage loan that met certain characteristics, then the federal government would guarantee the repayment of both the principal and interest on the loan.[140] This removed the credit risk for lenders, since the downside of a loan default was someone else's problem.[141]

Perhaps most importantly for our purposes, the FHA's requirement that loans meet certain characteristics in order to participate in the insurance program created a significant amount of standardization where none had existed prior.[142] Loan terms were set at twenty years—much more affordable for homeowners.[143] And interest rates were capped at 5%,[144] where they could be as high as 10% before.[145] Further, the FHA would insure loans of up to 80% and later 97% loan-to-value, which lessened the down payment burden.[146] And lastly, the interest rate would be fixed, and the loan would be fully amortized—

were designed so as to be *for* white borrowers and homeowners); RICHARD ROTHSTEIN, THE COLOR OF LAW: A FORGOTTEN HISTORY OF HOW OUR GOVERNMENT SEGREGATED AMERICA (2017) (describing how government housing policies systematically imposed residential segregation).

134. For a more fulsome explanation, see LEVITIN & WACHTER, *supra* note 96, at 16–80.

135. *Id.* at 42–45.

136. *Id.* at 45.

137. *See id.* at 45–46.

138. *See id.* at 47–49.

139. *See id.* at 47–48; ODINET, FORECLOSED, *supra* note 97, at 66–67.

140. *See* LEVITIN & WACHTER, *supra* note 96, at 47–48; ODINET, FORECLOSED, *supra* note 97, at 66–67.

141. LEVITIN & WACHTER, *supra* note 96, at 49; ODINET, FORECLOSED, *supra* note 97, at 66–67.

142. *See* LEVITIN & WACHTER, *supra* note 96, at 50.

143. *See id.* at 48.

144. *See id.*

145. *See* Frederiksen, *supra* note 9, at 221.

146. *See* LEVITIN & WACHTER, *supra* note 96, at 48.

meaning that the monthly loan payments were the same for the entire term and, upon the final payment, the debt would be satisfied.[147] This was a complete turnaround from the balloon or bullet payments inherent in prior, pre-New Deal mortgage lending.[148] Now the terms of the mortgage loan contract were shifted significantly in favor of the borrower, providing both more time to pay and a more predictable (and lower cost) payment schedule.

Finally, Congress created what would be the first of two government sponsored entities ("GSEs"). The first was the Federal National Mortgage Association, which is known today as Fannie Mae.[149] This was the first step in creating the foundational piece of the mortgage finance market that had been heretofore missing—a national secondary market.[150] Fannie Mae's job was to purchase FHA-insured mortgage loans[151] and then later mortgage loans for discharged servicemembers that were insured by the Veterans Administration ("VA").[152] Now there was a secondary market for government-backed mortgage loans.[153] No longer would a lender need to keep the loan on its own books for the full repayment term. The loan could be made and then sold to Fannie Mae at a discount, thereby refilling the lender's coffers to make more mortgage loans.[154] Because such a large amount of the FHA and VA lending was conducted by nonbank mortgage lenders, Fannie Mae was viewed primarily as a government support program specifically for them.[155]

With the development of FHA insurance and Fannie Mae, nonbank mortgage lenders became a larger part of the lending market.[156] Thrifts, such as savings banks, were designed to make loans to those in a given geographic

147. *See id.*

148. *See id.* at 40.

149. *Id.* at 52–53; David Reiss, *The Federal Government's Implied Guarantee of Fannie Mae and Freddie Mac's Obligations: Uncle Sam Will Pick Up the Tab*, 42 GA. L. REV. 1019, 1029 (2008).

150. LEVITIN & WACHTER, *supra* note 96, at 55.

151. *Id.* at 53.

152. *Id.* at 54; INGRID GOULD ELLEN, JOHN NAPIER TYE & MARK A. WILLIS, N.Y.U. FURMAN CTR. FOR REAL EST. & URB. POL'Y, IMPROVING U.S. HOUSING FINANCE THROUGH REFORM OF FANNIE MAE AND FREDDIE MAC: ASSESSING THE OPTIONS 2 (2010), https://furmancenter.org/files/publications/Improving_US_Housing_Finance_Fannie_Mae_Freddie_Mac_9_8_10.pdf [https://perma.cc/L5RJ-KTRR]. The VA mandate arose in the 1940s. *See* LEVITIN & WACHTER, *supra* note 96, at 54. It should be noted that although the VA loan program did not exclude Black service members, they were largely left out of this program because banks would simply refuse to lend to them, even though the loans would be guaranteed by the federal government. *See* Erin Blakemore, *How the GI Bill's Promise Was Denied to a Million Black WWII Veterans*, HISTORY (Apr. 20, 2021), https://www.history.com/news/gi-bill-black-wwii-veterans-benefits [https://perma.cc/M6DW-78KR].

153. LEVITIN & WACHTER, *supra* note 96, at 55.

154. *See* Reiss, *supra* note 149, at 1023.

155. LEVITIN & WACHTER, *supra* note 96, at 72; Adam J. Levitin & Susan M. Wachter, *The Public Option in Housing Finance*, 46 U.C. DAVIS L. REV. 1111, 1155–57 (2013).

156. *See* LEVITIN & WACHTER, *supra* note 96, at 77.

region.[157] They were also meant to be portfolio lenders, meaning that they made the loan and also kept the loan on their books for the entire repayment period.[158] The business model of nonbank mortgage lenders, on the other hand, was merely to find capital to make mortgage loans and then to sell those loans as soon as possible to someone else.[159] Thus, the FHA insurance program and the secondary market for these loans created by Fannie Mae gave rise to a booming nonbank mortgage lending business.[160]

Later, in response to high interest rates in the late 1960s and early 1970s, Congress created the other GSE: the Federal Home Loan Mortgage Corporation, known as Freddie Mac.[161] Freddie Mac's mission was to purchase mortgage loans that were not FHA- or VA-insured but that still met certain underwriting criteria (often known simply as "conventional loans").[162] This now created another secondary market for mortgage loans more broadly.[163] Importantly, just as Fannie Mae was associated with nonbank mortgage lenders,[164] Freddie Mac was largely meant to help the liquidity needs of the thrift companies.[165] In other words, the savings banks wanted their own Fannie Mae—and they got it.[166] Eventually, Fannie Mae was allowed to purchase conventional loans just as Freddie Mac was,[167] although each entity continued to serve its own interest group of lenders.[168]

3. The Rise of Securitization

The final—and most important—act in the story of how the American mortgage market was forever transformed involves securitization.[169] Before

157. *See id.*

158. *See id.*

159. *See id.*; Arthur E. Wilmarth, Jr., *Too Good To Be True? The Unfulfilled Promises Behind Big Bank Mergers*, 2 STAN. J.L. BUS. & FIN. 1, 56 (1995) (discussing the business model of mortgage companies).

160. LEVITIN & WACHTER, *supra* note 96, at 77.

161. Reiss, *supra* note 149, at 1029; LEVITIN & WACHTER, *supra* note 96, at 72.

162. Reiss, *supra* note 149, at 1029–30; LEVITIN & WACHTER, *supra* note 96, at 72.

163. *See* Reiss, *supra* note 149, at 1029.

164. LEVITIN & WACHTER, *supra* note 96, at 72, 77.

165. *Id.* at 72; *see also* W. SCOTT FRAME, ANDREAS FUSTER, JOSEPH TRACY & JAMES VICKERY, FED. RSRV. BANK OF N.Y., THE RESCUE OF FANNIE MAE AND FREDDIE MAC 6–7 (2015), https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr719.pdf [https://perma.cc/S3L3-GKB5].

166. LEVITIN & WACHTER, *supra* note 96, at 72.

167. *See id.*

168. *See id.*

169. Much has been written about securitization, particularly since the 2008 financial crisis. *See, e.g.*, Kathleen C. Engel & Thomas J. Fitzpatrick IV, *Complexity, Complicity, and Liability up the Securitization Food Chain: Investor and Arranger Exposure to Consumer Claims*, 2 HARV. BUS. L. REV. 345 (2012); Kuhu Parasrampuria, *The Review of Banking & Financial Law's Symposium Papers: Securitization: 10 Years After the Financial Crisis*, 37 REV. BANKING & FIN. L. 755 (2018); Tamar Frankel, *Securitization: The Conflict Between Personal and Market Law (Contract and Property)*, 18 ANN. REV. BANKING L. 197 (1999); Anupam Chander, *Odious Securitization*, 53 EMORY L.J. 923 (2004); Tracy Lewis & Alan

going into the details of how securitization works, it is important to understand the function that it serves. It is, in short, a funding device, and it was created specifically to be a replacement funding device in the mortgage market.[170] The thing it replaced was the very tenuous and often unpredictable funding mechanism that had heretofore dominated the mortgage market—balance sheet funding and commercial borrowing. Commercial banks, thrifts, and insurance companies funded mortgage loans from their own balance sheets—through the deposits and insurance premiums of their customers.[171] The problem with both of these was that they could quickly disappear.[172] Customers could withdraw their funds or change banks, as well as cancel their policies and change insurance companies.[173] Nonbank mortgage lenders relied on loans from commercial banks in order to fund their own mortgage programs.[174] But, if the commercial bank declined to lend, then the nonbank mortgage lender's operations ceased.[175] Securitization was an answer to all these problems.

The first true securitization transaction was undertaken by an as-of-yet-unmentioned government corporation: the Government National Mortgage Association, or Ginnie Mae, as it is more commonly referred.[176] Ginnie Mae was created in 1968 by virtue of the division of Fannie Mae.[177] The aftermath of this bifurcation resulted in the creation of two separate entities. One was a corporation, still called Fannie Mae, that would continue to purchase FHA and

Schwartz, *Unenforceable Securitization Contracts*, 37 YALE J. ON REG. 164 (2020); Jonathan C. Lipson, *Securitization and Social Distance*, 37 REV. BANKING & FIN. L. 827 (2018); Steven L. Schwarcz, *Securitization and Post-Crisis Financial Regulation*, 102 CORNELL L. REV. ONLINE 115 (2016); Erik F. Gerding, *Bank Regulation and Securitization: How the Law Improved Transmission Lines Between Real Estate and Banking Crises*, 50 GA. L. REV. 89 (2015); Thomas E. Plank, *Securitization of Aberrant Contract Receivables*, 89 CHI.-KENT L. REV. 171 (2014); Adam J. Levitin, *The Paper Chase: Securitization, Foreclosure, and the Uncertainty of Mortgage Title*, 63 DUKE L.J. 637 (2013); John Patrick Hunt, *What Do Subprime Securitization Agreements Say About Mortgage Modification?*, 31 YALE J. ON REG. ONLINE 11 (2013); Dov Solomon, *The Rise of a Giant: Securitization and the Global Financial Crisis*, 49 AM. BUS. L.J. 859, 859 (2012); Jonathan C. Lipson, *Re: Defining Securitization*, 85 S. CAL. L. REV. 1229 (2012); Kathleen C. Engel & Patricia A. McCoy, *Turning a Blind Eye: Wall Street Finance of Predatory Lending*, 75 FORDHAM L. REV. 2039 (2007); Christopher K. Odinet, *Securitizing Digital Debts*, 52 ARIZ. ST. L.J. 477 (2020).

170. *See* LEVITIN & WACHTER, *supra* note 96, at 66–67.

171. *Id.*; *see also* Christopher K. Odinet, *Banks, Break-Ins, and Bad Actors in Mortgage Foreclosure*, 83 U. CIN. L. REV. 1155, 1163–65 (2015) [hereinafter, Odinet, *Break-Ins*] (discussing securitization).

172. *See* LEVITIN & WACHTER, *supra* note 96, at 66.

173. *See id.*

174. *Id.* at 42. Liquidity problems for nonbank mortgage originators persist today. *See* You Suk Kim, Steven M. Laufer, Karen Pence, Richard Stanton & Nancy Wallace, *Liquidity Crisis in the Mortgage Market*, BROOKINGS PAPERS ON ECON. ACTIVITY, Spring 2018, at 347, 348.

175. *See* LEVITIN & WACHTER, *supra* note 96, at 65.

176. GINNIE MAE, GINNIE MAE AT 50, at 3, https://www.ginniemae.gov/newsroom/publications/Documents/ginnie_at_50.pdf [https://perma.cc/XU2N-VFVS].

177. *See Our History*, GINNIE MAE, https://www.ginniemae.gov/about_us/who_we_are/pages/our_history.aspx [https://perma.cc/NE5Z-ESHG] [hereinafter GINNIE MAE, *Our History*] (describing the history of Ginnie Mae); *see also* 12 U.S.C. § 1716b.

VA (and eventually conventional) mortgage loans.[178] It was also privatized, such that members of the public could purchase shares of stock in the corporation, although a portion of its board was still appointed by the President of the United States.[179]

The other resulting entity was Ginnie Mae.[180] It was, and remains, a completely government-owned and operated entity within the Department of Housing and Urban Development.[181] Its purpose was to facilitate the transformation of FHA and VA-backed mortgage loans into marketable securities that carried an all-important government guarantee.[182] This would infuse the American mortgage finance market with private capital, as investors would purchase the mortgage-backed securities. For investors, payment on the securities would be guaranteed. If homeowners failed to pay, the federal government would cover the investors' loss.[183]

With some variation, the securitization process works as follows: a lender makes the initial mortgage loan to the borrower.[184] This lender is called the mortgage originator.[185] Not long after the loan is made—sometimes a few weeks or merely a matter of days—the mortgage originator sells the mortgage loan to a third-party called a sponsor or arranger.[186] The sponsor purchases many mortgage loans and then transfers the loans to a subsidiary entity known as a depositor.[187] Importantly, the depositor will have no other assets or liabilities—the mortgage loans are the only things the entity owns.[188] The purpose of this transfer is to remove the loans from the balance sheet of the sponsor. Next, the depositor will transfer the loans to a special purpose entity (typically a trust is

178. LEVITIN & WACHTER, *supra* note 96, at 68–69.

179. *Id.*

180. *See* GINNIE MAE, *Our History*, *supra* note 177.

181. *See* 12 U.S.C. §§ 1717(a)(2), 1723(a).

182. *See* GINNIE MAE, *Our History*, *supra* note 177; *see also Funding Government Lending*, GINNIE MAE, https://www.ginniemae.gov/about_us/who_we_are/Pages/funding_government_lending.aspx [https://perma.cc/P49Q-XWDE] (discussing Ginnie Mae guaranty).

183. LEVITIN & WACHTER, *supra* note 96, at 70. It is worth noting that Ginnie Mae does not actually purchase mortgage loans and sponsor securitizations. *Id.* Instead, Ginnie Mae approves a network of financial institutions that are authorized to sponsor securitizations of FHA- and VA-backed mortgage loans. *Id.* Ginnie Mae's role, aside from certifying the financial institution, is also to attach a federal government guarantee to the mortgage-backed securities that are subsequently issued. *See id.*

184. ODINET, FORECLOSED, *supra* note 97, at 25–27.

185. For a regulatory definition, see 12 C.F.R. § 1007.102 (2020).

186. The sponsor/arranger is sometimes the same entity as, or an affiliate or subsidiary of, the mortgage originator. *See* Levitin, *supra* note 169, at 671–72.

187. ODINET, FORECLOSED, *supra* note 97, at 26.

188. *Id.*

chosen, although not one with typical fiduciary duties[189]).[190] Once the loans are held in trust, with a financial institution appointed as the trustee, the trust will issue securities that are backed by the pool of mortgage loans. Hence the name: mortgage-backed securities.[191] The securities are then sold to, and subsequently traded by, private capital markets investors such as insurance companies, banks, and retirement funds.[192]

These mortgage-backed securities, often called pass-through certificates, entitle their holders to a portion of the monthly payments made by homeowners.[193] The mortgage payments are "passed through" to the investors. While the trustee holds title to the mortgage loans themselves, the owners of the mortgage-backed securities are the beneficial owners because they are entitled to the economic benefits of the loans.[194] Consequently, a homeowner's mortgage payments are no longer direct to the originator.[195] Instead, the trustee, on behalf of the securities holders, employs a third party—the mortgage loan servicer—to collect payments, handle borrower relations, and, most importantly, represent the interests of the securities investors.[196]

Notably, securitization makes mortgage relationships nonbinary. It is not between a mortgagor and a mortgagee. Indeed, the loan itself is hardly distinct, as it is pooled together with many other loans. An investor in a mortgage-backed security has an interest in the payment stream from the pool, not from any particular loan—the borrower has no direct or meaningful connection to this person.[197] Indeed, homeowners almost never interact with the securitization

189. These securitization trustees (also sometimes called indenture trustees) are a different form of trustees of estate planning and have no fiduciary duties but rather only owe those duties detailed in trust agreements. *See* Elliott Assocs. v. J. Henry Schroder Bank & Tr. Co., 838 F.2d 66, 70 (2d Cir. 1988) (finding indenture trustee had no duty to consider financial interests of debenture holders); AG Cap. Funding Partners, L.P. v. State St. Bank & Tr. Co., 896 N.E.2d 61, 66 (N.Y. 2008) (discussing duties of indenture trustee).

190. Levitin, *supra* note 169, at 672; *see also Role of the Trustee in Asset Securitization*, WILMINGTON TR., https://library.wilmingtontrust.com/corporate-institutional/role-of-the-trustee-in-asset-securitization [https://perma.cc/B4TR-DK34] [hereinafter *Role of the Trustee*].

191. *See* ODINET, FORECLOSED, *supra* note 97, at 25. For a description of an issuance of securities backed by Fannie Mae, see FANNIE MAE, GUARANTEED MORTGAGE PASS-THROUGH CERTIFICATES (SINGLE-FAMILY RESIDENTIAL MORTGAGE LOANS) (2020) [hereinafter FANNIE MAE 2020 PROSPECTUS], https://capmrkt.fanniemae.com/syndicated/documents/mbs/mbspros/SF_May_1_2020.pdf [https://perma.cc/X2BK-ANLP].

192. ODINET, FORECLOSED, *supra* note 97, at 26.

193. FANNIE MAE 2020 PROSPECTUS, *supra* note 191, at 6–7.

194. *See Role of the Trustee*, *supra* note 190, at 1–2.

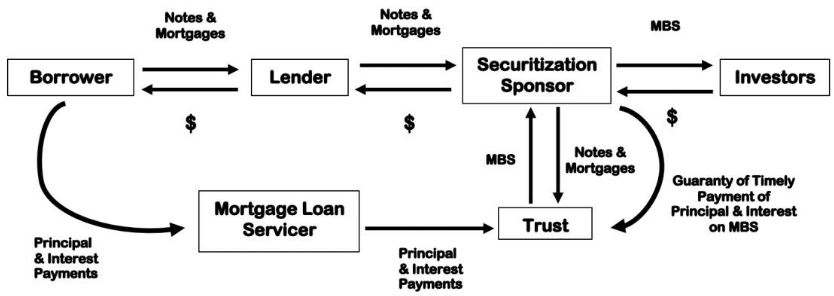
195. ODINET, FORECLOSED, *supra* note 97, at 27.

196. *Id.* at 27, 42; *see also Role of the Trustee*, *supra* note 190, at 1–2 ("The trustee's primary duty is to protect the interests of the investors who purchase the securities issued pursuant to the securitization and administer the duties of the [special purpose vehicle] under the requisite agreements.").

197. *See* Diane E. Thompson, *Foreclosing Modifications: How Servicer Incentives Discourage Loan Modifications*, 86 WASH. L. REV. 755, 764–65 (2011).

trustee, much less the investors themselves.[198] Rather, it is the mortgage servicer[199]—an entity that is chosen for the borrower, who is completely outside the borrower's ability to change, and who works not for the borrower but on behalf of invisible and distant investors—with whom the borrower interacts.[200] Figure 2 below depicts a generic securitization transaction structure.

Figure 2. Securitization Structure Basics



As noted above, the first ever securitization was conducted by Ginnie Mae in February 1970 with a pool of $7.5 million dollars' worth of FHA loans, all originated by the nonbank mortgage lender Tower Mortgage.[201] Very soon after, Freddie Mac and Fannie Mae also became involved in securitizations. First came Freddie Mac, which would purchase non-FHA, non-VA mortgage loans from originators and act as its own securitization sponsor, thereby creating its own trust to hold the loans and issue the mortgage-backed securities.[202] Importantly, Freddie (like Ginnie) would also guarantee payment of principal and interest on the securities sold to its investors.[203] Freddie would also engage a loan servicing company to handle administration of the mortgage loans in the

198. ODINET, FORECLOSED, *supra* note 97, at 26–27.

199. The most prominent definition of a mortgage servicer comes from the Real Estate Settlement Procedures Act, which is codified at 12 U.S.C. § 2601. "The term 'servicer' means the person responsible for servicing of a loan (including the person who makes or holds a loan if such person also services the loan)." *Id.* § 2605(i)(2). Additionally,

> [t]he term "servicing" means receiving any scheduled periodic payments from a borrower pursuant to the terms of any loan, including amounts for escrow accounts described in section 2609 of this title, and making the payments of principal and interest and such other payments with respect to the amounts received from the borrower as may be required pursuant to the terms of the loan.

Id. § 2605(i)(3).

200. ODINET, FORECLOSED, *supra* note 97, at 27.

201. Jonathan Tower, *Ginnie Mae Pool No. 1: A Revolution Is Paid Off*, SEATTLE TIMES, Sept. 19, 1999, at F1.

202. LEVITIN & WACHTER, *supra* note 96, at 73.

203. *Id.*

trust.[204] Faced with rising interest rates in 1981,[205] Fannie Mae also started securitizing the conventional loans that it purchased, accompanied by its own corporate guarantee.[206]

By the 1980s, the transformation of the mortgage market was complete. Moving forward, the notion of a lender that made a loan to a borrower who repaid that loan over a period of time—with the two parties locked into the same, static relationship for years—virtually ended. Now, loans would largely be made, sold, securitized, and then placed under the administration of a servicing company—completely unknown to and not selected by the homeowner. Moreover, that loan servicer could change over time, as the right to service the loan may be sold multiple times. As of the third quarter of 2020, loans that are held by originators (portfolio loans) made up a little less than 20% of all "first lien" mortgage loan originations.[207] On the other hand, nearly 80% of all first mortgage loans are securitized, either by Ginnie Mae or Fannie Mae/Freddie Mac. Thus, today, the vast majority of mortgage loans are financialized and standardized by the dominance of the federal government in the housing market. Figure 3 shows the percentage break-down over time.[208]

204. Paul Volcker, *Guarantee Fees History*, FED. HOUS. FIN. AGENCY (Dec. 14, 2020), https://www.fhfa.gov/PolicyProgramsResearch/Policy/Pages/Guarantee-Fees-History.aspx [https://perma.cc/9NV9-TQMU].

205. *What Led to the High Interest Rates of the 1980s?*, PBS (May 29, 2009, 12:02 PM), https://www.pbs.org/newshour/economy/what-led-to-the-high-interest [https://perma.cc/42E2-HCYQ].

206. LEVITIN & WACHTER, *supra* note 96, at 75.

207. A so-called "first lien mortgage loan" is typically the loan that is first used to purchase the property, and the accompanying mortgage has a first-priority position in terms of the value of the collateral. *See* Adam J. Levitin & Susan M. Wachter, *Second Liens and the Leverage Option*, 68 VAND. L. REV. 1243, 1264 (2015).

208. HOUS. FIN. POL'Y CTR., URB. INST., HOUSING FINANCE AT A GLANCE: A MONTHLY CHARTBOOK 8 (2020), https://www.urban.org/sites/default/files/publication/103273/housing-finance-at-a-glance-a-monthly-chartbook-november-2020_0.pdf [https://perma.cc/L46U-TLZU].

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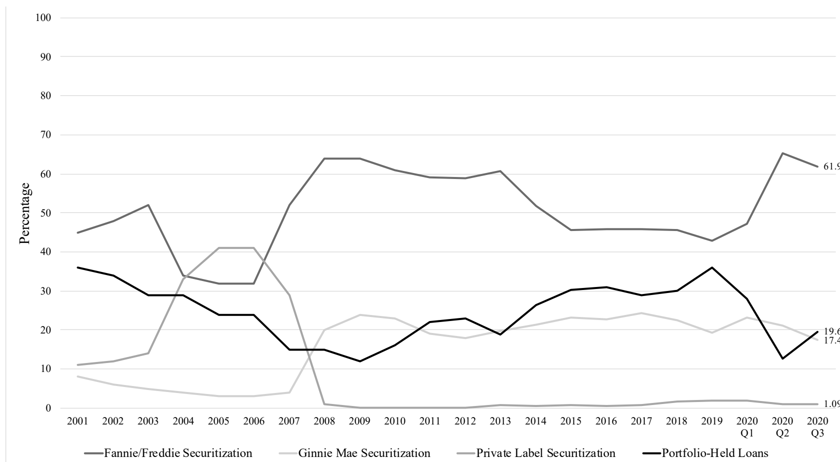
Figure 3. Mortgage Loan Origination Volume & Type by Percentage (2001–Q3:2020)



II. MORTGAGE LAW'S FINANCIALIZATION PROBLEM

As Part I describes, the mortgage transaction looks nothing like it did centuries ago when mortgage law was being formed. In the beginning it was bilateral, local, funded by individuals, commercial and agricultural in purpose, and contractually heterogenous. These historical attributes played a significant role in how mortgage law developed. The rules, norms, and theories of mortgage law that were established and honed over the course of the centuries were in response to the historical transaction, which did not envision in the slightest the many different actors that would eventually form the core of the modern mortgage transaction.

But today's mortgage transaction would be unrecognizable to Osborne, Jones, Glen, Kent, and other early scholars of real property security law. The mortgage transaction is now fueled by a nationwide financial network involving sundry (and distant) financial institutions, government agencies, and secondary market actors. It involves many entities, often unknown and invisible to the borrower, and is dominated by standardized residential mortgage loans.

Because the mortgage transaction looks so different, one would naturally assume that mortgage law has adjusted to account for these differences. Since the assumptions behind these historical rules no longer apply, one would think that the law—through legislatures and through courts—would naturally change to account for new assumptions. Unfortunately, that has not happened. Mortgage law, far from evolving to meet the problems created by the financialization of mortgage loans, remains largely the same, crystalized and immovable since the turn of the twentieth century. In the face of borrower harm and lender misfeasance or outright gross negligence, mortgage law rarely ever rises to the occasion to work justice—or perhaps more aptly, to work equity—between the parties. This part explains these failures.

To frame the discussion that follows, it is important to note that the role played by mortgage servicers is not contemplated by American mortgage law. And, as such, the law often does not provide an adequate remedy when homeowners suffer harms at the hands of servicers.

A. *Multilateral Problems*

The first issue that is often raised by aggrieved homeowners in mortgage litigation deals with what exactly the nature of the relationship between the mortgagor and the mortgagee is. What duties do they owe each other, both with respect to the underlying loan and with respect to the mortgaged property? What complicates this question, as the cases bear out, is the fact that the inquiry is not really about the mortgagor and mortgagee at all. Rather, it is about the mortgagor (homeowner) and the mortgage servicer, which may or may not be the same thing as the mortgagee. As noted above, the servicer acts as an intermediary between the mortgage borrower and the holders of the mortgage-backed securities, through the securitization trustee. As Part I explained, traditional mortgage law conceptualizes the relationship as being bilateral. The historical treatises on mortgage law that guided doctrinal development in this space all speak in terms of the mortgagor's rights and the mortgagee's rights without taking into account the many intermediaries—certainly not loan servicers—that now exist.[209]

1. Servicers as Mortgagees

Before one can explore the relationship question, though, one must determine what loan servicers actually are. These are the firms with whom the borrower contends in all things relative to the mortgage loan—from collecting payments, to answering loan questions, to considering loan modifications and workouts, to conducting foreclosures.[210] Might this make the servicer the mortgagee, as that person is conceived under mortgage law? The term mortgagee has a number of definitions. *Black's Law Dictionary* describes it as "[o]ne to whom property is mortgaged, the mortgage creditor, or lender."[211] The *Restatement (Third) of Property: Mortgages* describes a mortgage as "a conveyance or retention of an interest in real property as security for performance of an obligation."[212] This suggests, then, that the mortgagee is the person who received said conveyance or interest. But it is not clear that the servicer is

209. GLENN, *supra* note 74, at VIII–IX; Jones, *supra* note 32, at XXX–XXXI; 1 FRANCES HILLIARD, THE LAW OF MORTGAGES OF REAL AND PERSONAL PROPERTY xi–xii (4th ed. 1872).

210. *See* ODINET, FORECLOSED, *supra* note 97, at 41.

211. *Mortgagee*, BLACK'S LAW DICTIONARY (11th ed. 2019).

212. § 1.1 (AM. L. INST. 1997).

actually the person to whom the property is mortgaged or to whom the conveyance or interest is given. As the New Hampshire Supreme Court observed when faced with this question in litigation against the mortgage servicing giant Ocwen Financial: "We note . . . that Ocwen is not the mortgagee itself, but the mortgagee's loan servicer."[213]

Recall the securitization process described above. The person to whom the note and mortgage are given is frequently the loan originator, who is titled the "lender" in the standard form documents used by Fannie and Freddie.[214] Sometimes in these form mortgage documents the lender will be listed as one party (the loan originator) and the mortgagee as another party who is "acting solely as a nominee for Lender" (said party being the notorious Mortgage Electronic Registration System, Inc., or simply known as "MERS").[215] This suggests that the mortgagee is one person—MERS—and the lender is another—the loan originating entity. It is uncertain as to whether this is even possible, since the mortgage is attached to the principal obligation that is the debt. Is nominee the same as agent?

But even in these cases, if we were to accept this seeming bifurcation, it is not clear from other sources outside the four-corners of the mortgage contract that MERS actually is a mortgagee. Indeed, Fannie Mae states in its Selling Guide: "Even when MERS is named as the nominee for the beneficiary in the security instrument, it has no beneficial interest in the mortgage."[216]

213. Eldridge v. Ocwen Loan Servicing, LLC, No. 2016-0328, 2017 WL 5983705, at *4 (N.H. Oct. 12, 2017).

214. *See, e.g.*, *Multistate Fixed-Rate Note*, FANNIE MAE, https://singlefamily.fanniemae.com/media/11656/display [https://perma.cc/GMX9-XZ6R]; *see also Iowa Mortgage*, FANNIE MAE, https://singlefamily.fanniemae.com/media/document/doc/iowa-security-instrument-form-3016-word [https://perma.cc/E5N2-33DC] ("Lender is the mortgagee under this Security Instrument."); *New York Mortgage*, FANNIE MAE, https://singlefamily.fanniemae.com/media/document/doc/new-york-security-instrument-form-3033-word [https://perma.cc/J7M7-4D4R] ("I mortgage, grant and convey the Property to Lender subject to the terms of this Security Instrument."); *Florida Mortgage*, FANNIE MAE, https://singlefamily.fanniemae.com/media/document/doc/florida-security-instrument-form-3010-word [https://perma.cc/Z8BU-8Q6Q] ("Lender is the mortgagee under this Security Instrument."); *Texas Deed of Trust*, FANNIE MAE, https://singlefamily.fanniemae.com/media/document/doc/texas-security-instrument-form-3044-word [https://perma.cc/B2P3-Q8SS] ("Lender is the beneficiary under this Security Instrument."); *California Deed of Trust*, FANNIE MAE, https://singlefamily.fanniemae.com/media/document/doc/california-security-instrument-form-3005-word [https://perma.cc/AS2Y-DLGY] ("Lender is the beneficiary under this Security Instrument.").

215. *See, e.g.*, Johnson County, Iowa, Mortgage Loan #8880162028 bk. 6005, at 1 (June 11, 2020) (on file with the North Carolina Law Review); *see also Selling Guide, Chapter B8-7: Mortgage Electronic Registration (MERS)*, FANNIE MAE (Aug. 4, 2021), https://selling-guide.fanniemae.com/Selling-Guide/Origination-thru-Closing/Subpart-B8-Closing-Legal-Documents/Chapter-B8-7-Mortgage-Electronic-Registration-MERS/ [https://perma.cc/93N8-3SZ] [hereinafter *Selling Guide*, *Chapter B8-7*] ("MERS is an electronic system that assists in the tracking of loans, servicing rights, and security interests . . . . A seller/servicer that wants to register a newly originated loan . . . with MERS may prefer to designate MERS as the nominee for the beneficiary in the security instrument.").

216. *Selling Guide, Chapter B8-7*, *supra* note 215.

But if MERS is not the mortgagee, who is? This suggests the "Lender" on whose behalf MERS is the nominee must actually be the mortgagee—with MERS merely being an agent by another name.[217] To add more complication, post-2008 case law has sometimes held that MERS is actually the mortgagee, separate and apart from holding a distinct interest in the underlying debt.[218] Much has been written about the confusing nature of MERS and what this private company actually holds when it is named in mortgages.[219] Even today, the question of who *really* is the mortgagee—and what that even means anymore—remains unclear.

2. Servicers of Servicers

Even if one were able to resolve or otherwise put aside the issue of MERS, this still does not answer the question of what the servicer is and whether it can be deemed the mortgagee. If we take it as truth that the lender (the loan originator) is the mortgagee at the start, then we also know that the loan and mortgage are transferred to a securitization sponsor. They are then transferred to a special purpose entity (a trust) from which the mortgage-backed securities are issued. To better understand what happens at this juncture, I look to the standard securitization documents used by Fannie Mae. As one of the two giants that dominate the residential mortgage market, Fannie's transactional structures are instructive.

Fannie Mae uses a standard Master Trust Agreement that facilitates the pooling of the mortgage loans in the trust, the subsequent issuance of certificates, and the servicing of the loans thereafter.[220] In effectuating a typical securitization, the Master Trust Agreement as of January 1, 2021, states that Fannie Mae "unconditionally, absolutely, and irrevocably . . . conveys to the

217. Deutsche Bank Nat'l Tr. Co. v. Pietranico, 928 N.Y.S.2d 818, 829 (Sup. Ct. 2011), *aff'd*, 102 957 N.Y.S.2d 868 (App. Div. 2013) ("[T]he language of the mortgage appoints MERS as nominee, or agent, for the lender.").

218. *See, e.g.*, Sullivan v. Kondaur Cap. Corp., 7 N.E.3d 1113, 1119 (Mass. App. Ct. 2014); *see also* Shea v. Fed. Nat'l Mortg. Ass'n, 31 N.E.3d 1122, 1124 (Mass. App. Ct. 2015); *Deutsche Bank Nat'l Tr. Co.*, 928 N.Y.S.2d at 829 (confusingly holding that MERS is the agent of the lender and therefore can act on its behalf in enforcing the mortgage and also holding that MERS is the actual holder of the mortgage); Bucci v. Lehman Bros. Bank, FSB, 68 A.3d 1069, 1089 (R.I. 2013) (furnishing a similarly confusing holding by seeming to recognize MERS as the mortgagee as well as the agent of the mortgagee-lender).

219. For a nonexhaustive review of the literature, see Dale A. Whitman, *A Proposal for a National Mortgage Registry: MERS Done Right*, 78 MO. L. REV. 1 (2013); Christopher L. Peterson, *Two Faces: Demystifying the Mortgage Electronic Registration System's Land Title Theory*, 53 WM. & MARY L. REV. 111 (2011); Christopher L. Peterson, *Foreclosure, Subprime Mortgage Lending, and the Mortgage Electronic Registration System*, 78 U. CIN. L. REV. 1359 (2010).

220. *See* FANNIE MAE, GUARANTEED MORTGAGE PASS-THROUGH CERTIFICATES (SINGLE-FAMILY RESIDENTIAL MORTGAGE LOANS) 11, 77 (2021) [hereinafter FANNIE MAE, 2021 PROSPECTUS], https://capmrkt.fanniemae.com/syndicated/documents/mbs/mbspros/SF_January_1_2021.pdf [https://perma.cc/7LS2-HMP8].

Trustee . . . all of [Fannie Mae's] right, title, and interest in and to the Mortgage Loans."[221] If the principle holds true that the mortgage follows the note,[222] then the trustee now holds legal title to the note and is also the mortgagee. Notably, the sponsor of the securitization is Fannie Mae (in its corporate capacity) and the trustee of the securitization is also Fannie Mae (in a separate and limited trustee capacity).[223]

It is Fannie Mae (in its capacity as the securitization sponsor) and the trustee (which is Fannie Mae in a separate capacity), then, who engage the servicer.[224] This relationship springs from a contract that has typically been known as the pooling and servicing agreement or the selling and servicing agreement. However, the engagement of a servicer is not a one-on-one transaction. As the Master Trust Agreement shows, there is yet another layer of complexity within the servicer tier. First, Fannie Mae (a counterparty to itself yet again) is designated as the Master Servicer who must "supervise, monitor and oversee the obligation of the Direct Servicers to service and administer the applicable Mortgage Loans."[225]

Now, to be clear, Fannie does not actually do any real servicing work in its Master Servicer role. Instead, Fannie "contract[s] with the direct servicers to perform servicing functions under [Fannie's] supervision."[226] A Direct Servicer is "responsible, on behalf of and for the benefit of each Trust . . . to service the related Mortgage Loans pursuant to Accepted Servicing Practices."[227] Thus, it is actually the Direct Servicer that borrowers encounter in the course and scope of managing their home loan.[228] Here we introduce the servicing contract—an agreement between the Master Servicer and the Direct Servicer.

To add yet another layer, the Master Servicer or the Direct Servicer may engage one or more subservicers "to provide some or all of the functions" of the

221. FANNIE MAE, SECOND AMENDED AND RESTATED 2016 SINGLE-FAMILY MASTER TRUST AGREEMENT 18 (2021) [hereinafter FANNIE MAE, MASTER TRUST AGREEMENT], https://capitalmarkets.fanniemae.com/media/20531/display [https://perma.cc/9JBA-6TCF].

222. *See* RESTATEMENT (THIRD) OF PROP.: MORTGS. § 5.4 cmt. a (AM. L. INST. 1997) ("When the right of enforcement of the note and the mortgage are split, the note becomes, as a practical matter, unsecured.").

223. FANNIE MAE, MASTER TRUST AGREEMENT, *supra* note 221, at 1.

224. *Id.*

225. *Id.* at 29.

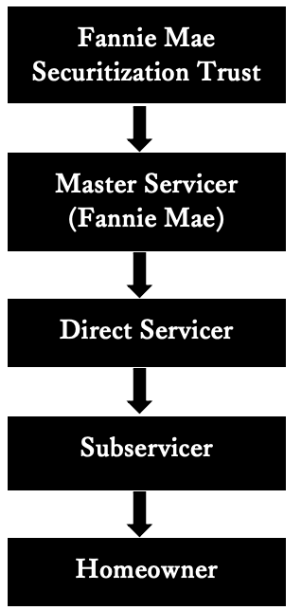
226. FANNIE MAE, 2021 PROSPECTUS, *supra* note 220, at 76.

227. FANNIE MAE, MASTER TRUST AGREEMENT, *supra* note 221, at 29.

228. FANNIE MAE, 2021 PROSPECTUS, *supra* note 220, at 77 ("Duties performed by a direct servicer may include general loan servicing responsibilities, collecting and remitting payments on the mortgage loans, administering mortgage escrow accounts, collecting insurance claims and, if necessary, making servicing advances and foreclosing on defaulted mortgage loans."); *see also id.* at 83 ("The direct servicers collect payments from borrowers and may make servicing advances, foreclose upon defaulted mortgage loans, and take other actions as set forth in the trust documents.").

Direct Servicer.[229] In this case, it is the subservicer with whom the homeowner must contend. And it is not just Fannie Mae securitizations that are like this; Freddie Mac also uses such a multi-tiered servicing structure,[230] as does Ginnie Mae in its securitizations.[231] Figure 4 shows the Fannie Mae multi-party structure.

Figure 4. GSE Single-Family Mortgage-Backed Securitization Servicing Structure



All in all, there is not actually just one loan servicer per securitization. Indeed, there can be many firms that wear the mantle of servicer of one kind or

229. FANNIE MAE, MASTER TRUST AGREEMENT, *supra* note 221, at 14, 29–30.

230. *See* FREDDIE MAC, UMBS AND MBS MASTER TRUST AGREEMENT 9–10 (2019) [hereinafter FREDDIE MAC, MASTER TRUST AGREEMENT], http://www.freddiemac.com/mbs/docs/umbs_mbs_mta_043019.pdf [https://perma.cc/HYF8-H7JR]. Like Fannie Mae, Freddie Mac serves as Administrator (similar to the role of Master Servicer). FREDDIE MAC, OFFERING CIRCULAR FOR UMBS AND MBS 19 (2020), http://www.freddiemac.com/mbs/docs/umbs_mbs_oc_06012021.pdf [https://perma.cc/YR6L-A97W]. This duty entails "entering into contracts with servicers to service the Mortgages, monitoring and overseeing the servicers, ensuring the performance of certain functions if the servicer fails to do so, [and] establishing certain procedures and records for each Pool." *Id.* at 70. Similarly to Fannie Mae, servicers that are employed by Freddie Mac may themselves engage subservicers. *See* FREDDIE MAC, MASTER TRUST AGREEMENT, *supra*, at 9.

231. The issuer of the Ginnie Mae-backed securities serves as the servicer. GINNIE MAE, MASTER SERVICING AGREEMENT 1, https://www.ginniemae.gov/issuers/program_guidelines/FormsLibrary/HUD-11707.pdf [https://perma.cc/UXG3-W4WD]. Subservicers are also used in Ginnie Mae securitizations. *See id.* ("Mortgages are to be serviced, whether by the Issuer or by a subservicer . . . .").

another. How very far mortgage transactions have come from their bilateral origins and the law that developed around them.

B. *Relational Problems*

With so many different kinds of intermediaries forming part of the modern mortgage relationship, the issue now turns to their connectedness. When a consumer-interfacing servicer wrongs a homeowner or otherwise violates the law, who might be liable? How are the parties connected to each other and then, eventually, to the holder of the mortgage loans? This section unpacks these relationships and shows how difficult the current system makes answering these questions under existing law.

1. Agency and Tiering

The securitization transaction documents serve as the starting point. These collectively set forth the relationships that the parties enter into and how they conceive of these connections from the outset.

As described and depicted above, there are different tiers of parties in a typical residential mortgage securitization. It may be that the subservicer, with whom the harmed borrower may have dealt, acted as a servant-agent of the Direct Servicer or of the Master Servicer. In such a case, we would expect that the liability of the servant-agent would be imputed to the master.

Yet, an agency relationship cannot be assumed. Let us look again to Fannie Mae's Master Trust Agreement. It recognizes that a Servicing Contract between a Master Servicer and a Direct Servicer "may include an independent contractor" relationship.[232] We must also assume, in turn, that a contract with a subservicer could also designate an independent contractor relationship. In either case, this designation, combined with the significant autonomy that the Master Trust Agreement gives to the servicers (as indicated in Section II.B.2 below), militates against agency and the accompanying liability.

One theory that might resolve the relationship conundrum is that, at the very least, the Master Servicer is an agent of the trustee. The trustee holds the mortgage loans (and therefore the mortgage rights) and the Master Servicer, through the Direct Servicer, is responsible for managing those loans. In this way, we might say that the Master Servicer is not the mortgagee but acts on behalf of the mortgagee (the trustee). Similarly, we could then say that the Master Servicer is also acting on behalf of the mortgagee *through* the Direct Servicer. And then finally, the subservicer, through this chain, might also be said to be acting on behalf of the mortgagee (trustee).

Agency law states that an essential element of the servant-agent relationship is that the "principal has the right to control the conduct of the

232. FANNIE MAE, MASTER TRUST AGREEMENT, *supra* note 221, at 4.

agent with respect to matters entrusted to him."[233] Indeed, the level of control is significant—"the extent of the right to control the physical acts of the agent" is considered "an important factor in determining whether or not a master-servant relationship between them exists."[234] If there is a master-servant agency relationship, then the "master is subject to liability for injuries caused by the tortious conduct of servants within the scope of their employment."[235] Indeed, "[i]t is well established that traditional vicarious liability rules ordinarily make principals . . . vicariously liable for acts of their agents . . . in the scope of their authority."[236]

This can be compared to the independent contractor relationship, which does not generally create liability for the principal.[237] Courts look to a set of factors, all largely focused on control and autonomy of the individual, in order to gauge whether there exists a master-servant agency relationship on the one hand or an independent contractor relationship on the other.[238]

To try to answer this question, consider again the Fannie Mae securitization structure. Fannie Mae serves as the Master Servicer under the Master Trust Agreement and the loans are "serviced for and on behalf of Holders."[239] However, it can hardly be said that this means the Master Servicer is the servant-agent of the trustee. The agreement provides that the Master Servicer has the "full power and authority to do any and all things which it may deem necessary or appropriate" and it may do these things "in its sole discretion in connection with such master servicing and administration" as long as they are "consistent with Accepted Servicing Practices."[240] This suggests very little actual control by the trustee over the servicer's activities. The only limitations

233. RESTATEMENT (FIRST) OF AGENCY § 14 (AM. L. INST. 1933); *see also* Meyer v. Holley, 537 U.S. 280, 286 (2003) (approving of the restatement approach).

234. RESTATEMENT (FIRST) OF AGENCY § 14 cmt. a (AM. L. INST. 1933).

235. *Id.* § 219(1).

236. *Meyer*, 537 U.S. at 285 (citing Burlington Indus. Inc. v. Ellerth, 524 U.S. 742, 756 (1998)).

237. RESTATEMENT (FIRST) OF AGENCY § 220 cmt. c (AM. L. INST. 1933).

238. *Id.* § 220(2) ("In determining whether one acting for another is a servant or an independent contractor, the following matters of fact, among others, are considered: (a) the extent of control which, by the agreement, the master may exercise over the details of the work; (b) whether or not the one employed is engaged in a distinct occupation or business; (c) the kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the employer or by a specialist without supervision; (d) the skill required in the particular occupation; (e) whether the employer or the workman supplies the instrumentalities, tools, and the place of work for the person doing the work; (f) the length of time for which the person is employed; (g) the method of payment, whether by the time or by the job; (h) whether or not the work is a part of the regular business of the employer; and (i) whether or not the parties believe they are creating the relationship of master and servant."); *see, e.g.*, Duffy v. Harden, 179 N.W.2d 496, 502 (Iowa 1970); Martin v. State Farm Mut. Auto. Ins. Co., 108 So. 2d 21, 23–24 (La. Ct. App. 1958); Cooper v. Asheville Citizen-Times Publ'g Co., 258 N.C. 578, 587, 129 S.E.2d 107, 113–14 (1963); Keith v. Mid-Continent Petroleum Corp., 272 P.2d 371, 376 (Okla. 1954).

239. FANNIE MAE, MASTER TRUST AGREEMENT, *supra* note 221, at 29.

240. *Id.*

are those contained in the Accepted Servicing Practices, which are, as defined, any specific rules set forth in the Master Trust Agreement or a servicing contract or, vaguely, "the customary servicing practices" that are observed by "prudent servicers in servicing and administering mortgage loans similar to the Mortgage Loans for their own accounts."[241]

To be sure, the Master Trust Agreement does assign certain, more specific responsibilities to the Master Servicer, but even those provisions leave much up to the Master Servicer's discretion. For example, the Master Servicer can decide which loss mitigation agreements (like a loan forbearance or modification) are appropriate for a borrower[242] and can "adopt and modify its policies and procedures regarding the custody of Mortgage Documents."[243] In sum, there are specific duties indicated but servicers are given wide berth in determining how they are met.

Next take the relationship between the Master Servicer and a Direct Servicer. As noted above, the Master Trust Agreement states that a Direct Servicer may be "an independent contractor of the Master Servicer," although in two other places the agreement also leaves open the possibility that the Direct Servicer may actually be an agent of the Master Servicer.[244] The Freddie Mac Master Trust Agreement also leaves open the question of whether servicers employed by Freddie Mac (in its role as Administrator, which is another way of saying master servicer)[245] are servant-agents or independent contractors.[246] And, there as well, the relationship between Freddie Mac as Administrator and the securitization trustee leaves much up to the discretion of the administrator.[247] In its servicing capacity, Freddie Mac has the "full power and authority to do or cause to be done any and all things in connection with such servicing and administration that the Administrator deems necessary or

241. *Id.* at 2.

242. *Id.* at 9.

243. *Id.* at 28.

244. *Id.* at 19 ("[N]either Fannie Mae (in any of its corporate capacities) nor the Trustee will, directly or indirectly (by causing or permitting a Direct Servicer, a Custodian *or other agent or independent contractor to do so*), assign, sell, dispose of or transfer all or any portion of or interest in the Trust Fund . . . ." (emphasis added)); *id.* at 38 ("Prior to the removal of the REO Property from the Trust pursuant to Section 2.5, the Master Servicer will, *either itself or through an agent or independent contractor (which may be the Direct Servicer)*, manage, conserve, protect and operate the REO Property." (emphasis added)).

245. *See* FREDDIE MAC, MASTER TRUST AGREEMENT, *supra* note 230, at 9.

246. *Id.* ("In performing its servicing responsibilities hereunder, the Administrator may engage servicers, subservicers and other independent contractors or agents."); *see also id.* at 10 (making a similar statement).

247. *Id.* at 9 ("[T]he Administrator shall service or supervise servicing of the related Mortgages and administer, on behalf of the Trustee, in accordance with the provisions of the Guide and this Agreement . . . ."). Notably, like with Fannie Mae, Freddie Mac also serves as trustee in a separate capacity from its role as securitization sponsor and its role as administrator (which is to say, Master Servicer). *Id.*

desirable."[248] And as with Fannie, these obligations are then passed to a Direct Servicer, and so on.

2. Agency and RESPA/TILA Claims

In light of these ill-defined layers, it is no surprise that plaintiffs have a difficult time pleading the necessary facts to establish an agency relationship in mortgage servicing litigation. The securitization structure is so opaque and does not map on to traditional bilateral lending relationships.[249] Courts have generated conflicting and often confusing decisions on the matter.[250] The vast majority of these cases arise in the context of claims made under either the Truth in Lending Act[251] ("TILA") or the Real Estate Settlement Procedures Act[252] ("RESPA"). Both statutes form the bedrock of federal law governing mortgage lending, and both impose various duties on mortgage servicers and sometimes securitization trustees.

The general trend in TILA is to accept agency liability. Most courts have held that, despite the lack of an explicit provision on vicarious liability in TILA, if a servicer fails to meet its statutory obligations, then the owner of the loan itself can be held vicariously liable as the master.[253] The theory under this line of cases is that if the owner of the loan cannot be held liable for the servicer's failure, then the homeowner is essentially left without a remedy.[254] Therefore, "it would seem that . . . there is fair chance Congress intended vicarious liability

248. *Id.*

249. *See, e.g.*, Christiana Tr. v. Riddle, 911 F.3d 799, 804 (5th Cir. 2018) (holding that there is no agency relationship between banks and their servicers because a servicer's duties are defined by statute, not by the bank).

250. *See* Dupuis v. Fed. Home Loan Mortg. Corp., 879 F. Supp. 139, 143 (D. Me. 1995) (finding an agency relationship between Freddie Mac and its servicer); LaSalle Bank Nat'l Ass'n v. Citicorp Real Est., Inc., No. 02 CIV. 7868(HB), 2003 WL 21671812, at *3 (S.D.N.Y. July 16, 2003) (finding no agency relationship between a servicer and the trustee of a loan securitization trust).

251. Truth in Lending Act of 1968, Pub. L. No. 90-321, 82 Stat. 146 (codified as amended at 15 U.S.C. §§ 1601–1667f). This statute was enacted to make the opaque process of obtaining a mortgage loan more readily understandable for borrowers, as well as to make it illegal for real estate professionals (like realtors and appraisers) to drive up the cost of borrowing with kickbacks and referral fees. *See* ODINET, FORECLOSED, *supra* note 97, at 111–13.

252. Real Estate Settlement Procedures Act of 1974, Pub. L. No. 93-533, 88 Stat. 1724 (codified as amended at 12 U.S.C. §§ 2601–2617). RESPA was passed with the goal of imposing disclosure requirements, as well as some substantive term regulation, to credit transactions broadly—not just mortgages. *See* ODINET, FORECLOSED, *supra* note 97, at 111–12.

253. *See* Consumer Sols. REO, LLC v. Hillery, No. C-08-4357, 2010 WL 144988, at *3 (N.D. Cal. Jan. 8, 2010), *adhered to on reconsideration*, No. C-08-4357, 2010 WL 334417, at *3 (N.D. Cal. Jan. 28, 2010); Kissinger v. Wells Fargo Bank, 888 F. Supp. 2d 1309, 1315 (S.D. Fla. 2012); Rinegard-Guirma v. Bank of Am., No. 10-cv-01065-PK, 2012 WL 1110071, at *8–9 (D. Or. Apr. 2, 2012).

254. *See* Khan v. Bank of N.Y. Mellon, 849 F. Supp. 2d 1377, 1382 (S.D. Fla. 2012) ("[T]he Court is persuaded that Congress meant to extend agency principles to creditors."); *Rinegard-Guirma*, 2012 WL 1110071, at *9.

to obtain."[255] But even in these cases where courts hold that agency liability is possible for certain TILA violations, many fail to furnish the actual analysis and state whether an agency relationship exists.[256]

At least one court, however, has held the opposite. In *Holcomb v. Federal Home Loan Mortgage Corp.*,[257] the borrowers obtained a home loan from AFS Financial in 2007, which was then sold to Freddie Mac and came to be serviced by Wells Fargo.[258] In response to a later foreclosure action, the borrowers raised a TILA violation, claiming that the original loan documents underreported the amount of fees and expenses FSI Financial initially charged.[259] Additionally, Wells Fargo failed to respond to subsequent notices and requests for information, as is required under TILA. As part of their case, the borrowers sought to hold Freddie Mac[260] liable as the owner of the loan by virtue of Wells Fargo being an agent-servant.[261] However, rather than the decision turning on whether there was an agency relationship under the traditional restatement analysis, the court held that the language of TILA suggested Congress meant "not . . . to apply agency principles to TILA."[262] The rationale was that because TILA imposed the duty to respond to such requests on *servicers*, Congress must have meant to preclude liability for anyone else.[263]

Conversely, the trend among RESPA cases is to reject vicarious liability. In the 2018 case of *Christiana Trust v. Riddle*,[264] Mary Sue Riddle took out a home equity loan with Bank of America in 2006.[265] The loan was later securitized and held by Christiana Trust, which then engaged Ocwen Loan Servicing, LLC as the mortgage servicer (with the servicing being later transferred to BSI Financial Services).[266] At some point, Riddle was unable to make her scheduled payments and submitted a loss mitigation application to

255. *Hillery*, 2010 WL 144988, at *3.

256. *See, e.g.*, *Khan*, 849 F. Supp. 2d at 1382 ("Accordingly, the Court rejects Defendant's position that it cannot be vicariously liable for damages under § 1641(a) . . . ."); *cf.* Davis v. Greenpoint Mortg. Funding, Inc., No. 09-CV-2719-CC-LTW, 2011 WL 7070221, at *6 (N.D. Ga. Mar. 1, 2011) (holding that the typical act of servicing a mortgage loan results in an agency relationship), *report and recommendation adopted in part, rejected in part*, No. 09-CV-2719-CC-LTW, 2011 WL 7070222, at *6 (N.D. Ga. Sept. 19, 2011).

257. No. 10-81186-CIV, 2011 WL 5080324, at *1 (S.D. Fla. Oct. 26, 2011).

258. *Id.* at *1.

259. *Id.*

260. In this case, the loan appeared not to have been securitized but rather was still held on the books of Freddie Mac. *Id.*

261. *See* Amended Complaint at 14, Holcomb v. Fed. Home Loan Mortg. Corp., 2011 WL 5080324 (S.D. Fla. Oct. 26, 2011) (No. 10–81186–CIV) ("[T]he Defendant, Freddie Mac, is liable for its agent and servicer, Wells Fargo . . . .").

262. *Holcomb*, 2011 WL 5080324, at *6 (citing 15 U.S.C. § 1641(g)).

263. *Id.*

264. 911 F.3d 799 (5th Cir. 2018).

265. *Id.* at 801.

266. *Id.*

both Ocwen and BSI in order to see if she could find a way to remain in her home.[267] When a foreclosure suit was commenced, she counterclaimed based on a violation of RESPA—specifically the provision that requires servicers to evaluate such applications within a set window of time.[268] Part of Riddle's claim was against Bank of America, arguing that Ocwen and BSI were the bank's agents.[269] The court held that because RESPA imposes the obligation specifically on *servicers*,[270] then Congress must have meant to avoid "the incorporation of traditional vicarious liability rules."[271] Although this case did not allege an agency relationship between the servicer and the trust, it is instructive as to how courts view the independent nature of servicers. Other cases have indeed directly addressed the trustee-servicer relationship for RESPA claims and similarly rejected agency liability.[272] For example, in the earlier 2015 case of *Bennett v. Nationstar Mortgage*,[273] the plaintiff brought an action against his mortgage servicer, Nationstar Mortgage, and against Bank of New York Mellon, as trustee for the securitization pool, claiming that the servicer's RESPA violation should be imputed to the trustee.[274] Similar to *Riddle*, however, the court rejected the claim, stating that only servicers could be liable for RESPA violations.[275]

Indeed, only one case appears to have held that vicarious liability *is* available for RESPA violations. In *Rouleau v. US Bank, N.A.*,[276] the court was faced with a claim of RESPA liability on the part of the loan servicer and whether such liability could be imputed to the trust.[277] Here, rather than in the other cases, the court observed that merely because RESPA used the word "servicer" to impart the duty did not mean that Congress intended to nullify agency claims.[278] Rather, "when Congress creates a tort action, it legislates against a legal background of ordinary tort-related vicarious liability rules."[279] Thus, if the servicer is an agent of the trust, and the servicer committed a

267. *Id.* at 803.
268. *Id.*
269. *Id.* at 802.
270. 12 U.S.C. § 2605(f), (k)(1)(E).
271. *Christiana Tr.*, 911 F.3d at 805.
272. *See, e.g.*, Hawk v. Carrington Mortg. Servs., LLC, No. 14-CV-1044, 2016 WL 4433665, at *2 (M.D. Pa. Aug. 17, 2016) ("There is nothing in the language of RESPA that may be read to extend statutory liability to the passive mortgage holder, however salutary such a provision might be had it been included in the Act.").
273. No. CA 15-00165-KD-C, 2015 WL 5294321 (S.D. Ala. Sept. 8, 2015).
274. *Id.* at *3.
275. *See id.* at *10.
276. No. 14-cv-568-JL, 2015 WL 1757104 (D.N.H. Apr. 17, 2015).
277. *Id.* at *6.
278. *Id.* at *7.
279. *Id.* at *7 (quoting Meyer v. Holley, 537 U.S. 280, 285 (2003)).

RESPA violation, then, so the court reasoned, that liability can be imputed to the trust.[280]

In all of these cases, courts sidestep a true analysis of the relationship between the parties—between trustee and servicer and between servicer and subservicers. Indeed, sometimes it seems that the reason for this is due to the fact that courts themselves are unsure how the parties relate to each other and where the true property rights—the rights in the loan and the mortgage on the real estate—actually reside.

3. Agency and the *Merrill* Doctrine

Lastly, even where an agency relationship is found such that vicarious liability for the wrongful acts of the servicer can be imputed to the owner of the loan as principal, courts have created a significant barrier in actually obtaining recovery in certain instances involving government principals. This barrier is known as the *Merrill* doctrine.

The doctrine finds its origins in a 1947 case where the Supreme Court was asked whether the Federal Crop Insurance Corporation could be held liable for the negligent acts of its private, county-level processing contractor, the Agricultural Conservation Committee.[281] In that case, farmers had nominally obtained crop insurance from the federal corporation through the county committee, but the county committee had failed to forward along certain disqualifying information about the application.[282] When the farmers made a subsequent claim for crop losses, the federal corporation denied their claim on the basis of their lack of qualifications to participate in the insurance program.[283] When the farmers sued the Federal Crop Insurance Corporation, the Court held that "anyone entering into an arrangement with the Government takes the risk of having accurately ascertained that he who purports to act for the Government stays within the bounds of his authority."[284] In short: "the federal government cannot be bound by the unauthorized acts of its agents."[285] The basis for the rule is that because the federal government engages in such a wide array of activities—either through executive agencies or defined corporations—it is inevitable that its representatives will from time to time "err in interpreting statutes and regulations."[286] In support of the *Merrill* doctrine, one federal

280. *Id.* at *7.

281. Fed. Crop Ins. Corp. v. Merrill, 332 U.S. 380, 382 (1947); *see also* Heckler v. Cmty. Health Servs. of Crawford Cnty., Inc., 467 U.S. 51, 67 (1984) (approving of *Merrill*); Schweiker v. Hansen, 450 U.S. 785, 788 (1981) (per curiam) (same).

282. *Merrill*, 332 U.S. at 382.

283. *Id.*

284. *Id.* at 384.

285. Faiella v. Fed. Nat'l Mortg. Ass'n, 928 F.3d 141, 147 (1st Cir. 2019).

286. Wagner v. Dir., FEMA, 847 F.2d 515, 519 (9th Cir. 1988) (citing United States v. Kirkpatrick, 22 U.S. (9 Wheat.) 720, 735 (1824)).

circuit court observed that "[t]he government could scarcely function if it were bound by its employees' unauthorized representations."[287]

In service of these notions of protecting the public fisc, courts have extended the *Merrill* doctrine to shield both Fannie Mae and Freddie Mac from vicarious liability stemming from the wrongful acts of their mortgage loan servicers. In *Mendrala v. Crown Mortgage Co.*,[288] commercial borrowers brought an action against their loan servicer and Freddie Mac on account of the refusal of the loan servicer, Crown Mortgage Company, to accept prepayment on the loan.[289] While the court found that Freddie Mac was not entitled to protection from tort suits under the Federal Tort Claims Act (because Freddie Mac is not a "federal agency"), the court did hold that Freddie Mac was a "federal instrumentality" for purposes of the *Merrill* doctrine.[290] The court reasoned that holding Freddie Mac "responsible for the unauthorized actions of an entity such as Crown would thwart its congressional purpose" of maintaining "the secondary mortgage market and assist[ing] in meeting low- and moderate-income housing goals."[291]

Similarly, in the 2019 case of *Faiella v. Federal National Mortgage Ass'n*,[292] a homeowner brought an action against Fannie Mae, claiming that the corporation was liable for the negligent misrepresentations and deceptive acts of its loan servicer in connection with a mortgage foreclosure.[293] In that case, the court pointed to *Mendrala* and reasoned that "Freddie Mac and Fannie Mae are siblings under the skin."[294] As such, the *Faiella* court concluded that Fannie Mae was also "a federal instrumentality for purposes of the *Merrill* doctrine and, thus, cannot be held liable for the unauthorized acts of its agents."[295]

C. *Possessory Problems*

The next significant issue between servicers and homeowners deals with possession. As noted in Part I, the right to possession casts a long shadow over the rights of mortgagor and mortgagee. Indeed, some of the most noted commentators of mortgage law observe that the right to possession is the defining feature of the mortgage device, particularly when it comes to separating the two theories. Yet, as this section explains, the nature and extent of the right to possession related to a mortgage and how it interacts with mortgage theory and traditional rights of ownership are anything but certain.

287. Goldberg v. Weinberger, 546 F.2d 477, 481 (2d Cir. 1976).
288. 955 F.2d 1132 (7th Cir. 1992).
289. *Id.* at 1133.
290. *Id.* at 1139.
291. *Id.* at 1140–41.
292. 928 F.3d 141 (1st Cir. 2019).
293. *Id.* at 144.
294. *Id.* at 148–49.
295. *Id.* at 149.

1. Possession by Contract

First, we look to the mortgage contract. The standard Fannie Mae/Freddie Mac mortgage contract contains three key provisions that deal with possession. Section Six states that the borrower "will occupy the Property and use the Property as my principal residence within 60 days after I sign this Security Instrument" and will continue to do so for one year thereafter.[296] After the one-year period (or with the Lender's consent) the borrower need not use the property as the primary residence, but it is implicit that the borrower maintains the right to otherwise possess the real estate. As noted in Part I, in some states, the borrower's right to possess would be automatic, even without this provision (in the lien-theory states). In the title-theory states, a contractual agreement like this would be necessary in order for the mortgagee to take possession.

However, the owner's right to possession is significantly curtailed by two other provisions. First, Section Seven provides that the "Lender, and others authorized by Lender, may enter on and inspect the Property" provided it is done "in a reasonable manner and at reasonable times."[297] Moreover, provided the purpose for doing so is reasonable, the "Lender may inspect the inside of the home . . . ."[298] All that is required for the interior inspection is notice providing the reason, which can be given "[b]efore or at the time of an inspection."[299] Importantly, this right—which many homeowners would likely find surprising—exists in favor of the lender even if the borrower has been timely in making scheduled payments.

Last and most importantly, Section Nine provides that if the borrower fails to fulfill any promise in the agreement (not merely making payment timely) or if the property is ever abandoned, then the lender can broadly "do and pay for whatever is reasonable or appropriate to protect Lender's interest."[300] This is followed by a lengthy list of actions, ranging from "securing and/or repairing the Property" to entering the Property "to make repairs, change locks . . . have utilities turned on or off, and *take any other action to secure the Property*."[301] Lastly, all of this can occur without any kind of notice and the term abandonment is not defined.[302]

These provisions, which are couched in terms of reasonableness and fair notice, have often created disastrous results for homeowners when put into action. And, because of this, litigation over possession between servicers and

296. *New York Mortgage*, *supra* note 214.
297. *Id.* at 9.
298. *Id.*
299. *Id.*
300. *Id.* at 10.
301. *Id.* (emphasis added).
302. *See id.* at 9–10 (including no notice requirement); *id.* at 1–2 (lacking a definition of "abandonment").

homeowners has been some of the highest profile in post-2008 foreclosure disputes.[303] Yet, as with so many aspects of mortgage law, homeowners often lack the tools to effectively defend themselves in these cases. And this is all the truer through the lens of race. As Professor Sara Sternberg Greene has observed, Black individuals were much less likely to seek or even consider obtaining the services of a lawyer to solve their legal problems, compared to their white counterparts.[304] In a study from the mid-1990s, the American Bar Association found that although nearly half of all low-income families (of which communities of color comprise a significant portion relative to their incidence in the population)[305] who were surveyed reported having problems that required legal services to solve, only about 25% of them actually sought legal advice.[306] Thus, as the fall-out from the financial crisis unfolded and foreclosure filing piled up in courts across the country, Black homeowners in financial distress were far more likely to face servicer misbehavior alone.

A fact scenario that has become all too common in this litigation involves a homeowner falling behind on payments and beginning to communicate with the mortgage servicer about loss mitigation options. However, at the same time, a different department within the servicing company will initiate a work order to a third-party property contractor—a business that belongs to the so-called mortgage field services industry.[307] This contractor (usually a regional company like Safeguard Properties)[308] then engages a local subcontractor to actually travel to the property and conduct the work. The purpose of this visit—which is ultimately at the behest of the servicer—is to discern whether the property is being damaged and/or if it has been abandoned. All too often, however, contractors wrongfully determine that the homeowner has abandoned the

303. Andrew Martin, *In a Sign of Foreclosure Flaws, Suits Claim Break-Ins by Banks*, N.Y. TIMES (Dec. 21, 2010), https://www.nytimes.com/2010/12/22/business/22lockout.html [https://perma.cc/2HG5-UAR2 (dark archive)]; Gwendolyn Bounds, *For This Niche Industry, Foreclosures Bring a Boom*, WALL ST. J. (Feb. 19, 2008, 11:59 PM), https://www.wsj.com/articles/SB120338279213675763 [https://perma.cc/6CCG-A948 (staff-uploaded, dark archive)]; Brady Dennis, *Good Business for Bad Times: Mortgage Field Services*, WASH. POST (Oct. 29, 2011), https://www.washingtonpost.com/business/good-business-for-bad-times-mortgage-field-services/2011/10/24/gIQA2FTlPM_story.html [https://perma.cc/2UM7-LWMP (staff-uploaded, dark archive)]; *see also* Odinet, *Break-Ins*, *supra* note 171, at 1186–95.

304. Sara Sternberg Greene, *Race, Class, and Access to Civil Justice*, 101 IOWA L. REV. 1263, 1268 (2016).

305. *Poverty in America Continues To Affect People of Colour Most*, ECONOMIST (Sept. 26, 2019), https://www.economist.com/special-report/2019/09/26/poverty-in-america-continues-to-affect-people-of-colour-most [https://perma.cc/9LRM-PEM4 (dark archive)].

306. Greene, *supra* note 304, at 1265.

307. *See, e.g.*, Hill v. Wells Fargo Bank, N.A., No. 12 C 7240, 2015 WL 232127, at *2 (N.D. Ill. Jan. 16, 2015).

308. *See* Ben Hallman, *Safeguard Properties Internal Documents Reveal Rampant Complaints of Thefts, Break-Ins*, HUFFINGTON POST (Apr. 29, 2013), https://www.huffpost.com/entry/safeguard-properties-complaints_n_3165191 [https://perma.cc/G4YJ-8CCC].

premises[309] and then begin to conduct aggressive property preservation activities, such as boarding up the windows, padlocking the doors, turning off the utilities, and, in some cases, cleaning out the personal effects within the home.[310] According to reports, these preservation activities have included the tossing out of family photos, electronics, heirlooms, jewelry, children's toys, and even an urn containing funeral remains.[311] In a number of cases, the homeowner was merely away for a week or so, or even at work.[312]

2. Homeowner Litigation Victories

Sometimes homeowners are successful in cases where they seek to defend themselves against abuse by their servicer's property contractor.[313] The Washington Supreme Court's 2016 decision in *Jordan v. Nationstar Mortgage*[314] provides the best, although unfortunately one of the few, examples. In that case, the court held that although provisions like Sections Seven and Nine of the standard mortgage contract are not strictly prohibited under state law: "Washington law prohibits lenders from taking possession of the borrower's property before foreclosure."[315] And, because of this, "the [mortgage] provisions are in conflict with state law" and "are unenforceable."[316] Unsurprisingly,

309. *See* ODINET, FORECLOSED, *supra* note 97, at 97–103; *see also* Ben Hallman, *To Clean Up Foreclosure Mess, Banks Rely on Little-Known Industry Plagued by Fraud*, *Abuse*, HUFFINGTON POST (Apr. 3, 2013), www.huffingtonpost.com/2013/04/03/foreclosure-bank-fraud-abuse_n_2999790.html [https://perma.cc/X2XW-XY96] (noting that one subcontractor interviewed stated: "I have gone to inspect properties reported as vacant that were still occupied. This happens too often").

310. *See* Jessica Silver-Greenberg, *Invasive Foreclosure Tactic Draws Scrutiny*, N.Y. TIMES (Sept. 9, 2013), https://dealbook.nytimes.com/2013/09/09/invasive-tactic-in-foreclosures-draws-scrutiny/ [https://perma.cc/VUA7-KUJF].

311. *See* Ben Hallman, *Bank Contractors Break Into Occupied Homes, Terrify Residents, Lawsuits Say*, HUFFINGTON POST (July 19, 2012), https://www.huffpost.com/entry/bank-contractors-break-ins_n_1682672 [https://perma.cc/MS77-SBD5]; Sarah Buduson, *Investigation: Homeowners Complain Safeguard Properties Damaged Their Homes, Trashed the Belongings*, NEWS5 CLEVELAND (Dec. 11, 2013), https://web.archive.org/web/20170615080504/www.news5cleveland.com/news/local-news/investigations/investigation-homeowners-complain-safeguard-properties-damaged-their-homes-trashed-the-belongings [https://perma.cc/38B6-LVKK]; *Mitzi Osborne Sues To Recover Stolen Property*, ARK. BUS. (Mar. 11, 2013), https://www.arkansasbusiness.com/article/91275/mitzi-osbourne-sues-to-recover-stolen-property [https://perma.cc/F65Z-PUUG (staff-uploaded, dark archive)].

312. ODINET, FORECLOSED, *supra* note 97, at 98–100.

313. Dautrich v. Nationstar Mortg., LLC, No. CV 15-8278, 2018 WL 3201786, at *11 (D.N.J. June 29, 2018) ("Nationstar asserts that the economic loss doctrine bars the Dautrichs' claim which essentially asserts that their house was negligently damaged when the locks were changed. This argument fails.").

314. 374 P.3d 1195 (Wash. 2016).

315. *Id.* at 889; *see also* Britton v. Servicelink Field Servs., LLC, No. 18-CV-0041-TOR, 2019 WL 3400683, at *1 (E.D. Wash. July 26, 2019).

316. *Jordan*, 374 P.3d at 1202; *see also* Jordan v. Nationstar Mortg., LLC, No. 14-CV-0175-TOR, 2017 WL 5616362, at *4–5 (E.D. Wash. Nov. 21, 2017).

Washington is a lien-theory state,[317] although Professors William Stoebuck and John Weaver suggest that a Washington mortgagee can take possession of the property with the mortgagor's post-loan closing but pre-foreclosure consent.[318]

Yet, more often these victories are not the result of strong doctrinal lines being drawn between the possessory rights of owners on the one hand and the security rights of mortgagees on the other. Rather, they are decided for reasons that are particular to the jurisdiction and that cannot be ported elsewhere. In one case involving property preservation gone wrong, the Illinois homeowners claimed that the servicer and its contractors entered their home "forcibly and in reckless disregard for the [borrowers'] property rights" and, in doing so, interfered with their "possessory rights."[319] The defendants argued that the property was abandoned and thus, under Section Nine of the mortgage, the servicer was entitled to winterize and secure the premises. The court held that because Illinois had a specific statute defining abandonment, and because those specific statutory requirements were not met, then the servicer "violated the [homeowners'] possessory interest in the Property by trespassing to perform an unwanted winterization."[320]

Yet, even when contractors are found liable, servicers assert that they do not bear the blame because the contractor was not a servant-agent, but rather a mere independent contractor.[321] Just as in the trustee-servicer-subservicer context, the agency issue is rarely resolved in the homeowner's favor.[322]

Some courts have found that servicing guidelines on how property preservation activities are to be conducted suggest enough evidence of control to plausibly create an agency relationship,[323] holding that because the contractor goes to the property on the servicer's behest, then the servicer "is liable for [the contractor's] activities as its principal."[324]

317. *See* Hays v. Merchants' Bank, 44 P. 137, 137 (Wash. 1896); *see also* Cochran v. Cochran, 195 P. 224, 225, *aff'd*, 198 P. 270 (Wash. 1921). As noted above, in a lien-theory state the mortgagee does not have legal title to the property but instead has only a security right against the real estate. *See supra* Section I.A.1.

318. 18 WILLIAM B. STOEBUCK & JOHN W. WEAVER, WASHINGTON PRACTICE: REAL ESTATE: PROPERTY LAW AND TRANSACTIONS §§ 17.1, 18.7 (2d ed. 2021).

319. Fed. Nat'l Mortg. Ass'n v. Obradovich, No. 14-CV-04664, 2020 WL 2767578, at *5 (N.D. Ill. May 28, 2020).

320. *Id.* at *6.

321. *Id.*; *see also* Rusk v. Specialized Loan Servicing, LLC, No. CV418-211, 2020 WL 2772771, at *8 (S.D. Ga. May 28, 2020) ("The Court has no other evidence before it regarding any kind of agency relationship between Defendant SLS and ServiceLink and, therefore, cannot find that Defendant SLS can be held liable for any unauthorized actions taken by ServiceLink.").

322. *See supra* Sections II.A–B.

323. *See Obradovich*, 2020 WL 2767578, at *6.

324. Sifuentes v. Rushmore Loan Mgmt. Servs., LLC, No. 17 C 3982, 2018 WL 1469014, at *3 (N.D. Ill. Mar. 26, 2018).

Yet, these victories are few and far between. More often, however, courts will merely look to the language used in the contract between the servicer and the contractor, which practically always provides for an independent contractor relationship, and hold that there is no agency relationship.[325] For example, a federal district court in Georgia in 2014, without analyzing any of the trappings of control found in the *Restatement of Agency*, held that "the Court is persuaded that the relationship of [the contractor] to [the servicer] was that of an independent contractor" and this was completely "based on the agreement between the two entities."[326] Even when there are sufficient facts in the record indicating mortgage servicers furnish contractors with guidelines for performance of the work (in other words, indicia of control), courts are consistently hesitant to find the master-servant relationship.[327]

3. Homeowner Litigation Losses

More often, homeowners are unsuccessful in their possession-related claims against servicers.[328] Unlike the Washington Supreme Court, most courts do not look to mortgage law concepts in setting the boundaries of these mortgagor-mortgagee relationships. Indeed, they do not look to property law at all.[329] Instead, they hold that the contents of the mortgage contract constitute "the law between the parties" and that the right to engage in property preservation activities upon a determination of abandonment is a "contractual right under the Mortgage."[330] Courts will explain that borrowers "specifically

325. *See, e.g.*, Franklin v. Bayview Loan Servicing, LLC, 110 N.E.3d 1193, 2018 WL 4275430, at *5–6 (Ind. Ct. App. 2018) (unpublished table decision). The opinion does not state what kind of mortgage loan this was, but if it was backed by any kind of government program, then servicing guidelines from Fannie, Freddie, or any of the other agencies would have required that the servicer supervise and ensure the quality of any property preservation services relative to the mortgaged property. *See* ODINET, FORECLOSED, *supra* note 97, at 96–97.

326. Bussell v. Am. Home Mortg. Servicing, Inc., No. 12-CV-0129-JEC-AJB, 2014 WL 12857985, at *10 (N.D. Ga. Jan. 23, 2014), *report and recommendation adopted*, No. 12-CV-129-JEC-AJB, 2014 WL 12858063 (N.D. Ga. Mar. 10, 2014).

327. *See* Jackson v. Bank of N.Y., 62 F. Supp. 3d 802, 815–16 (N.D. Ill. 2014).

328. *See, e.g.*, James v. Safeguard Properties LLC, 821 F. App'x 683, 686 (9th Cir. 2020) (deciding a CPA claim occurring prior to the Washington Supreme Court's decision in *Jordan v. Nationstar Mortg., LLC*, 374 P.3d 1195 (Wash. 2016) (en banc)).

329. *See, e.g.*, Bess v. Ocwen Loan Servicing, LLC, No. C15-5020 BHS, 2015 WL 1188634, at *3 (W.D. Wash. Mar. 16, 2015).

330. Lebeau v. Saxon Mortg. Servs., Inc., 2018-0199, p. 4, 8 (La. App. 4 Cir. 4/17/19); 269 So. 3d 970, 973, 975; *see also* Halkiotis v. WMC Mortg. Corp., 144 F. Supp. 3d 341, 362–63 (D. Conn. 2015); Santoro v. OCWEN Loan Servicing, LLC, No. 14-CV-0522-TC, 2015 WL 4920836, at *1 (D. Or. June 15, 2015), *report and recommendation adopted as modified*, No. 14-CV-0522-TC, 2015 WL 4920827 (D. Or. Aug. 14, 2015); Bennett v. Bank of Am., N.A., No. 12CV34-HEH, 2012 WL 1354546, at *10 (E.D. Va. Apr. 18, 2012); Thompson v. JP Morgan Chase Bank, N.A., No. WDQ-13-1982, 2014 WL 4269060, at *7 (D. Md. Aug. 27, 2014); PNC Bank, N.A. v. Van Hoornaar, 44 F. Supp. 3d 846, 857 (E.D. Wis. 2014).

consent[] to entry . . . in the Deed of Trust [they] willingly sign[]."[331] And, as though an actual negotiation occurred, courts observe "[t]he parties contracted on this matter."[332] For any claims related to a disturbance of possession, "[c]onsent negates the existence of the tort itself."[333]

One might think that homeowners can fall back on arguments about the reasonableness of a servicer's exercise of possessory contract rights. However, when homeowners claim that servicers have not undertaken their contractually authorized activities in good faith, courts will dismiss such claims under the theory that, in a host of states, "there is no 'free-floating' duty of good faith and fair dealing that is unattached to an existing contract."[334] Said another way, "when parties to a contract create valid and binding rights," then "an implied covenant of good faith and fair dealing is inapplicable to those rights."[335] Even though the mortgage contract language itself, in both Sections Seven and Nine, directly imposes a reasonableness standard on servicer activities, courts hardly ever pay it any mind.

D. *Duty of Care Problems*

The final major issue that homeowners face when dealing with servicers pertains to the duty that is owed between the two. To be sure, the homeowner owes a contractual duty to repay the loan.[336] Also, under long-standing general property law, the homeowner owes a duty not to damage the property (pursuant to the doctrine of waste), as that would injure the value of the mortgagee's collateral.[337] Indeed, in some ways, the borrower duties are fairly well-defined. What suffers from significant ill-definition, however, are the duties that the servicer owes to the homeowner.

1. Loan Modifications

One of the most significant contexts in which the duties of servicers have been tested is with loss mitigation applications. Loss mitigation is a simple phrase used to mean all the different ways that mortgagors and mortgagees

331. *Santoro*, 2015 WL 4920836, at *1.

332. *Id.*

333. *Id.*

334. *Bess*, 2015 WL 1188634, at *4; *see also* Adams v. Life & Cas. Ins. Co. of Tenn., No. A14-89-00559-CV, 1990 WL 98501, at *3 (Tex. App. July 12, 1990); Bonham v. HBW Holdings, Inc., No. CIV.A. 820-N, 2005 WL 3589419, at *11 (Del. Ch. Dec. 23, 2005).

335. *Bennett*, 2012 WL 1354546, at *10 (quoting Ward's Equip., Inc. v. New Holland N. Am., Inc., 493 S.E.2d 516, 520 (Va. 1997)).

336. *See* Bannoura v. Bannoura, 655 So. 2d 1187, 1188 (Fla. Dist. Ct. App. 1995).

337. *See* RESTATEMENT (THIRD) OF PROP.: MORTGS. § 4.6 (AM. L. INST. 1997); David A. Leipziger, *The Mortgagee's Remedies for Waste*, 64 CALIF. L. REV. 1086, 1088 (1976).

negotiate to avoid a foreclosure once there has been a default.[338] There are a number of different categories of loss mitigation, but the most common is a permanent loan modification. In such a case, the lender (the servicer) will consider the borrower's current financial position and the existing terms of the loan and, in doing so, will agree to extend the length of the repayment term, lower the interest rate, forgive past missed payments, or even reduce the principal still due.[339]

In the course of obtaining a loan modification, a borrower must furnish the servicer with significant amounts of documentation about financial position and hardship.[340] Borrowers are almost never assisted by an attorney and the back-and-forth proceeds over a span of time, under varying deadlines, and via both telephone and mail.[341] Frequently these endeavors do not go smoothly.[342] The 2008 financial crisis revealed significant breakdowns in loss mitigation where phone calls were not returned, documentation was lost in transit, forms were never completed to the servicer's satisfaction, and the number and types of documents needed from the borrower were ever-changing.[343] Part of the reason for this was due to the fact that mortgage servicers operate from different locations and have multiple departments within a single organization. Internal disconnect and mixed messages were not uncommon.[344] To make matters worse, the right to service the loan would often be transferred mid-process, leaving the borrower having to start at square one with a new servicer.[345]

When these breakdowns would occur, sometimes homeowners would muster the mental strength and marshal the financial resources to fight back in court.[346] Yet, their victory depended on a court finding that the servicer breached its obligation to the homeowner in the course and scope of the loss mitigation application. Despite how egregious these breakdowns were, courts

338. ODINET, FORECLOSED, *supra* note 97, at 43–44; Daria Kelly Uhlig, *Loss Mitigation Options*, SFGATE, http://homeguides.sfgate.com/loss-mitigation-options-7531.html [https://perma.cc/B7VE-24FJ].

339. ODINET, FORECLOSED, *supra* note 97, at 43–44.

340. *See* John E. Waites & Andrew A. Powell, *Any Port(al) in a Storm (of Foreclosure) Refining Loss Mitigation Through Technology*, 28 S.C. LAW. 38, 40 (2016).

341. *See id.*

342. *See id.*

343. *See In re* Bank of Am., N.A. Charlotte, NC, No. 2011-048, 2011 WL 6941540, at *1 (O.C.C. Apr. 13, 2011) (finding numerous instances of deficiencies in the handling of loss mitigation applications by mortgage servicers); Cenatiempo v. Bank of Am., N.A., 219 A.3d 767, 779 (Conn. 2019) (noting that "servicers were not executing HAMP modification reviews with the 'high standard of care' required by the program").

344. *See* CONSUMER FIN. PROT. BUREAU, MONTHLY COMPLAINT REPORT 12 (2015), http://files.consumerfinance.gov/f/201509_cfpb_monthly-complaint-report-vol-3.pdf [https://perma.cc/RJ2V-2XVW] ("Complaints where [borrowers] assert that they sent documents but [lenders] report never having received them are common."); Waites & Powell, *supra* note 340, at 38, 43.

345. *See* ODINET, FORECLOSED, *supra* note 97, at ix–x.

346. *See* ODINET, FORECLOSED, *supra* note 97, at 95, 142–43.

often rejected these claims based on the surprising idea that servicers don't actually owe borrowers the kind of duty needed to prevail in court.[347]

2. Is a Duty Even Owed?

To be sure, the legal duties of servicers are more defined now than they were before the 2008 financial crisis. The Consumer Financial Protection Bureau ("CFPB") has enacted rules that require a number of things from the vast majority of mortgage servicers, including a mandate to respond to a borrower's loss mitigation request within a certain period of time and a limit on the ability to foreclose when an application is pending.[348] But, importantly, nothing in the CFPB rules require mortgage servicers to actually offer a loss mitigation option to a financially distressed borrower in the first place.[349] Also, the CFPB's rules do not obligate a servicer to approve an application or even set a standard for how an application must be evaluated.[350] In essence, although servicers are obligated to maintain policies and procedures that, among other things, are aimed at "properly evaluating loss mitigation applications," in the end, the servicer is still left with significant discretion.[351]

This discretion is cabined, then, only by the agreement with the securitization trustee. These servicing agreements generally provide that in reviewing a loss mitigation application, the servicer must conduct a net-present-value analysis.[352] This requires the servicer to determine whether it would be more profitable for the mortgage-backed securities investors to approve a modification or else to foreclose on the property.[353] Thus, without direct regulatory guidance, courts typically use a tort framework to analyze whether a servicer has a duty of care in its review of loss mitigation applications, the extent of that duty, and the degree to which that duty has been breached to judge

347. *See infra* Section II.D.2.

348. 12 C.F.R. § 1024.41 (2020). A number of other rules were enacted after the crisis that impose a number of operational rules on servicers. *See id.* § 1024.17 (requiring escrow accounts); *id.* § 1024.35 (requiring error resolution procedures); *id.* § 1024.36 (regulating requests for information); *id.* § 1024.37 (requiring forced placed insurance); *id.* § 1024.38 (setting out general servicing policies, procedures, and requirements); *id.* § 1024.39 (requiring early intervention); *id.* § 1024.41 (outlining loss mitigation procedures); *id.* § 1026.20 (setting disclosure requirements regarding post-closing); *id.* § 1026.36 (regulating payment processing); *id.* § 1026.40 (requiring continuity of contact); *id.* § 1026.41 (requiring periodic account statements).

349. *Id.* § 1024.41 ("Nothing in § 1024.41 imposes a duty on a servicer to provide any borrower with any specific loss mitigation option.").

350. The only requirement in the rule is that the servicer exercise "reasonable diligence" in obtaining the necessary documentation for the loss mitigation application to be complete. *Id.* § 1024.41(b)(1), (c)(2)(ii), (c)(4)(i).

351. *Id.* § 1024.38(a), (b)(2).

352. ODINET, FORECLOSED, *supra* note 97, at 46.

353. *See* John R. Chiles & Matthew T. Mitchell, *HAMP: An Overview of the Program and Recent Litigation Trends*, 65 CONSUMER FIN. L.Q. REP. 194, 196 (2011).

whether a servicer should be liable when it comes to loan modification breakdowns.[354]

As a general matter, many of the states faced with the question have refused to impose a general tort-based duty on servicers when it comes to loan modifications.[355] The vast majority of courts to have addressed the issue are in California, where the general rule is that "lenders do not owe borrowers a duty of care" except when the lenders' "involvement in a transaction goes beyond their conventional role as a mere lender of money."[356] As such, and because offering loan modifications is inherently part of conventional money lending, "lenders have no duty to offer or approve a loan modification."[357]

Additionally, the Supreme Court of Connecticut stated as recently as 2019 that "[a]s a general matter, the law does not impose a duty on lenders to use reasonable care in its commercial transactions with borrowers" due to the fact that "the relationship between lenders and borrowers is contractual and loan transactions are conducted at arm's length."[358] Oddly, the state high court explained that "there exists no fiduciary relationship merely by virtue of a borrower-lender relationship"—suggesting that a legal tort-based duty to review a loss mitigation application with care could only spring from the recognition of a fiduciary duty.[359] Also, the court noted that "[a] lender has the right to further its own interest in a mortgage transaction" and is not in any way responsible for representing "the customer's interest."[360] In perhaps the most noteworthy example of how little courts truly understand about the mortgage securitization structure, the Connecticut Supreme Court in this case calls the

354. *See* Weimer v. Nationstar Mortg., LLC, 260 Cal. Rptr. 3d 712, 728–29 (Ct. App.), *cert. granted*, 469 P.3d 404 (Cal. 2020).

355. *See* Sheen v. Wells Fargo Bank, N.A., 250 Cal. Rptr. 3d 677, 682 (Ct. App. 2019).

356. *See* Rossetta v. CitiMortgage, Inc., 227 Cal. Rptr. 3d 598, 605 (Ct. App. 2017) (quoting Nymark v. Heart Fed. Sav. & Loan Ass'n, 283 Cal. Rptr. 53, 56 (Ct. App. 1991)).

357. *Id.* (citing Lueras v. BAC Home Loans Servicing, LP, 163 Cal. Rptr. 3d 804 (Ct. App. 2013)); *see also* Vargas v. Wells Fargo Bank, N.A., No. SACV1800875AGPLAX, 2018 WL 6016157, at *2 (C.D. Cal. Sept. 17, 2018) (Guilford, J., in chambers); Razzak v. Wells Fargo Bank, N.A., No. 17-CV-04939-MMC, 2018 WL 1524002, at *5 (N.D. Cal. Mar. 28, 2018); Santana v. BSI Fin. Servs., Inc., 495 F. Supp. 3d 926, 945–46 (S.D. Cal. 2020); Seitzinger v. Select Portfolio Servicing, Inc., No. 17-CV-06122-BLF, 2018 WL 2010993, at *5 (N.D. Cal. Apr. 30, 2018); Fisher v. Nationstar Mortg. LLC, No. 17-CV-02994-BLF, 2018 WL 1933300, at *8 (N.D. Cal. Apr. 24, 2018).

358. Cenatiempo v. Bank of Am., N.A., 219 A.3d 767, 792 (Conn. 2019) (citing Saint Bernard Sch. of Montville, Inc. v. Bank of Am., 95 A.3d 1063, 1078 (Conn. 2014)); *see* Southbridge Assocs., LLC v. Garofalo, 728 A.2d 1114, 1119 (Conn. App. Ct. 1999) (limiting a mortgage lender-borrower fiduciary relationship to those instances "when the bank becomes the borrower's financial advisor" (citing Stone v. Davis, 419 N.E.2d 1094 (Ohio 1984))). Connecticut courts use a multifactor test when determining whether a special relationship exists. *Cenatiempo*, 219 A.3d at 793.

359. *Cenatiempo*, 219 A.3d at 793 (quoting *Southbridge Assocs., LLC*, 728 A.2d at 1119).

360. *Id.* (quoting *Southbridge Assocs., LLC*, 728 A.2d at 1119). In defense of its decision not to find a duty of care, the Connecticut Supreme Court warned of "far-reaching consequences" that would likely lead to servicers never offering loss mitigation applications. *See id.*

borrower a customer—as though homeowners have some say in the selection of their mortgage loan servicers and could simply have made a different choice.

California and Connecticut are hardly alone. A federal court in Rhode Island has also held that in the context of borrower litigation against a mortgage servicer "[t]he general rule is that a bank does not owe a duty to a borrower."[361] Federal courts in Michigan have held similarly, specifically by "deny[ing] a duty of reasonable care in the loan modification context."[362] The Seventh Circuit, applying Illinois law, has also refused to find a tort-based "duty to service [a borrower's] home loan responsibly and with competent personnel."[363] The circuit court said only a contract could impose such a duty, and (in once again a case of conflating concepts) a mortgage contract imposes no such "fiduciary relationship between the parties."[364]

3. Economic Loss Doctrine

To make matters worse, even in those jurisdictions that *do* find that a duty is owed, recovery is not possible in most cases because of the existence of the so-called *economic loss doctrine*.[365] This doctrine, which has been a significant barrier to recovery against servicers for their botched loan modifications, comes in the way of a tort law limitation on purely economic losses.[366]

The economic loss doctrine is, as one court described it, "a judicially created rule to preserve the distinction between contract and tort" that requires individuals "to pursue only their contractual remedies when asserting an economic loss claim."[367] The *Restatement (Third) of Torts* describes the concept in stating that "[a]n actor has no general duty to avoid the unintentional infliction of economic loss on another."[368] The rationale behind the rule is "the

361. Pickett v. Ditech Fin., LLC, 322 F. Supp. 3d 287, 293 (D.R.I. 2018) (citing Mackenzie v. Flagstar Bank, FSB, 738 F.3d 486, 495 (1st Cir. 2013)) (admitting that there may be an exception in the case of the wrongful withholding of property insurance proceeds).

362. Ross v. Fed. Nat'l Mortg. Ass'n, No. 13-12656, 2014 WL 3597633, at *9 (E.D. Mich. July 22, 2014) (citing Dingman v. OneWest Bank, FSB, 859 F. Supp. 2d 912, 921 (E.D. Mich. 2012)); *see* Dorr v. Wells Fargo Bank, N.A., No. 13-14526, 2014 WL 1328200, at *6 (E.D. Mich. Mar. 28, 2014).

363. Wigod v. Wells Fargo Bank, N.A., 673 F.3d 547, 568 (7th Cir. 2012).

364. *Id.* (quoting Catalan v. GMAC Mortg. Corp., 629 F.3d 676, 693 (7th Cir. 2011)).

365. The doctrine finds its origins in a California Supreme Court case involving a warranty claim over a defective vehicle. *See* Seely v. White Motor Co., 403 P.2d 145, 151 (Cal. 1965).

366. The term "purely economic loss" means "pecuniary or commercial loss that does not arise from actionable physical, emotional or reputational injury to persons or physical injury to property." S. Cal. Gas Leak Cases, 441 P.3d 881, 885 (Cal. 2019) (quoting Dan B. Dobbs, *An Introduction to Non-Statutory Economic Loss Claims*, 48 ARIZ. L. REV. 713, 713 (2006)).

367. Srok v. Bank of Am., No. 15-CV-239, 2015 WL 6828078, at *7 (E.D. Wis. Nov. 6, 2015); *see also* Kaloti Enterprises, Inc. v. Kellogg Sales Co., 2005 WI 111, ¶ 28, 283 Wis. 2d 555, 579, 699 N.W.2d 205, 216.

368. RESTATEMENT (THIRD) OF TORTS: LIAB. FOR ECON. HARM § 1(1) (AM. L. INST. 2020); *see also S. Cal. Gas Leak Cases*, 441 P.3d at 891 (quoting the Restatement description of the economic loss doctrine); Sheen v. Wells Fargo Bank, N.A., 250 Cal. Rptr. 3d 677, 682 (Ct. App. 2019) (same).

need to separate matters best left to contract from those properly resolved by the law of tort" and so "[i]f two parties have a contract, the argument for limiting tort claims between them is at its most powerful."[369]

Many cases against servicers stemming from poorly to grossly mishandled loan modification applications, among other injuries, are dismissed under the economic loss doctrine.[370] For example, in one case involving "alleged misrepresentations of the amount owed" by a mortgage servicer and related to the servicer's "attempt to foreclose while the amount was in dispute," the court held that the claim was "dependent entirely on [the borrower's] obligations under the mortgaged agreement."[371] Thus, "they are barred by the economic loss rule" from recovery in tort.[372] In another case involving dual-tracking, the abusive practice of a servicer beginning a loss mitigation application process and a foreclosure simultaneously, the court held that because the loss of their home "was the subject of their contract with Wells Fargo," then "the losses [borrowers] allege[d] were merely economic losses."[373] As such, they could not "support a negligence cause of action."[374]

To be sure, not all hope is lost in the face of the economic loss rule. Some jurisdictions recognize exceptions to the doctrine. However, these loopholes are

The Restatement explains that the doctrine comes in one of two iterations—a special circumstances tort duty (the Restatement approach) that generally bars economic losses and a more stand-alone doctrine adopted by some states. *See* RESTATEMENT (THIRD) OF TORTS: LIAB. FOR ECON. HARM § 1 cmt. c (AM. L. INST. 2020). The former approach admits that exceptions to the prohibition are possible but "require justification on more particular grounds than do duties to avoid causing physical harm." *Id.* § 1 cmt. b. These typically include professional services transactions, such as between lawyers and their clients. *See id.* § 1 cmt. d(1).

369. RESTATEMENT (THIRD) OF TORTS: LIAB. FOR ECON. HARM § 3 cmt. a (AM. L. INST. 2020). "The justification for the doctrine was that purchasers of products could seek recompense for purely economic harm through a breach of warranty claim." *See* Carruthers v. Messner Enters. Northgate, No. CI-09-07812, 2013 WL 10872127, at *3 (Pa. Ct. Com. Pl. Nov. 19, 2013).

370. *See, e.g.*, Nelson v. Ocwen Loan Servicing, LLC, No. CV H-16-778, 2016 WL 7324284, at *8 (S.D. Tex.), *report and recommendation adopted*, No. CV H-16-778, 2016 WL 7242735 (S.D. Tex. Dec. 15, 2016) ("Here, Plaintiffs' complaints about the alleged misrepresentations of the amount owed on their loan and Defendant's attempt to foreclose while the amount was in dispute are dependent entirely on Defendant's obligations under the mortgaged agreement. Therefore, they are barred by the economic loss rule."); *see also* Birchler v. JPMorgan Chase Bank, No. 14-CV-81, 2015 WL 1939438, at *4 (E.D. Tex. Apr. 29, 2015); Anchorbank, FSB v. Bogenschneider, 2014 WI App 120, ¶ 22, 358 Wis. 2d 711, 856 N.W.2d 346 (per curiam) (referencing the circuit court below); Homebuyers Inc. v. Watkins, No. A-18-258, 2019 WL 2361760, at *14 (Neb. Ct. App. 2019); Cabot Addison 1, LLC v. U.S. Bank Nat'l Ass'n, No. X04HHDCV146055758S, 2015 WL 9920553, at *5 (Conn. Super. Ct. Dec. 31, 2015) (applying the economic loss doctrine in the commercial mortgage loan context); Shellnut v. Wells Fargo Bank, N.A., No. 02-15-00204-CV, 2017 WL 1538166, at *1 (Tex. App. Apr. 27, 2017); Masters Grp. Int'l, Inc. v. Comerica Bank, 2015 MT 192, ¶ 70, 380 Mont. 1, 23, 352 P.3d 1101, 1117 (declining to apply the economic loss doctrine to claims by a borrower against a commercial mortgage lender).

371. *Nelson*, 2016 WL 7324284, at *8.

372. *Id.*

373. *Homebuyers Inc.*, 2019 WL 2361760, at *14.

374. *Id.*

narrow and typically involve clunky multi-factor tests or analytical frameworks that can be unavailing to aggrieved homeowners. For instance, Illinois recognizes three exceptions to the economic loss doctrine,[375] the first requiring a "sudden or dangerous occurrence," the second requiring an "intentional, false representation," and the third requiring the defendant to be in the business of "supplying information for the guidance of others in their business transactions."[376] Essentially, all of them require "the existence of an extra-contractual duty between the parties" that can, in turn, "[give] rise to a cause of action in tort separate from one based on the contract itself."[377] In the mortgage servicing context, the first is hard to meet because it requires "personal injury or property damage."[378] Also, since proving an intentional misrepresentation (as opposed to a negligent one) is difficult, the second exception is hardly useful to homeowners in litigation. And the third is not applicable to the consumer mortgage credit transaction.

Wisconsin's exception to the doctrine appears useful to homeowners, but in practice has not proven to be so.[379] Recognizing its products liability origins, the economic loss doctrine in Wisconsin only applies to contracts for *products*, not to contracts for *services*.[380] However, this distinction has not been availing in mortgage servicing litigation. In *Srok v. Bank of America*,[381] a homeowner brought suit on account of the mortgage servicer's bungled loss mitigation process, including the fact that the servicer made explicit representations that the application for a modification would be approved.[382] The federal court, however, held that because "[t]he processing of the paperwork for a loan modification" is part of "obtaining the modified product—the mortgage loan," the relationship between the parties was *not* one for services.[383]

Unfortunately, the *Srok* court's analysis for the assumption that the modification of the loan necessarily signified the modification of a product was brief. The court made no effort to see distinctions between tangible products (the focus of products liability from which the economic loss doctrine springs) and intangible financial products (which are created and only exist via contract). The court also failed to see that the job of a mortgage servicer is to do exactly

375. *See* Moorman Mfg. Co. v. Nat'l Tank Co., 435 N.E.2d 443, 448–52 (Ill. 1982).

376. First Midwest Bank, N.A. v. Stewart Title Guar. Co., 843 N.E.2d 327, 333–34 (Ill. 2006)

377. Catalan v. GMAC Mortg. Corp., 629 F.3d 676, 692–93 (7th Cir. 2011).

378. *See* Des Moines Flying Serv., Inc. v. Aerial Servs. Inc., 880 N.W.2d 212, 222 (Iowa 2016).

379. *See* Sunnyslope Grading, Inc. v. Miller, Bradford & Risberg, Inc., 437 N.W.2d 213, 217–18 (Wis. 1989) (recognizing this exception to the economic loss doctrine for the first time in the state); *see also* Digicorp, Inc. v. Ameritech Corp., 662 N.W.2d 652, 659–60 (Wis. 2003) (providing a summary rule statement of the economic loss doctrine and the underlying policy informing it).

380. Ins. Co. of N. Am. v. Cease Elec. Inc., 688 N.W.2d 462, 464 (Wis. 2004).

381. No. 15-CV-239, 2015 WL 6828078, at *1–2 (E.D. Wis. Nov. 6, 2015).

382. *Id.* at *1–2.

383. *Id.* at *7.

that—provide a *service*, that being the administration of the loan. While changing the terms of the loan does, in one sense, involve changing the product, it is primarily a change in the way in which the loan is collected (either over time or in a certain amount, or both). In the context of securitization and intermediate loan administration, it would seem that the relationship tilts more heavily toward that of a service contract. And even if this really could be a product-based contract, it is hardly one analogous to a products-liability context. This is not the case of a buyer suing a seller for a defect, but rather one of a borrower suing an ill-defined market intermediary for failing to properly exercise a reasonable duty of care, when acting on behalf of distant beneficial securities owners in negotiating the modification of home loan. The court provided no analysis attempting to bridge the factual or policy gap between these two scenarios. Instead, what resulted was a brief declaration of the court's product-based view and the fact that the exception to the economic loss doctrine did not apply.

Some states like New Hampshire,[384] Montana,[385] and California[386] conceptualize their exception as a special relationship between the parties. New Hampshire's version of this is particularly ill-used[387] and has only been extended to a small number of cases—one involving a bank and its deposit account customer,[388] another between an attorney and a client,[389] and one involving an insurance investigator.[390] California's special relationship exception, however, has seen significant litigation in recent years.[391] Not only does the California special relationship create a duty, but it specifies that duty as being one that

384. *See* Eldridge v. Ocwen Loan Servicing, LLC, No. 2016-0328, 2017 WL 5983705, at *3 (N.H. Oct. 12, 2017).

385. Story v. City of Bozeman, 791 P.2d 767, 776 (Mont. 1990) ("In common contract actions, tort-type damages are not available for breach of the implied covenant of good faith and fair dealing. . . . The tort of bad faith may still apply in exceptional circumstances . . . to discourage oppression in contracts which necessarily give one party a superior position . . . involving special relationships which are not otherwise controlled by specific statutory provisions."); *see also* Odom v. Bank of N.Y. Mellon, 2020 MT 58N, ¶ 28, 399 Mont. 552, 459 P.3d 225 (unpublished table opinion) (refusing to find a special relationship between a mortgage servicer and a borrower).

386. *See* Biakanja v. Irving, 320 P.2d 316, 319 (Cal. 1958); J'Aire Corp. v. Gregory, 598 P.2d 60, 63 (Cal. 1979).

387. Wyle v. Lees, 162 N.H. 406, 410 (2011) ("[W]e noted that economic loss recovery may be permitted in such a situation only where there is: (1) a "special relationship" between the plaintiff and the defendant that creates a duty owed by the defendant; or (2) a negligent misrepresentation made by a defendant who is in the business of supplying information.").

388. *See* Robinson v. Colebrook Sav. Bank, 109 N.H. 382, 383 (1969).

389. Simpson v. Calivas, 139 N.H. 1, 4–5 (1994).

390. Morvay v. Hanover Ins. Cos., 127 N.H. 723, 726 (1986).

391. *See, e.g.*, Weimer v. Nationstar Mortg., LLC, 260 Cal. Rptr. 3d 712, 721 (Ct. App. 2020); Rossetta v. CitiMortgage, Inc., 227 Cal. Rptr. 3d 598, 606 (Ct. App. 2017); Daniels v. Select Portfolio Servicing, Inc., 201 Cal. Rptr. 3d 390, 415 (Ct. App. 2016); Alvarez v. BAC Home Loans Servicing, L.P., 176 Cal. Rptr. 3d 304, 308 (Ct. App. 2014); Jolley v. Chase Home Fin., LLC, 153 Cal. Rptr. 3d 546, 553 (Ct. App. 2013); S. Cal. Gas Leak Cases, 441 P.3d 881, 887 (Cal. 2019).

demands a financial institution to "use due care to avoid economic injury" to a borrower.[392] This special relationship exception is much broader than in places like New Hampshire. The California Supreme Court explained that "[w]hat we mean by special relationship is that the plaintiff was an intended beneficiary of a particular transaction but was harmed by the defendant's negligence in carrying it out."[393]

But even here, the facts needed to trigger the special relationship are hard to find. There is a six-factor test that California courts use,[394] and the state's high court has noted that the analysis can "be a subtle enterprise."[395] Moreover, recent case law requires not only the weighing of the six factors, but also answering the question of "whether this is a case where plaintiff was intended to benefit from the transaction but was harmed by the defendant's negligence in carrying it out."[396] Even with a few victories in the loss mitigation context,[397] overall the application of the factors bring mixed results, as "California Courts of Appeal have not settled on a uniform application of the [six] factors in cases that involve a loan modification."[398]

4. Lack of Privity

Naturally, the flip side of the tort-based claim is one arising under contract. If the economic loss doctrine is meant to preclude recovery under tort where the law of contract more appropriately settles the dispute, one might imagine that many of these botched loan modification disputes are settled in the contract arena.

Not so, unfortunately. The reason for this is due to the age-old requirement of privity of contract. Homeowners typically raise a contract claim in two ways, as detailed below, but both fail because of the privity obstacle.

First, in these cases homeowners often point to the servicer's failure to follow certain loss mitigation guidelines as a breach of contract. The theory is that if a servicer fails to follow servicing guidelines (like those issued by Fannie

392. Weimer v. Nationstar Mortg., LLC, 260 Cal. Rptr. 3d 712, 720 (Ct. App. 2020).

393. *See S. Cal. Gas Leak Cases*, 441 P.3d at 887.

394. *See* Biakanja v. Irving, 320 P.2d 16, 19 (1958). The six factors are (1) "the extent to which the transaction was intended to affect the plaintiff"; (2) "the foreseeability of harm" to plaintiff; (3) "the degree of certainty that the plaintiff suffered injury"; (4) "the closeness of the connection between the defendant's conduct and the injury suffered"; (5) "the moral blame attached to the defendant's conduct"; and (6) "the policy of preventing future harm." *Id.*

395. *S. Cal. Gas Leak Cases*, 441 P.3d at 887.

396. Weimer v. Nationstar Mortg., LLC, 260 Cal. Rptr. 3d 712, 721 (Ct. App.), *discretionary review granted*, 469 P.3d 404 (Cal. 2020).

397. Rossetta v. CitiMortgage, Inc., 227 Cal. Rptr. 3d 598, 606 (Ct. App. 2017); Daniels v. Select Portfolio Servicing, Inc., 201 Cal. Rptr. 3d 390, 415 (Ct. App. 2016); Alvarez v. BAC Home Loans Servicing, L.P., 176 Cal. Rptr. 3d 304, 308 (Ct. App. 2014); Jolley v. Chase Home Fin., LLC, 153 Cal. Rptr. 3d 546, 553 (Ct. App. 2013).

398. *See Rossetta*, 227 Cal. Rptr. 3d at 605.

Mae, Freddie Mac, or any of the Ginnie Mae-related programs), then a homeowner can raise a breach of contract claim as a third-party beneficiary.[399]

However, these suits are almost always dismissed.[400] For example, a common suit has involved the post-2008 government initiative known as the Home Affordable Modification Program ("HAMP"), which was designed to help distressed homeowners remain in their homes under modified loan terms after the financial crisis.[401] Under the theory that the HAMP statute did not create a private right of action[402] and due to the Supreme Court's decision in *Astra USA, Inc. v. Santa Clara County*,[403] courts have held that servicers "undertake their HAMP obligations voluntarily via contract with the Department of the Treasury."[404] Because of this, "claims by homeowners seeking HAMP modifications as third-party beneficiaries" were routinely dismissed.[405] In essence, courts would say, because "Congress provided a private right of action [for HAMP violations against] the Secretary of the Treasury" then "Congress did not intend to create a private right of action for violation of HAMP against [servicers]."[406] Moreover, not only do homeowners "have no right to bring third-party suits to enforce" any agreement between a servicer and Fannie Mae or Freddie Mac regarding the HAMP program, but, even if they did under general contract law, the language of the agreements themselves expressly excluded such third-party beneficiary claims.[407]

399. *See* RESTATEMENT (SECOND) OF CONTS. § 302 (AM. L. INST. 1981) ("(1) Unless otherwise agreed between promisor and promisee, a beneficiary of a promise is an intended beneficiary if recognition of a right to performance in the beneficiary is appropriate to effectuate the intention of the parties and either (a) the performance of the promise will satisfy an obligation of the promisee to pay money to the beneficiary; or (b) the circumstances indicate that the promisee intends to give the beneficiary the benefit of the promised performance. (2) An incidental beneficiary is a beneficiary who is not an intended beneficiary."); *see also* Klamath Water Users Protective Ass'n v. Patterson, 204 F.3d 1206, 1211 (9th Cir. 1999), *amended on denial of reh'g*, 203 F.3d 1175 (9th Cir. 2000).

400. Nolasco v. CitiMortgage, Inc., No. H-12-1875, 2012 WL 3648414, at *4 (S.D. Tex. Aug. 23, 2012) (collecting cases).

401. This was a program created by Congress and administered by the U.S. Treasury meant to help homeowners avoid foreclosure. *See* ODINET, FORECLOSED, *supra* note 97, at 39.

402. Pinkney-Price v. PNC Mortg., No. 17-CV-00189, 2017 WL 6892913, at *4 (M.D. Pa. Nov. 17, 2017), *report and recommendation adopted*, No. 17-CV-0189, 2018 WL 386163 (M.D. Pa. Jan. 11, 2018); *see also* Keosseian v. Bank of Am., No. CIV.A. 11-3478 JAP, 2012 WL 458470, at *2 (D.N.J. Feb. 10, 2012) (collecting cases).

403. Astra USA, Inc. v. Santa Clara Cnty., 563 U.S. 110 (2011).

404. Srok v. Bank of Am., No. 15-CV-239, 2015 WL 6828078, at *6 (E.D. Wis. Nov. 6, 2015); *In re* Pulsifer, No. 13-C-648, 2014 WL 4748233, at *3 (E.D. Wis. Sept. 23, 2014); *see* Speleos v. BAC Home Loans Servicing, L.P., 937 F. Supp. 2d 177, 182 (D. Mass. 2013).

405. *Srok*, 2015 WL 6828078, at *6; *In re Pulsifer*, 2014 WL 4748233, at *3. *But see Speleos*, 937 F. Supp. 2d at 186 (denying a servicer's motion for summary judgment).

406. Manabat v. Sierra Pac. Mortg. Co., No. CV F 10-1018, 2010 WL 2574161, at *11 (E.D. Cal. June 25, 2010); *see also* Marks v. Bank of Am., N.A., No. 10-CV08039PHXJAT, 2010 WL 2572988, at *2 (D. Ariz. June 22, 2010).

407. Allen v. CitiMortgage, Inc., No. 10-2740, 2011 WL 3425665, at *7 (D. Md. Aug. 4, 2011).

Second, sometimes homeowners made claims based on actual oral agreements between the servicer and the individual with respect to the HAMP modification, rather than on the guidelines. Yet, while they recognized the possibility of an independent state law contract-based claim, courts still viewed these claims as being based on the HAMP procedures.[408] Because the conversations (and any breaches of agreements arising therefrom) necessarily arose in the context of the program and its documentation, courts would hold, to quote an Oregon district court, that "the facts and allegations as pleaded in this case are premised chiefly on the terms and procedures set forth via HAMP and," as such, "are not sufficiently independent to state a separate state law cause of action for breach of contract."[409] Even when courts have been receptive to recognizing an actual, direct contractual relationship between servicer and borrower, they do so with great hesitancy[410] and only rarely.[411]

* * *

Taken together, existing tort law and contract law, as well as agency principles, do no work in the service of aggrieved homeowners when they challenge the wrongful acts of servicers. Homeowners are blocked or asked to squeeze their claims around numerous twist-and-turn exceptions, with results that would hardly inspire confidence in an individual contemplating whether to find justice in the courts. And perhaps most lamentably, despite being at the heart of these matters, *mortgage law* does no work at all.

III. CRAFTING A REMEDY FOR MORTGAGE FINANCE'S HARMS

As scholars observe, property law often only changes "with glacial speed" because of both "the normal inertia of established law" and "the innate conservatism connected to a commodity that once was the primary source of wealth and power."[412]

But the problem is not that mortgage law is developing slowly. Mortgage law has become obsolete. It long ago ceased to develop.[413] But this doesn't mean that it cannot start to do so now, and, indeed, the need to do so may never be so great as it is presently.

408. *See, e.g.*, Vida v. OneWest Bank, F.S.B., No. 10-987, 2010 WL 5148473, at *5 (D. Or. Dec. 13, 2010).

409. *Id.*

410. "[I]t is a close question . . . ." *See Allen*, 2011 WL 3425665, at *6.

411. *See, e.g.*, Bosque v. Wells Fargo Bank, N.A., 762 F. Supp. 2d 342, 352–53 (D. Mass. 2011); *In re* Bank of Am. Home Affordable Modified Program (HAMP) Cont. Litig., No. 10-MD-02193, 2011 WL 2637222, at *3–5 (D. Mass. July 6, 2011).

412. Burkhart, *Freeing Mortgages*, *supra* note 1, at 284.

413. *But cf.* Burkhart, *Lenders and Land*, *supra* note 1, at 315 (arguing the modern mortgage finance system has resulted in law that increases the burden on lenders to protect the public good by mitigating "crime, pollution, and the decay of the inner cities").

Millions of households in the United States face housing insecurity as the various COVID-19 moratoria come to an end.[414] And for Black and Brown homeowners who have been hit hardest by the pandemic—both in terms of health and economic outcomes—this insecurity will be felt most acutely.[415] Federal and state relief came, for the most part, in the way of pressing pause on monthly mortgage payments, thereby giving homeowners some breathing room.[416] Instead of paying money to a mortgage servicer—money that would likely have come from savings accounts since so many lost their jobs during 2020—families could instead buy groceries or pay for medical care. Yet, this pause in payments did not and does not equal forgiveness.[417] Homeowners will have to make these payments up in the future.[418] Without a significant infusion of cash or a return to steady income in order to accommodate these demands, defaults and foreclosure will lie ahead.[419] When homeowners try to seek justice in the court system on account of mortgage servicing misbehavior, they will face the same problems, still unresolved under the law, as did the victims of the last recession.

This part explains how courts should take up the reins of equity in mortgage law as they once did and move this body of law forward. I start by explaining the harms that are caused by the law's many failures described in Part II above.[420] Finally, I advocate for courts to adopt a doctrine of *equitable privity*, and remedies stemming from it, between homeowners and all the various parties that now make up the architecture of homeownership in America. I conclude by showing that there are links to be made between similar harms and remedies found in other areas of the law.

414. *See Housing Insecurity in the Time of COVID-19*, FED. RSRV. BANK ST. LOUIS (Sept. 23, 2020), https://www.stlouisfed.org/dialogue-with-the-fed/housing-insecurity-in-the-time-of-covid-19 [https://perma.cc/QYP5-E584]; *Tracking the COVID-19 Recession's Effects on Food, Housing, and Employment Hardships*, CTR. ON BUDGET & POL'Y PRIORITIES (Sept. 10, 2021), https://www.cbpp.org/research/poverty-and-inequality/tracking-the-covid-19-recessions-effects-on-food-housing-and [https://perma.cc/K6SA-ZV39].

415. Yung Chun & Michal Grinstein-Weiss, *Housing Inequality Gets Worse as the COVID-19 Pandemic Is Prolonged*, BROOKINGS (Dec. 18, 2020), https://www.brookings.edu/blog/up-front/2020/12/18/housing-inequality-gets-worse-as-the-covid-19-pandemic-is-prolonged/ [https://perma.cc/UDS4-MGHV] ("Data from our recent survey indicates that the impact of COVID-19 on homeowners not only still exists, but it has significantly worsened, especially among Black and Hispanic households and young adults.").

416. *See* Pamela Foohey, Dalié Jiménez & Christopher K. Odinet, *The Debt Collection Pandemic*, 11 CALIF. L. REV. ONLINE 222, 227–30 (2020) [hereinafter Foohey et al., *The Debt Collection Pandemic*]; Pamela Foohey, Dalié Jiménez & Christopher K. Odinet, *CARES Act Gimmicks: How Not To Give People Money During a Pandemic and What To Do Instead*, 2020 U. ILL. L. REV. ONLINE 81, 83–86.

417. Pamela Foohey, Dalié Jiménez & Christopher K. Odinet, *The Folly of Credit as Pandemic Relief*, 68 UCLA L. REV. DISCOURSE 126, 130 (2020).

418. *Id.*

419. *See* Foohey et al., *The Debt Collection Pandemic*, *supra* note 416, at 226–27.

420. *See supra* Part II.

A. *Defining the Harms*

The harms from the mortgage financialization problems described in Part II stem from a cumulation of failures in the law. Lenders owe no duties, so their negligence in loan modifications lead not only to psychological harms but also foreclosure—all without a remedy. Wrongdoing by contractors in the pre-foreclosure period deny individuals the sanctuary and security of the home. Sometimes contractor activities even lead to significant property damage, including property that, as the noted property law scholar Margaret Jane Radin explained, has strong connections to our personhood.[421] And lastly, the law fails to give homeowners a clear point of recourse because the connections between the various parties in the securitization are so doctrinally ill-defined.[422]

From an individual perspective, these harms are both economic and psychological for homeowners. These harms work together to place homeowners in a particularly vulnerable situation vis-à-vis mortgage companies since the psychological harms render homeowners feeling helpless to fight back against wrongdoing by mortgage servicers and the economic harms hobble individuals far into the future, making financial transactions and even maintaining a basic livelihood all the more difficult. For those groups who already come to the table under chronic financial distress and with few options to turn to, such as families of color who have been subjected to systemic marginalization by both the government and the financial sector, the harms are magnified. And lastly, while not localized to a particular plaintiff, there are broader social harms that buttress the argument for a major overhaul and modernization of mortgage law.

1. Economic Harms

As economists have shown, significant economic harms stem from foreclosure and the housing insecurity associated with it. A study conducted by HUD in 2010 of the agency's refinancing program for underwater mortgage loans revealed that of the $51,061 average cost of a foreclosure, $10,300 of that is borne by the homeowner in moving expenses, legal fees, and administrative charges.[423] A 2020 study by economists Rebecca Diamond, Adam Guren, and Rose Tan found that individuals who have experienced foreclosure often find

421. Margaret Jane Radin, *Property and Personhood*, 34 STAN. L. REV. 957, 959 (1982) ("Most people possess certain objects they feel are almost part of themselves . . . . They may be as different as people are different, but some common examples might be a wedding ring, a portrait, an heirloom, or a house.").

422. *See supra* Sections II.A–B.

423. U.S. DEP'T OF HOUS. & URB. DEV., ECONOMIC IMPACT ANALYSIS OF THE FHA REFINANCE PROGRAM FOR BORROWERS IN NEGATIVE EQUITY POSITIONS 12 (2010), https://www.hud.gov/sites/documents/IA-REFINANCENEGATIVEEQUITY.PDF [https://perma.cc/AEH7-VFPS].

themselves needing to make multiple moves over the first few years following the event, and these individuals are 20% less likely to own their home thereafter.[424]

Foreclosures also have a significant impact on credit scores, which are used as the primary mechanism by which individuals obtain credit in the future, as well as access to rental dwellings.[425] Kenneth Brevoort and Cheryl Cooper explained in their 2010 study that for subprime borrowers, a post-foreclosure credit score recovery is slow and often does not materialize.[426] A low credit score means an individual will not be able to obtain loans in the future (such as to purchase another home or buy a car) or else will pay a significantly higher interest rate. In the latter case, the increased financial strain can cause a financial spiral from which the individual may never recover. Because landlords often use credit scores to determine whether to rent and at what rate, the hit can have a spillover effect into non-ownership-related housing tenure. Some studies reveal that renting is more expensive than owning equivalent housing, which results in yet another increased financial obligation.[427] This is particularly true for low-income individuals since they typically must make very quick housing decisions in the wake of a foreclosure that can, in turn, lead to poor financial choices.[428] Even finding employment can be significantly hindered, as some employers use credit scores in making hiring decisions.[429]

Even healthcare costs are related to foreclosure. In a 2015 study, Janet Currie and Erdal Tekin show that foreclosures produced an increase in hospital visits for causes that are unplanned but preventable.[430] Foreclosure is also

424. Rebecca Diamond, Adam Guren & Rose Tan, *The Effect of Foreclosures on Homeowners, Tenants, and Landlords* 3–4 (Nat'l Bureau for Econ. Rsch., Working Paper No. 27358, 2020), https://www.nber.org/system/files/working_papers/w27358/w27358.pdf [https://perma.cc/NEB5-D3N5]. For further analysis regarding postforeclosure, see generally Raven Molloy & Hui Shan, *The Postforeclosure Experience of U.S. Households*, 41 REAL EST. ECON. 225 (2013).

425. CHERYL R. COOPER & DARRYL E. GETTER, CONG. RSCH. SERV., R44125, CONSUMER CREDIT REPORTING, CREDIT BUREAUS, CREDIT SCORING, AND RELATED POLICY ISSUES 7 (2020). For a comprehensive history of credit scoring, see generally JOSH LAUER, CREDITWORTHY: A HISTORY OF CONSUMER SURVEILLANCE AND FINANCIAL IDENTITY IN AMERICA (2017).

426. Kenneth P. Brevoort & Cheryl R. Cooper, *Foreclosure's Wake: The Credit Experiences of Individuals Following Foreclosure*, 41 REAL EST. ECON. 747, 760–61, 769 (2013).

427. ANA MORENO, FAM. HOUS. FUND, COST EFFECTIVENESS OF MORTGAGE FORECLOSURE PREVENTION 12 (1995), https://www.fhfund.org/wp-content/uploads/2019/09/Cost-Effectiveness-of-Mortgage-Foreclosure-Prevention-1995.pdf [https://perma.cc/4WZ9-Z5SN].

428. *See* ROBIN E. SMITH, THE URB. INST., HOUSING CHOICE FOR HOPE VI RELOCATEES 10–11, 16 (2002) [hereinafter SMITH, HOUSING CHOICE FOR HOPE VI RELOCATEES], https://www.urban.org/sites/default/files/publication/60636/410592-Housing-Choice-for-HOPE-VI-Relocatees.PDF [https://perma.cc/WDX8-9MBF].

429. *See* MATT FELLOWES, THE BROOKINGS INST., CREDIT SCORES, REPORTS, AND GETTING AHEAD IN AMERICA 2 (2006), https://projects.iq.harvard.edu/files/ablconnect/files/brookings_credit_scores.pdf [https://perma.cc/GF3W-9M36].

430. Janet Currie & Erdal Tekin, *Is There a Link Between Foreclosure and Health?*, 7 AM. ECON. J. 63, 67, 86 (2015).

connected to food insecurity among households. After the 2008 financial crisis, certain states that experienced high levels of foreclosure saw their food stamp cases increase by as much as 20% in a single year.[431]

2. Psychological Harms

There are also immense psychological harms that stem from foreclosure and its lead-up. A foreclosure is typically accompanied by other demoralizing life events, such as loss of a job, illness, or related traumas.[432]

Also, for elderly homeowners faced with foreclosure, the volatility can be particularly harmful. Studies show that the elderly experience relocation, particularly when it is involuntary, more negatively than others.[433] Older individuals have a strong emotional attachment to places.[434] They rely more heavily on connection to places in order to assist them in feeling control and predictability when experiencing declines in health and independence.[435] For some elderly individuals, the "series of emotional and physical setbacks" emanating from a foreclosure may be insurmountable.[436]

Children are also victims of foreclosure and related housing instability. This is particularly true since, as noted above, foreclosure is typically followed by not just one but multiple moves over a short period of time, sometimes resulting in changing schools and the loss of other familiar settings. Dwelling instability can lead to low levels of education and poor performance in school.[437] Family turbulence also results, which means "a parent's ability to keep a consistent bedtime, mealtime, or homework schedule" is negatively affected.[438]

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431. G. THOMAS KINGSLEY, ROBIN SMITH & DAVID PRICE, THE URB. INST., THE IMPACTS OF FORECLOSURES ON FAMILIES AND COMMUNITIES 11 (2009), https://www.urban.org/sites/default/files/publication/30426/411909-The-Impacts-of-Foreclosures-on-Families-and-Communities.PDF [https://perma.cc/8C57-J87J].

432. *See* Alexander C. Tsai, *Home Foreclosure, Health, and Mental Health: A Systematic Review of Individual, Aggregate, and Contextual Association*, PLOS ONE (Apr. 7, 2015), https://journals.plos.org/plosone/article?id=10.1371/journal.pone.0123182 [https://perma.cc/APN7-QTKN]. *See generally* Kyle F. Herkenhoff & Lee E. Ohanian, *The Impact of Foreclosure Delay on U.S. Employment*, 31 REV. ECON. DYNAMICS 63 (2019) (detailing the negative impact foreclosure delay has on the U.S. labor market).

433. *See* Berth Danermark & Mats Ekström, *Relocation and Health Effects on the Elderly: A Commented Research Review*, 17 W. MICH. U. J. SOCIO. & SOC. WELFARE 25, 36–43 (1990).

434. ROBIN E. SMITH & KADIJA FERRYMAN, THE URB. INST., SAYING GOOD-BYE: RELOCATING SENIOR CITIZENS IN THE HOPE VI PANEL STUDY 3 (2006) [hereinafter SMITH, SAYING GOOD-BYE], http://webarchive.urban.org/UploadedPDF/311279_Roof_10.pdf [https://perma.cc/EG4Q-UKF6].

435. STEPHEN M. GOLANT, A PLACE TO GROW OLD: THE MEANING OF ENVIRONMENT IN OLD AGE 168–69 (1984).

436. KINGSLEY ET AL., *supra* note 431, at 9.

437. *See* U.S. GEN. ACCT. OFF., ELEMENTARY SCHOOL CHILDREN: MANY CHANGE SCHOOLS FREQUENTLY, HARMING THEIR EDUCATION 6–9 (2006), http://archive.gao.gov/t2pbat4/150724.pdf [https://perma.cc/8Y9M-7NGF].

438. KINGSLEY ET AL., *supra* note 431, at 10.

3. Social Harms

Although the harms to individuals alone are enough to merit mortgage law reform, there are broader harms to the larger community that lend support to this cause. Foreclosure results in declining property values across the area, as well as deterioration of the physical environment.[439] Housing policy scholars Dan Immergluck and Geoff Smith found in their 1997–1998 study of distressed properties in Chicago that there was a direct correlation between a foreclosure and the value of homes within one-eighth of a mile from that location.[440] This decline was even more robust in low- to moderate-income neighborhoods.

The cycle is one that feeds into itself. When properties are vacant, potential new homeowners and their realtors veer away on account of the perception that the area is in decline. Vacant properties can also become havens for crime and squatters. A 2003–2007 study conducted by the Charlotte-area police department in North Carolina found an increase in violent and property crimes in neighborhoods with high foreclosure rates.[441] Also, when utilities are turned off or rendered inoperable for a period of time, the structure itself will begin to deteriorate.[442] Thus, the decline in values goes on. Of course, the number of foreclosures in an area must reach a certain threshold before these negative consequences start to flow, but in an area with already weak home values, even a handful of foreclosures can trigger a downward slide.[443]

And lastly, foreclosures can have a broad, negative impact on the local government's ability to provide necessary public services.[444] The decline in property values leads to a decline in property tax revenue.[445] This, in turn, leads to budget shortfalls and cuts to services.[446] The loss of revenue is particularly problematic since increased foreclosures actually mean cities must spend more money, such as on expenses related to securing vacant property.[447]

439. *Id.* at 17.

440. Dan Immergluck & Geoff Smith, *The External Costs of Foreclosure: The Impact of Single-Family Mortgage Foreclosures on Property Values*, 17 HOUS. POL'Y DEBATE 57, 58 (2006).

441. Michael Bess, *Assessing the Impact of Home Foreclosures in Charlotte Neighborhoods*, 1 GEOGRAPHY & PUB. SAFETY 2, 3–4 (2008).

442. *See, e.g.*, *Here's What Happens When You Don't Flush Your Toilet Properly*, LAKE NORMAN PLUMBER ON CALL, https://lakenormanplumberoncall.com/2021/06/23/what-happens-when-you-dont-flush-your-toilet-properly/ [https://perma.cc/8BD3-KPWN].

443. *See* KINGSLEY ET AL., *supra* note 431, at 16.

444. *See id.* at 18–20.

445. WILLIAM C. APGAR & MARK DUDA, HOMEOWNERSHIP PRES. FOUND., COLLATERAL DAMAGE: THE MUNICIPAL IMPACT OF TODAY'S MORTGAGE FORECLOSURE BOOM 7 (2005), https://www.communityprogress.net/filebin/pdf/nvpc_trnsfr/Apgar_Duda_collateraldamage.pdf [https://perma.cc/AXP9-W6UV].

446. MICHAEL A. PAGANO & CHRISTOPHER W. HOENE, NAT'L LEAGUE OF CITIES, CITY FISCAL CONDITIONS IN 2008, at 1–7 (2008), https://dataspace.princeton.edu/bitstream/88435/dsp01gq67jr348/1/city_fiscal_conditions_Sep2008.pdf [https://perma.cc/DAB7-Y8R3].

447. KINGSLEY ET AL., *supra* note 431, at 20.

B. *A New Doctrine of Equitable Privity of Estate*

The way to fundamentally modernize mortgage law is for courts to recognize (or arguably, unearth) a doctrine of *equitable privity of estate* in mortgages.

Equity is part of the history of mortgage law. In 1830, the noted American legal scholar and jurist James Kent wrote in his commentaries that the law of "mortgages is one of the most splendid instances in the history of our jurisprudence of the triumph of equitable principles over technical rules" and, in turn, "the homage which those principles have received in the courts of law."[448] The time has come for equity to once again play a muscular role in policing the mortgage relationship. As the following subsections explain, the contours of this privity provide a legal connection between the various parties to the securitization that brings with it multi-party obligations and a meaningful system of liability.

1. The Connection

First, courts should find that as a matter of property law, privity exists between the mortgagor and whomever holds the ultimate rights to the underlying debt, and this privity includes anyone who acts for or on behalf of such person under the mortgage. This concept achieves a number of goals. First, it recognizes the disaggregation between the traditionally bilateral mortgagor and mortgagee relationship by sweeping into the relationship all intermediary parties. This includes not only mortgage servicers but also subservicers and contractors of the servicer, all of whom act with respect to the property pursuant to the powers granted by the mortgage. Second, it also recognizes that the holder of the underlying debt is the person for whom the mortgage exists. This will help clarify ambiguity in the case law regarding whether one can be the mortgagee, yet not the one who is owed performance on the debt. Fourth, by focusing on privity as a property law concept, the awkwardness of contractual privity—whereby the mortgagor signs a mortgage contract but then is denied rights against those who act in accordance with that contract—is set aside.

And in fact, the idea of property rights linking parties together is not without precedent. In the law of servitudes (specifically, real covenants), courts long recognized a link between parties that was created upon the transfer of a property interest.[449] This link (called privity of estate)[450] could, in turn, serve as a basis for conferring rights and duties upon the parties themselves. A grantor

448. KENT, *supra* note 70, at 151–52.

449. *See* Whitinsville Plaza, Inc. v. Kotseas, 390 N.E.2d 243, 247 (Mass. 1979). The rule was derived originally from England. *See* Keppell v. Bailey (1834) 39 Eng. Rep. 1042, 1048–50.

450. RESTATEMENT (FIRST) OF PROP. § 548 cmt. a (AM. L. INST. 1944) ("By privity is meant, in this connection, that there is, between the parties to the promise, some relation with respect to the land respecting the use of which the promise is made other than that arising out of the promise itself.").

could convey land to a grantee and, in doing so, impose upon the grantee, as the new owner of the land, the obligation to undertake or refrain from undertaking certain activities.[451] The obligation of the grantee was not based on contract but rather on the law of property—on the *horizontal privity of estate*[452] between the grantor and the grantee.[453] Moreover, a later transfer of the land to a subsequent grantee carried with it these same responsibilities. This was known as *vertical privity of estate*.[454] The idea was that acquisition of the land—of the property right—entailed an embrace of the obligation.[455] The new owner, much like the one before, was obligated to perform as a matter of property law—as a matter of being the holder of the interest.[456] It did not matter that the original grantor and the subsequent grantee had not contracted with one another—in other words, it did not matter that they were not in privity of contract. Rather, the *privity of estate*, to quote courts and scholars, acts "as a substitute for privity of contract, which exists between the original covenanting parties and which is ordinarily required to enforce a contractual promise."[457] The privity approach described here may also find favor among scholars. For example, leading real estate scholar Wilson Freyermuth has argued for the application of servitude privity concepts to bind junior lienholders to a mandatory foreclosure arbitration provision contained in a senior mortgage contract.[458]

I advocate for reconceptualized privity of estate in the mortgage securitization setting as well. The interest that is conveyed from grantor to grantee is the mortgage interest. That interest is then conveyed again and subsequently fragmented as part of the securitization process. The servicer, acting pursuant to the mortgage so granted, also has privity with the homeowner, as do subservicers. Property contractors, whose primary purpose is to exercise the possessory rights of the mortgagee, also have privity with the homeowner.

At each stage, there remains a connection—a *privity* in property law—back to the mortgagor-homeowner. In recognizing this connection, courts will be able to hold that the mortgage servicer has privity of estate with the homeowner even though there is no privity of contract, and so on.

451. RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 2.4 cmt. a (AM. L. INST. 2000).

452. For a discussion of horizonal privity in the literature, see CHARLES E CLARK, REAL COVENANTS AND OTHER INTERESTS WHICH "RUN WITH LAND" 139–43 (2d ed. 1947).

453. *See* Wykeham Rise, LLC v. Federer, 52 A.3d 702, 714–15 n.18 (Conn. 2012).

454. For a discussion of the privities, see William B. Stoebuck, *Running Covenants: An Analytical Primer*, 52 WASH. L. REV. 861, 876–81 (1977).

455. *See* Runyon v. Paley, 331 N.C. 293, 302, 416 S.E.2d 177, 184 (1992).

456. Stoebuck, *supra* note 454, at 876.

457. *Runyon*, 331 N.C. at 302, 416 S.E.2d at 184; *see also* HERBERT THORNDIKE TIFFANY, A TREATISE ON THE MODERN LAW OF REAL PROPERTY AND OTHER INTERESTS IN LAND § 345 (1912).

458. *See* R. Wilson Freyermuth, *Foreclosure by Arbitration?*, 37 PEPP. L. REV. 459, 505–07 (2010) [hereinafter Freyermuth, *Foreclosure by Arbitration?*].

2. The Duty

Second, this equitable privity relationship, having been so established, should impose upon the parties a generalized duty to act in good faith. This obligation would create independent and customizable duties on the parties. The duty would be independent such that it would allow the homeowner to enforce the duty, rather than have it be a passive duty attached to specific provisions of a given contract. In other words, it would be *free floating* throughout the contract. It would also be customizable in that it would be context sensitive.[459] If the act of the servicer consisted of loss mitigation negotiations, then the duty of good faith would wrap around those proceedings. If the act of the servicer was engaging a contractor to perform property preservation services, then the duty would imbue that relationship and any accompanying acts.

Imposing this duty would address the fact that most states' tort law does not impose a duty on financial institutions, particularly in the loss mitigation context. It would also be more straightforward than the multi-factor and variable tests employed by some states in order to find that a duty (a special relationship) exists at all.

And here again, such a duty is not outside the bounds of existing property law. Under traditional property law categories, once the real covenant was confected (as described above), the law imposed default rules on the holder of the right so transferred. The individual entitled to enforce or enjoy the benefit of the real covenant was allowed to do so only "in a manner that is reasonably necessary for the convenient enjoyment of" it.[460] Disputes between the parties were resolved in court "in a spirit of mutual accommodation" and with an aim toward the "socially productive use of land."[461] Said another way, the connection created a kind of duty to act in good faith.

Of course, in the context of real covenants, the default rules could be contracted around by the parties, but here courts could borrow from early mortgage law to make them nonwaivable. As noted, equity played a once pivotal role in mortgage law—one need look no further than the equity of redemption. Courts enforced the right of a mortgagor to redeem the property by paying the amount due plus interest at any time prior to the foreclosure.[462] And this was the case even when overreaching creditors attempted to thwart the rule through contract; Jones observed that any "agreement or stipulation cutting off the right

459. *See* R. Wilson Freyermuth, *Enforcement of Acceleration Provisions and the Rhetoric of Good Faith*, 1998 BYU L. REV. 1035, 1041–69 (arguing for courts to impose "a broader conception of good faith" when it comes to the decision of a mortgagee to accelerate the debt after a default").

460. RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 4.10 (AM. L. INST. 2000).

461. *Id.* § 4.10 cmts. a, b.

462. *See* Newcomb v. Bonham (1681) 23 Eng. Rep. 266, 267.

of redemption has always been held to be utterly void."[463] The same rule could be applied here under the theory that this mortgage-based duty to act in good faith "is a creature of the law," and, as such, any curtailment or diminution of the right would be "contrary to the rules of equity" and could not "be carried into effect."[464]

The law of real covenants is not the only place, however, where property law imposes obligations on parties that are separate and apart from purely tort- or contract-based foundations. The doctrine of waste and the warranty of habitability can both serve as support for the fashioning of this duty of good faith. With respect to waste, the law broadly prohibits those with possessory interests in property from committing acts that would prejudice future interest holders.[465] This means not only refraining from committing acts that would affirmatively damage property but also failing to maintain the property.[466] Mortgage law could borrow from this concept and impose on mortgagees and those acting under the mortgage (in all their various forms ranging from servicers to contractors) the obligation to act in good faith as a derivative of the prohibition on committing acts of waste.

Even more analogous, in landlord-tenant law the implied warranty of habitability was designed for parallel reasons of creditor-like overreaching.[467] Prior to its creation by courts, urban landlords could (and did) maintain their properties in poor repair, leaving their tenants living in substandard housing.[468] The traditional rule, however, was that tenants accepted the property in the condition they received it (*caveat lessee*).[469] In the 1970s, however, tenants' rights advocates began what became known as the landlord-tenant revolution.[470] Among other victories, this resulted in courts (and then legislatures) imposing

463. JONES, *supra* note 32, at 7.

464. 2 LEONARD A. JONES, A TREATISE ON THE LAW OF MORTGAGES OF REAL PROPERTY 1039 (5th ed. 1894).

465. *See* Sally Brown Richardson, *Reframing Ameliorative Waste*, 65 AM. J. COMPAR. L. 335, 365–77 (2017). *See generally* Thomas W. Merrill, Melms v. Pabst Brewing Co. *and the Doctrine of Waste in American Property Law*, 94 MARQ. L. REV. 1055 (2011) (detailing how the rules of waste have changed through time and how courts compare economic values to analyze waste).

466. *See* Keesecker v. Bird, 490 S.E.2d 754, 769–70 (W. Va. 1997); Cowart v. White, 711 N.E.2d 523, 531–32 (Ind. 1999), *aff'd on reh'g*, 716 N.E.2d 401 (Ind. 1999).

467. *See* Frank I. Michelman, *The Advent of a Right to Housing: A Current Appraisal*, 5 HARV. C.R.-C.L.L. REV. 207, 213–14 (1970).

468. *See* Werner Z. Hirsch & Cheung-Kwok Law, *Habitability Laws and the Shrinkage of Substandard Rental Housing Stock*, 16 URB. STUD. 19, 19–22 (1979).

469. *See* Propst v. McNeill, 932 S.W.2d 766, 767–68 (Ark. 1996).

470. *See* Melissa T. Lonegrass, *Convergence in Contort: Landlord Liability for Defective Premises in Comparative Perspective*, 85 TUL. L. REV. 413, 414–15 (2010). *See generally* Mary Ann Glendon, *The Transformation of American Landlord-Tenant Law*, 23 B.C. L. REV. 503 (1982) (detailing what is known as the landlord-tenant revolution and examining its "fundamental shifts in the technical foundations of commercial and residential landlord-tenant law").

an implied duty on residential landlords[471] to make repairs to the leased premises when necessary and to generally keep the property suitable for human habitation.[472] Moreover, this rule applies regardless of what the lease contract might otherwise provide—it is not waivable.[473]

Notably, there are strong parallels between the law of the pre-warranty-of-habitability period and the assumptions that unfortunately still undergird mortgage law. The warranty was adopted in response to significant changes in the residential leasing market.[474] The old *caveat lessee* imagined a medieval tenant farmer who largely used the leased premises for agricultural purposes. The primary driver of the lease was not to use the property as a dwelling.[475] Thus, the sanctuary or housing considerations were more secondary, that is, if they were present at all. Also, tenant farmers, as those skilled in agricultural matters, would make most repairs themselves. This is not true of the modern residential tenant who often has no particular skill in conducting plumbing, electrical, or other work necessarily to maintain the dwelling in habitable condition. And lastly, the prior law envisioned generally equal bargaining power between the two, such that any terms and conditions agreed to had come about due to a true meeting of the minds and were mutually agreeable. The modern lease, however, is largely on a take-it-or-leave-it basis, without the tenant having any meaningful ability to negotiate. They are, in fact, contracts of adhesion.

All of these changes in the dynamics of the residential lease transaction led courts, then followed by lawmakers, to create an implied and nonwaivable duty aimed at balancing the power between landlords and tenants. As described in Part I, modern mortgage law still envisions the old way of transacting in landed security, but this vision is divorced from the modern transaction itself.[476] This is why, like with the landlord-tenant revolution of the 1970s, it is time for a *mortgage law revolution*—one that properly balances the rights of homeowners against the many invisible and overly powerful mortgage-creditor intermediaries. And, as noted above, property law already provides all the conceptual tools and precedents for a duty of good faith, conveyed through the transmission lines of privity of estate, to arise.

471. The first major adoption was in *Javins v. First National Reality Corp*., 428 F.2d 1071, 1072–73 (D.C. Cir. 1970), but the doctrine has its origins in *Delmater v. Foreman*, 239 N.W. 148, 149 (Minn. 1931).

472. *See* Young v. Patukonis, 506 N.E. 2d 1164, 1168 (Mass. App. Ct. 1987); Rosier v. Brown, 601 N.Y.S.2d 554, 557 (Rochester City Ct. 1993); Jack Spring, Inc. v. Little, 280 N.E. 2d 208, 217 (Ill. 1972); Hilder v. St. Peter, 478 A.2d 202, 208 (Vt. 1984).

473. Knight v. Hallsthammar, 623 P.2d 268, 272 (Cal. 1981).

474. *See* Paula A. Franzese, Abbott Gorin & David J. Guzik, *The Implied Warranty of Habitability Lives: Making Real the Promise of Landlord-Tenant Reform*, 69 RUTGERS U. L. REV. 1, 9–10 (2016).

475. Lisa T. Alexander, *Community in Property: Lessons from Tiny Homes Villages*, 104 MINN. L. REV. 385, 457–58 (2019).

476. *See supra* Section I.B.

3. The Liabilities

Third, and lastly, courts should deem, as part of the privity of estate link and accompanying duties, the holder of the mortgage debt liable for the acts of each and every person who acts on its behalf under the mortgage. This means that the wrongful acts of the mortgage servicer should create liability for the trust. Additionally, wrongful acts of subservicers should create liability for the master servicer, and the wrongful acts of contractors should create liability for the servicers or subservicers that engage them to perform the work.

The result of this would be that those who are best able to provide recourse (specifically, those with the most financial assets and in the best position to guard against wrongful acts) are obligated to do so. Litigants would no longer face an uphill climb in holding primary actors accountable merely because they lack access to sufficient internal details of the relationship between the parties in order to make out a successful agency claim. Additionally, it will remove the self-serving function of independent contractor provisions in servicing and other third-party contractor agreements.

Here again, the law provides doctrinal links—this time, not in the common law of property, but in the consumer protection provisions contained in the Uniform Commercial Code ("UCC"). Under Article 9 of the UCC, creditors who have a security interest in personal property of a debtor are allowed to engage in self-help by taking possession of the collateralized property after the debtor defaults.[477] The typical example where this occurs is in the context of auto lending.[478] A consumer will purchase a car from a dealer on credit.[479] The consumer takes the car with an obligation to pay over time (plus interest), and the dealer takes a security interest in the automobile.[480] If the consumer fails to pay, then the dealer can repossess the vehicle and thereafter recoup the loss. Importantly, however, Article 9 prohibits the secured creditor from seizing the vehicle if doing so would breach the peace.[481] Courts have interpreted this phrase quite broadly—even the mere perception of violation is enough to violate the standard and thereby force the creditor to retreat.[482] The use of

477. U.C.C. § 9-609 (AM. L. INST. & UNIF. L. COMM'N 2020).

478. *See* Ford Motor Credit Co. v. Ryan, 189 Ohio App. 3d 560, 2010-Ohio-4601, 939 N.E.2d 891, at ¶ 34.

479. *See generally* Adam J. Levitin, *The Fast and the Usurious: Putting the Brakes on Auto Lending Abuses*, 108 GEO. L.J. 1257 (2020) (providing an overview of the auto finance industry).

480. Jim Hawkins, *Credit on Wheels: The Law and Business of Auto-Title Lending*, 69 WASH. & LEE L. REV. 535, 538 (2012).

481. U.C.C. § 9-609 (AM. L. INST. & UNIF. L. COMM'N 2020).

482. *See* Deavers v. Standridge, 242 S.E.2d 331, 333–34 (Ga. Ct. App. 1978); Ryan McRobert, *Defining "Breach of the Peace" in Self-Help Repossessions*, 87 WASH. L. REV. 569, 580 (2012).

offensive or insulting language during the repossession will also suffice to cause a breach of the peace.[483]

Most importantly for our purposes, courts have imposed a jurisprudential absolute liability rule on secured creditors even when their agents are the ones that actually cause the breach of the peace.[484] Secured creditors almost always use repossession companies to retrieve collateral—auto lenders and dealers do not undertake such actions themselves.[485] Under this court-made rule, even if the agreement between the creditor and the contractor stipulates an independent contractor relationship—and even if the facts and circumstances of the relationship would not rise to the level of master-servant under traditional agency law—courts still hold the creditor liable for the illegal acts of the contractor.[486] The obligation not to breach the peace cannot be delegated to the contractor.

Homeowners do not benefit from this sensible rule in the mortgage context as they do in auto finance transactions—but they should. Courts should use the example of commercial law to hold mortgage creditors accountable for the acts of their contractors and not allow self-serving contractual provisions to serve as an escape from ultimate responsibility. This liability can run on the rails of the privity of estate and be powered by the general duty of good faith that each party must observe.

a. *Limiting* Merrill*'s Scope*

I do note here, as I did above,[487] that the *Merrill* doctrine has in the past served as a barrier to liability for state and federal courts in imposing master-servant liability when the party seeking to be held liable as principal is either Fannie Mae or Freddie Mac. I argue here, however, that the current articulation of *Merrill* is overly broad and, in fact, should not apply to issues of botched loss mitigation processes and the negligent supervision of third-party contractors under my privity of estate framework for two reasons. *Merrill* does not stand for the proposition that no federal instrumentality may ever be subject to an estoppel suit, as it has sometimes been interpreted.[488] Instead, as discussed in the following pages, the Court's holding is much narrower than that.

First, as to scope, the often-quoted language from *Merrill* is that an individual who enters into a contract "with the Government takes the risk of

483. *See* Fulton v. Anchor Sav. Bank, FSB, 452 S.E.2d 208, 213 (Ga. Ct. App. 1994); Freeman v. Gen. Motors Acceptance Corp., 205 N.C. 257, 258, 171 S.E. 63, 63 (1933); Martin v. Dorn Equip. Co., 821 P.2d 1025, 1028 (Mont. 1991).

484. Lewis v. Nicholas Fin., Inc., 686 S.E.2d 468, 470 (Ga. Ct. App. 2009).

485. *See* Hawkins, *supra* note 480, at 551.

486. U.C.C. § 9-609 cmt. 3 (AM. L. INST. & UNIF. L. COMM'N 2020).

487. *See supra* Section II.B.3 and accompanying discussion.

488. *See, e.g.*, Dupuis v. Fed. Home Loan Mortg. Corp., 879 F. Supp. 139, 145 (D. Me. 1995).

having accurately ascertained that he who purports to act for the Government *stays within the bounds of his authority*."[489] The inquiry thus centers on the agent's authority. In *Merrill*, the Court found that the Federal Crop Insurance Corporation did not have the authority to issue the insurance policy (either directly or through an agent) because of a then-existing regulation prohibiting insurance for reseeded wheat. Under this theory, the Court held that it did not matter that the farmers "reasonably believed that their entire crop was covered by petitioner's insurance."[490] They were charged with the knowledge of the regulation regardless, so it was not possible for the farmers to rely upon the agent-county committee's representation that the policy was valid. The decision over whether to issue crop issuance for reseeded wheat was not discretionary.[491]

These facts, of course, are quite different than those that typically arise in mortgage-servicer litigation outlined in prior parts of this Article. The process of approving a loss mitigation application and dictating to (and supervising) property contractors is not prescribed so starkly by regulation. Rather, these activities are largely left to the discretion of the servicer, as accorded to it by the sponsor of the securitization (Fannie or Freddie).[492] For example, the Fannie Mae Servicing Guide provides that "the policies and standards described in the [guide] are intended to set forth the broad parameters under which the servicer must exercise sound and professional judgment as a mortgage loan servicer in the performance of its duties."[493] Moreover, the guide provides that "in most instances Fannie Mae has not set forth absolute requirements because it believes that the servicer needs to maintain the discretion to apply appropriate judgment in dealing with borrowers and mortgage loans on a case by case basis, consistent with Fannie Mae's servicing policies."[494] Perhaps even more applicable here, Fannie Mae stipulates that even where it "has set forth a 'requirement,' it has not enumerated specifically how the servicer should implement it."[495] Freddie Mac gives similar discretion to its servicers.[496]

In light of these directives, one can see that when a servicer is careless or reckless in processing a loss mitigation application or managing a third-party contractor, it is a matter of exercising discretion poorly—discretion that it has

489. Fed. Crop Ins. Corp. v. Merrill, 332 U.S. 380, 384 (1947) (emphasis added).

490. *Id.* at 383.

491. *Id.*

492. *See* ODINET, FORECLOSED, *supra* note 97, at 43, 46, 48, 61.

493. *Servicing Guide: A2-1-01 General Servicer Duties and Responsibilities*, FANNIE MAE (July 10, 2019), https://servicing-guide.fanniemae.com/THE-SERVICING-GUIDE/Part-A-Doing-Business-with-Fannie-Mae/Subpart-A2-Getting-Started-with-Fannie-Mae/Chapter-A2-1-Servicer-Duties-and-Responsibilities/A2-1-01-General-Servicer-Duties-and-Responsibilities/1581707621/A2-1-01-General-Servicer-Duties-and-Responsibilities-07-10-2019.htm [https://perma.cc/P3FS-95S2].

494. *Id.*

495. *Id.*

496. FREDDIE MAC, SINGLE-FAMILY SELLER/SERVICER GUIDE 8101.1-1 (2020), https://guide.freddiemac.com/ci/okcsFattach/get/1008249_2 [https://perma.cc/3FYJ-MJ55].

been given the legal authority to exercise. This is very different than issuing an insurance policy for which the principal cannot provide (*Merrill*) or accepting prepayment on a contract that prohibits it (*Mendrala*).

Against this backdrop, courts faced with master-servant liability questions under my privity of estate framework should be able to distinguish *Merrill*. Consider that although the Seventh Circuit in *Mendrala* carefully drew parallels between the no prepayment provision in the promissory note and the lack of servicer authority to have accepted the prepayment (mirroring the analysis in *Merrill* dealing with the regulatory prohibition on insuring certain types of crop losses),[497] the First Circuit in *Faiella* (which dealt with a typical wrongful foreclosure case) engaged in no such analysis. Instead, the *Faiella* court broadly adopted the holding that under no circumstances may "the federal government . . . be bound by the unauthorized acts of its agents."[498] To support its claim, the court held that public policy considerations related to sovereign immunity demanded this result—the sweeping foundations of which have recently been fiercely contested by scholars like Kate Sablosky Elengold and Jonathan D. Glater.[499] The portion of the *Merrill* analysis—the linchpin of the decision—dealing with actual authority and the act wrongfully undertaken is missing from *Faiella* completely. Had this analysis been undertaken, the *Faiella* court should have distinguished *Merrill*.

b. *Expanding* Merrill*'s Exceptions*

The second rationale for imposing liability deals with exceptions to *Merrill*'s rule. To make this point, we set aside *Merrill* and look again to *Mendrala*, which dealt specifically with a master-servant claim made against Freddie Mac. In that case, the Seventh Circuit correctly said that the holding in *Merrill* stood for the proposition "that federal instrumentalities cannot be estopped by persons acting beyond their authority," but it also observed that the Supreme Court "has declined to declare explicitly that the no-estoppel rule is without exception."[500] Two things here are worthy of note: the focus on authority and the possibility for exceptions. The first point again (and appropriately) harkens back to *Merrill*, which focused on the actual authority of the agent compared to the act undertaken. The second point suggests that even if there was no actual authority, there still might be an instance where estoppel would lie.[501] This is consistent with other holdings, such as a 1984 case where

497. Mendrala v. Crown Mortg. Co., 955 F.2d 1132, 1139 (7th Cir. 1992).

498. Faiella v. Fed. Nat'l Mortg. Ass'n, 928 F.3d 141, 147 (1st Cir. 2019).

499. Kate Sablosky Elengold & Jonathan D. Glater, *The Sovereign Shield*, 73 STAN. L. REV. 969, 969 (2021); *see also* Kate Sablosky Elengold & Jonathan D. Glater, *The Sovereign in Commerce*, 73 STAN. L. REV. 1101, 1101–02 (2021).

500. *Mendrala*, 955 F.2d at 1140.

501. For an example of when a court has found such an exception, see *Azar v. U.S. Postal Serv.*, 777 F.2d 1265, 1269–71 (7th Cir. 1985).

the Court said that although it was urged to adopt "a flat rule that estoppel may not in any circumstances run against the Government," it has nevertheless "left the issue open in the past, and do[es] so again today."[502]

I argue here that one place where such an exception should exist is in instances where shielding a federal instrumentality, like Fannie or Freddie, would actually frustrate *Merrill*'s purpose. The court in *Mendrala* discussed how Freddie Mac "has a public statutory mission[] to maintain the secondary mortgage market and assist in meeting low- and moderate-income housing goals," and how these goals are furthered by providing *Merrill* protection against estoppel.[503] I argue that it is quite the opposite—shielding Freddie Mac from the wrongful acts of its agents in the way of botched loss mitigation applications and wrongful pre-foreclosure activities actually frustrates the congressional purpose. Keeping struggling homeowners in their homes through careful and good faith processing of their loss mitigation applications and properly dealing with property contractors in the pre-foreclosure period are exactly in line with the massive public intervention into the housing market that is the very essence of Freddie Mac. Indeed, the argument for such a reading is even stronger now than it has been in the past. One could at least assert that the pre-2008, private nature of Freddie Mac (and Fannie Mae, for that matter), in which it was controlled by shareholders, meant that it owed less of a public-facing duty to keep individuals in their homes to the largest extent possible. That argument, however, has almost no force today, when both entities are and have been for over a decade under the conservatorship of the federal government.[504]

The existence of the conservatorship supports the argument against applying *Merrill* to the servicer litigation outlined above for three reasons. First, the public is entirely in the driver's seat in running these two entities. The Federal Housing Finance Agency (a government entity whose head is appointed by the President and confirmed by the Senate) "has the powers of the management, boards, and shareholders of Fannie Mae and Freddie Mac."[505] Asset recovery derived from foreclosures and related activity is private firm-focused conduct. But Fannie and Freddie are not private firms in any meaningful sense. They are public mission-driven, they are run by the public, and, as outlined below, they were rescued from ruin by the public. Therefore, public considerations should drive any interpretation of the entities' missions—specifically, properly dealing with distressed homeowners in both loss mitigation and foreclosure-related activities.

502. Heckler v. Cmty. Health Servs. of Crawford Cnty., Inc., 467 U.S. 51, 60.

503. *Mendrala*, 955 F.2d at 1140–41.

504. *See Conservatorship*, FED. HOUS. FIN. AGENCY, https://www.fhfa.gov/Conservatorship [https://perma.cc/9KTV-XBPN].

505. *Id.*

Second, one of the three core objectives of the conservatorship is to "foster . . . national housing markets that support sustainable home-ownership."[506] Relatedly, one of the conservatorship's strategic goals is to benefit "homeowners . . . [by] ensuring mortgage credit availability for affordable housing through the economic cycle."[507] In both places, there is a focus on creating and maintaining homeownership and doing so in an affordable way, including through down economic periods. This again suggests that demanding careful and good faith loss mitigation processes for homeowners in distress (and providing liability in the face of failures to provide them) is in keeping with congressional intent for the GSEs. One need look no further for fresh evidence of this interpretation of Congress's primary intent for Fannie and Freddie than the various rescue packages and agency activities related to housing and the COVID-19 pandemic. All of those packages and activities focused on helping and protecting homeowners, whether through moratoria or mandatory loss mitigation frameworks.

Third, and lastly, Fannie Mae and Freddie Mac faced insolvency and ruin in the wake of the 2008 financial crisis.[508] Taxpayers bailed out the two firms in a total amount of $187 billion.[509] This bailout kept the firms themselves and the larger housing market operating.[510] It would seem quite unjust, then, to say that now that Fannie and Freddie have paid back that amount (although they still remain in conservatorship) that they owe no obligation to help individuals stay in their homes when possible and to treat them and their property with respect when engaging third parties to act on their behalf. To quote the Court in *Heckler v. Community Health Services of Crawford County, Inc.*,[511] the benefits of denying estoppel against the government can be "outweighed by the countervailing interest of citizens in some minimum standard of decency, honor, and reliability in their dealings with their Government."[512] For the reasons above, such interests exist in the mortgage servicer litigation outlined in this Article.

CONCLUSION

For too long, property law has abdicated responsibility for addressing the increasingly complex financial aspects of the mortgage transaction and the inequities that this complexity has caused. Instead, this space has been left to federal regulations governing the conduct of financial intermediaries,

506. *Id.*

507. *Id.*

508. ODINET, FORECLOSED, *supra* note 97, at 33–35.

509. Kimberley Amadeo, *What Was the Fannie and Freddie Mac Bailout?*, BALANCE (Dec. 1, 2020), https://www.thebalance.com/what-was-the-fannie-mae-and-freddie-mac-bailout-3305658 [https://perma.cc/57EZ-PASP].

510. *Id.*

511. 467 U.S. 51 (1984).

512. *Id.* at 61.

legislatures in governing specific aspects of the foreclosure process, and the ill-fitting and byzantine rules of tort and contract law to make up the difference. But common law property's equitable principles have a powerful role to play in the foundational aspects of the mortgage transaction. And this role of equity in mortgages has a long and storied pedigree. Yet, at some point in the last one hundred years, that history was set aside and the duty to police the fundamentals of the mortgage relationship was abandoned.

The financialization of the mortgage transaction requires courts to step into this role once again and modernize mortgage law. In describing the historical role of equity in mortgages, Osborne wrote: "When legal machinery fashioned to do one job is used for another for which it is ill adapted, the work is badly done, and sooner or later alterations in [the] machine must be made."[513] Yet, the time for mere alterations has come and passed. A fundamental and robust rethinking is necessary; this Article shows how it should be done.

One cannot put too fine a point on the serious consequences that were felt by so many families in the wake of the 2008 financial crisis due to mortgage law's obsolescence. Today, the effects of COVID-19 threaten the housing security of millions. And of those threatened, it will be those who are chronically hard-hit and least able to rebound who will bear the brunt. Communities of color experience disproportionately higher rates of homelessness, as well as housing and economic insecurity.[514] In one study of individuals conducted in April 2020, 32% of Black and 41% of Latinx adults reported employment losses because of the pandemic—with women in both of those groups being the most affected.[515] The loss of income and accumulated wealth resulting from this pandemic will have a serious impact on the ability of many individuals to pay their mortgage loans each month. Moreover, the scale of such financial distress will put enormous pressure on the mortgage finance system—a system that is already revealing itself to be ill-equipped to handle the flood of homeowner phone calls, loss mitigation applications, and forbearance requests.[516]

513. GEORGE E. OSBORNE, HANDBOOK ON THE LAW OF MORTGAGES 16 (1951).

514. NAT'L L. CTR. ON HOMELESSNESS & POVERTY, RACISM, HOMELESSNESS, AND COVID-19 (2020), https://nlchp.org/wp-content/uploads/2020/05/Racism-Homelessness-and-COVID-19-Fact-Sheet-_Final_2.pdf [https://perma.cc/QCV2-8J3N].

515. Kim Parker, Juliana Mesasce Horowitz & Anna Brown, *About Half of Lower-Income Americans Report Household Job or Wage Loss Due to COVID-19*, PEW RSCH. CTR. (Apr. 21, 2020), https://www.pewsocialtrends.org/2020/04/21/about-half-of-lower-income-americans-report-household-job-or-wage-loss-due-to-covid-19/ [https://perma.cc/54TH-GM87].

516. Mary Childs, *When Rent Doesn't Get Paid, Someone Pays a Price*, NPR (Apr. 16, 2020, 4:18 PM), https://www.npr.org/2020/04/16/836424399/when-rent-doesnt-get-paid-someone-pays-a-price [https://perma.cc/Q5FR-PJQX]; CONSUMER FIN. PROT. BUREAU, SUPERVISORY HIGHLIGHTS COVID-19 PRIORITIZED ASSESSMENTS SPECIAL EDITION 5–9 (2021), https://files.consumerfinance.gov/f/documents/cfpb_supervisory-highlights_issue-23_2021-01.pdf [https://perma.cc/E5S4-7TA2].

But this time, homeowners should have a tool to effectively defend themselves against mortgagor-creditor wrongdoing—and, as explained in these pages, a *modernized mortgage law* should and can be that tool.