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Life after 'Eaton': the good, the bad and the unknown

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The Supreme Judicial Court on June 22 issued its long-awaited decision in Eaton v. Federal Nat. Mortg. Ass'n, 462 Mass. 569 (2012), and established a new interpretation of the statutes governing mortgage foreclosures by sale.

The Eaton decision follows on the heels of U.S. Bank Nat. Ass'n v. Ibanez, 458 Mass. 637, 651 (2011) (answering question of who may foreclose and concluding the "foreclosing entity must hold the mortgage at the time of the notice and sale" or foreclosure is void), and Bevilacqua v. Rodriguez, 460 Mass. 762, 771 (2011) (addressing attempt by third party to quiet title to property after foreclosure that violated standard set forth in Ibanez and concluding he had no standing as his claim to title depended "on the validity of his grantor's title," which was void), and seemingly completes the foreclosure trilogy.

In Eaton, the SJC addressed "the propriety of a foreclosure by power of sale undertaken by a mortgage holder that did not hold the underlying mortgage note" and concluded that the term "mortgagee" as used in the Massachusetts foreclosure statutes refers to "the person or entity then holding the mortgage and also either holding the mortgage note or acting on behalf of the note holder" (emphasis added).

It is the language after the "and" that is the new interpretation and language that lenders and servicers were not happy to see.

By virtue of its holding, the SJC altered prior practice by many lenders by requiring that the mortgagee not only establish it is the mortgagee of record, but also demonstrate that it either holds the mortgage note or is acting on behalf of the note holder.

Given that mandated change in practice, the SJC then addressed whether its interpretation is to be given retroactive or prospective effect. If there was going to be any change in the prior practice of lenders, the issue was seminal to those in the lending and title industries as it could have opened the proverbial Pandora's box had it been retroactive.

Unlike its conclusion in Ibanez, the SJC held that the Eaton decision applies only prospectively, i.e., "only to mortgage foreclosure sales for which the mandatory notice of sale has been given after the date of this opinion."

While the SJC's new interpretation of the foreclosure statutes was a blow to lenders, those in the lending and title industries breathed a collective sigh of relief at its prospective application.

The good

From a lender's perspective, a typical foreclosure is conducted solely by the mortgagee, which in many cases is a servicer acting on behalf of the note holder.

That is especially true in today's world of securitized loans and Pooling and Servicing Agreements, or PSAs.

The lower court decision in Eaton required the unification of the note and mortgage in the foreclosing entity prior to foreclosure and concluded that "[a]llowing foreclosure by a mortgagee not in possession of the mortgage note is [improper]." Eaton v. Fed. Nat. Mortg. Ass'n, SUCV201101382, 2011 WL 6379284 at *5 (Mass. Super. June 17, 2011), vacated and remanded, 462 Mass. 569 (2012).

If the SJC upheld the lower court, the practices of many lenders would have been invalidated.

While the SJC's decision in Eaton requires that there be some connection between the mortgagee and the note holder, the foreclosing entity need not have physical possession or ownership of the note and can act as the authorized agent of the note holder.

Thus, the SJC's conclusion that general agency principles apply in the context of mortgage foreclosure sales makes the Eaton decision lender-friendly in this critical aspect.

Perhaps more importantly, the most appealing aspect of the Eaton decision to lenders is its prospective application.

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Given the SJC's "new" interpretation of G.L.c. 244, §14, which makes no direct mention that the mortgagee must also hold the note or act on behalf of the note holder, the SJC determined its decision should be prospective.

The SJC recognized that "there may be significant difficulties in ascertaining the validity of a particular title" if the new interpretation "is not limited to prospective application."

Such a pronouncement seemingly avoids a legal battle over the myriad of foreclosures occurring through June 22 and affords lenders and servicers an opportunity to comply with the new interpretation on a going forward basis.

From a borrower's perspective, the SJC allowed Toto to pull down the curtain to expose the Wizard and seemingly will permit borrowers to challenge whether a mortgagee of record actually holds the mortgage note or is acting on behalf of the note holder.

Under practice before Eaton, that was not a challenge courts typically permitted or a tactic commonly utilized by borrowers.

While one assumes a servicer, for example, will know the identity of the note holder and be able to locate a document such as a PSA to demonstrate the relationship between the note holder and mortgagee, that may not always be the case. Just look at Ibanez, wherein the lender was unable to produce documentation sufficient to demonstrate it held the mortgage at the time of notice and sale.

The bad

If you are a lender, the preferred result would have been a decision by the SJC that G.L.c. 244, §14 permits a "mortgagee" to conduct a foreclosure sale and that there is no need for the mortgagee of record to prove anything further.

Eaton, however, will require mortgagees to do more than simply rely on the customary record documents.

If you are a borrower, you were hoping the SJC would require that there be a unification of the note and mortgage before a mortgagee can issue a foreclosure notice and conduct a sale, and that any new interpretation of the foreclosure statutes be retroactive.

Borrowers lost on both fronts. If the lower court decision was upheld, it would have had a dramatic impact on the foreclosure landscape, invalidated countless foreclosures, stalled numerous others that are in process, and given borrowers leverage to try to undo foreclosures, modify their loans or extract other financial concessions, and potentially keep their homes.

The unknown

The unknown variable created by Eaton is how lenders can comply with the SJC's new interpretation of the statutes governing mortgage foreclosures by sale.

While the SJC attempted to provide a roadmap as to how to demonstrate the relationship between mortgagee and note holder, its commentary left many unanswered questions.

The SJC opined that an affidavit can be filed pursuant to G.L.c. 183, §5B stating that the mortgagee either held the note or acted on behalf of the note holder at the time of the foreclosure sale. However, the SJC also acknowledged that the sumission of such an affidavit is only available with respect to unregistered land.

So how do lenders provide that additional element of proof when confronted with registered land?

To avoid having to file S-petitions when confronted with registered land, or affidavits pursuant to G.L.c. 183, §5B when confronted with unregistered land, odds are that practitioners simply may insert language into the affidavit of sale required to be recorded pursuant to G.L.c. 244, §5 when dealing with both registered and unregistered land.

While not foreclosing that method of proof, it is curious that the SJC commented only on the availability of G.L.c. 183, §5B when dealing with unregistered land. It is also uncertain whether any such affidavit will constitute a prima facie case subject to attack by a borrower and how much leeway borrowers will have to conduct discovery in post-foreclosure eviction proceedings.

In addition, foreclosure is typically only half of the equation, as the purchaser at the foreclosure sale must then obtain possession of the property.

Although many view Ibanez, Bevilacqua and Eaton as a foreclosure trilogy, another recent decision entitled Bank of New York v. Bailey, 460 Mass. 327 (2011), has a practical impact.

In Bailey, 460 Mass. at 328, the SJC "conclude[d] that the Housing Court has jurisdiction to consider the validity of the plaintiff's title as a defense to a summary process action after a foreclosure sale pursuant to G.L. c. 239, § 1."

If you read Bailey and Eaton together, borrowers can now challenge a purchaser's title in a post-foreclosure eviction proceeding and can seemingly demand evidence that the mortgagee conducting the sale either held the mortgage note or was acting on behalf of the note holder.

In Eaton, the SJC commented in a footnote that the borrower "is entitled to pursue discovery" on that very issue on remand. Accordingly, the objective of securing "the just, speedy, and inexpensive determination of every summary process action" as commanded in Rule1 of the Uniform Summary Process Rules just became harder to achieve.

Overall, the Eaton decision is good news for foreclosing parties seeking to realize upon their collateral, but many practical questions are left unanswered.

It will be interesting to see how courts interpret Eaton and how title companies will address and potentially adopt new title standards seeking to comply with its mandate.