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INTRODUCTION

The past year has witnessed the greatest economic meltdown since the Great Depression. Institutions that have been household names have

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disappeared or de facto nationalized. As this paper is being written in the summer of 2009, the credit and stock markets have stabilized. However, most of the other economic news continues to be negative. The national unemployment rate is close to double digits and still climbing.[1] Several of our largest states passed that mark months earlier.[2] Foreclosures continue at high levels.[3] Welfare rolls are rising.[4] State governments are strapped for cash and many are drastically cutting services.[5]

At the core of this crisis is the mortgage meltdown. As a long-time mortgage law teacher, the past year has been perplexing, depressing and, at times, oddly exhilarating. Our subject matter, for good and ill, has clearly been at the heart of the American and world-wide economy. Just two or three years ago, I extolled to my classes the virtues of the secondary market for mortgages—how investors from all over the world were helping to finance home ownership in this country and elsewhere by purchasing mortgage-backed bonds secured by pools of home mortgages. Moreover, as Federal Reserve policy encouraged low interest rates,[6] housing prices soared, homeowners withdrew this newly created equity by refinancing and

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1. *News from the Jobs Front*, N.Y. TIMES, June 6, 2009, at A20 (noting that the May 2009 national unemployment rate rose to 9.4% and concluding that "[b]arring an economic miracle, unemployment will hit and probably surpass 10 percent this year"); *see also* Floyd Norris, *U.S. Jobless Rate Likely to Pass Europe's*, N.Y. TIMES, May 23, 2009, at B3.

2. *See* Justin Lahart & Erica Alini, *Unemployment Rate Rises in 48 States*, WALL ST. J., June 20, 2009, at A2 ("In 16 states and the District of Columbia, the unemployment rate topped the nation's 9.4% . . . ."); *California Led in Job Losses in April, Cutting 63,700*, N.Y. TIMES, May 23, 2009, at B2 (noting that for April 2009, the states with the highest unemployment rates are California, Michigan, Oregon, South Carolina and Rhode Island, all with rates eleven percent or higher).

3. Ruth Simon & James R. Hagerty, *Unemployment Vexes Foreclosure Plan*, WALL ST. J., June 26, 2009, at A4 ("Rising unemployment is complicating the . . . effort to reduce foreclosures and stabilize the housing market."); Editorial, *Foreclosures: No End in Sight*, N.Y. TIMES, June 2, 2009, at A22 ("A continuing steep drop in home prices combined with rising unemployment is powering a new wave of foreclosures."); Peter S. Goodman & Jack Healy, *Work Losses Hit Mortgages Seen as Safe*, N.Y. TIMES, May 25, 2009, at A1 ("With many economists anticipating that the unemployment rate will rise into the double digits from its current 8.9%, foreclosures are expected to accelerate.").

4. Sara Murray, *Numbers on Welfare See Sharp Increase*, WALL ST. J., June 22, 2009, at A1.

5. *See infra* note 155 and accompanying text.

6. *See* Scott E. Harrington, *Moral Hazard and the Meltdown*, WALL ST. J., May 23, 2009, at A9 ("The Federal Reserve played a key role in making these bets [on housing speculation and on taking out second mortgages] attractive to borrowers, lenders and investors. It kept interest rates at historically low levels until it was too late to prevent the eventual implosion. This deliberate policy and public statements by then Fed Chairman Alan Greenspan fueled demand for credit and housing and encouraged lenders to relax mortgage-lending criteria."); John B. Taylor, *How Government Created the Financial Crisis*, WALL ST. J., Feb. 9, 2009, at A19 (criticizing the Federal Reserve for keeping interest rates below known monetary guidelines which resulted in the housing boom and bust); Justin Fox, *Blame Them*, TIME, Jan. 12, 2009, at 43 ("[I]f the Fed is going to step in to prevent panics, it needs to do more to deflate the bubbles that inevitably precede those panics.").

thus found themselves newly enriched.[7] The prosperity seemed like it would never end.

At the core of this prosperity were mortgages that did not meet traditional credit standards. Sub-prime mortgages were packaged and sold as investment grade bonds to investors. These transactions were enabled by ratings agencies and investment banks which were mysteriously able to attach their seal of approval to these securities.[8] Everyone was betting on the continuing rise in real estate values. Then the bubble burst,[9] the economy tanked,[10] and the world continues to experience the negative externalities.

The financial cost of just the mortgage meltdown segment of the economic collapse for the federal government has been nothing short of breathtaking. Fannie Mae and Freddie Mac, the world's largest secondary

7. *See* Harrington, *supra* note 6, at A9 ("On the demand side, many subprime borrowers acquired properties with little or no money down. They faced relatively little loss if housing prices fell and they defaulted. Many people took cheap mortgages on investment property to speculate on housing-price increases. Others took cheap second mortgages to fund current consumption."); Peter Coy, *Lessons from the Front*, BUS. WEEK, Apr. 27, 2009, at 30–31 (referencing Hyun Song Shin from Princeton University, "The financial crisis arose, in large part, because companies and households borrowed too much."); Greg Ip et al., *Housing Bust Fuels Blame Game – Democrats Seize on Opponents' Role; Bipartisan Failures*, WALL ST. J., Mar. 19, 2008, at A1 ("Politicians of all stripes cheered on the lower interest rates that sparked the boom in housing and excesses in credit."); Fox, *supra* note 6, at 43 ("None of this would have happened if millions of us hadn't come to believe we could get something for nothing by taking on debts we couldn't repay.").

8. *See The Wages of Sin*, ECONOMIST, Apr. 25, 2009, at 80–81 ("By misreading the risk in mortgage-backed securities and other 'structured' products, the rating agencies Standard & Poor's, Moody's and Fitch played starring roles in the failure of finance."); Taylor, *supra* note 6, at A19 ("The effects of the boom and bust were amplified by several complicating factors including the use of subprime and adjustable-rate mortgages, which led to excessive risk taking. . . . Delinquency rates and foreclosure rates are inversely related to housing price inflation. These rates declined rapidly during the years housing prices rose rapidly, likely throwing mortgage underwriting programs off track and misleading many people. Adjustable-rate, subprime and other mortgages were packed into mortgage-backed securities of great complexity. Rating agencies underestimated the risk of these securities, either because of a lack of competition, poor accountability, or most likely the inherent difficulty in assessing risk due to the complexity.").

9. Steven Gjerstad & Vernon L. Smith, *From Bubble to Depression?*, WALL ST. J., Apr. 6, 2009, at A15 ("Both the Clinton and Bush administrations aggressively pursued the goal of expanding homeownership, so credit standards eroded. Lenders and the investment banks that securitized mortgages used rising home prices to justify loans to buyers with limited assets and income. Rating agencies accepted the hypothesis of ever rising home values, gave large portions of each security issue an investment-grade rating, and investors gobbled them up. . . . The price decline started in 2006. Then policies designed to promote the American dream instead produced a nightmare. Trillions of dollars of mortgages, written to buyers with slender equity, started a wave of delinquencies and defaults.").

10. *Id.* ("Borrowers' losses were limited to their small down payments; hence, the lion's share of the losses was transmitted into the financial system and it collapsed.").

market purchasers and securitizers of residential mortgages have failed and became wards of the federal government in 2008.[11] The cost of this nationalization to the taxpayers is now almost one hundred billion dollars and rising.[12] The U.S. Department of Treasury's Public-Private Investment Program (PPIP) is devoting an initial five hundred billion dollars to purchasing toxic mortgage-backed securities to remove them from the books of major financial institutions.[13] As one commentator described PPIP:

> In the event the securities end up worthless, private investors lose their money, but the bulk of the risk is borne by the government. If the securities hold their value or increase, on the other hand, the system is set up so that private investors get the majority of the gains, even though they put up only a minority of the money.[14]

In addition, the "Making Home Affordable" program announced by the Treasury in early 2009 is aimed at using federal subsidies of up to seventy-five billion dollars to modify millions of home loans.[15] While the final price tag for these and other federal programs is yet to be determined, it would hardly be surprising if it wound up being over a trillion dollars.

Ultimately, of course, billions of dollars worth of mortgages held directly or indirectly by the federal government will have to be foreclosed. Under our federal system, those foreclosures must be under state law.[16] While many states authorize a variety of nonjudicial or power of sale foreclosure procedures that are relatively efficient and fair, about forty percent of the states still use judicial foreclosure, a process that is costly, time-consuming and inefficient.[17] The functioning of judicial foreclosure during the current crisis in Florida can only be described as "surreal" or "Dickensian." In February 2009, Lee County, Florida's foreclosure docket consisted of 24,000 cases (as opposed to a normal caseload of 1900).[18] According to one journalist's description:

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11. *See infra* notes 173–80 and accompanying text.

12. *See infra* note 150 and accompanying text.

13. James B. Stewart, *Benefit from the Bailout*, SMART MONEY, July 2009, at 30, 30.

14. *Id.*

15. Press Release, U.S. Department of the Treasury, Making Home Affordable: Updated Detailed Program Description (Mar. 4, 2009), *available at* http://www.treas.gov/press/releases/reports/housing_fact_sheet.pdf.

16. *See generally* 1 GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW § 7 (5th ed. 2007).

17. *See infra* notes 26–28 and accompanying text.

18. Michael Corkery, *A Florida Court's 'Rocket Docket' Blasts Through Foreclosure Cases*, WALL ST. J., Feb. 18, 2009, at A1.

> During a break in the [judicial] hearing, lawyers used dollies to wheel in boxes containing hundreds of case files, which they piled onto tables and on the floor. One lawyer . . . ran between the judge's bench and the dozens of open boxes on the floor. His colleagues sat cross-legged on the courtroom floor, sorting through the files.[19]

State law governing security interests in rents in commercial mortgage transactions is also complex, conflicting and confusing.[20] When the current crisis hits commercial real estate and commercial mortgage-backed securities, federal bankruptcy courts will pay the price for this lack of uniformity.

It seems almost bizarre that a federal government that is largely footing this enormous bill for resolving the mortgage crisis should be subjected to this arcane, if quaint, state foreclosure procedure. While this patchwork system seems questionable in normal economic times, it clearly is unjustifiable in the present circumstances. This paper advocates congressional adoption of nonjudicial mortgage foreclosure both as to real estate and the rents it produces.[21] If such a pervasive approach is politically unrealistic, it advocates federalization when federal agencies foreclose or when security interests in rents are being enforced in bankruptcy courts.[22] It also suggests, but does not yet directly advocate, that it may be time for federal preemption of state anti-deficiency legislation.[23]

A. *State Law Divergence: An Overview*

"Uniform" is hardly a word one would appropriately use to describe the current law of real estate finance law. Mortgage law varies substantially from state to state and represents an often perplexing amalgam of English legal history, common law, and legislation.[24] This is the reality despite numerous attempts during the past century to achieve greater uniformity, and

19. *Id.* A similar caseload crisis exists in Miami-Dade County, Florida. During 2008, a total of 56,656 cases were filed. *See* Mortgage Foreclosure Filing Statistics, http://www.miami-dadeclerk.com/dadecoc/Mortgage-Statics.asp (last visited May 27, 2009). In 2005, before the mortgage crisis, the total was 7829. *Id.*

20. *See infra* notes 47–61, 194–96 and accompanying text.

21. *See infra* notes 140–92 and accompanying text.

22. *See infra* notes 193–98 and accompanying text.

23. *See infra* notes 239–47 and accompanying text.

24. 1 NELSON & WHITMAN, *supra* note 16, at 6–7.

even though the mortgage market is both national and international in scope and is a driving force in the nation's economy.[25]

This disarray is especially the case with respect to mortgage foreclosure. In about forty percent of the states, mortgages may be foreclosed only by a judicial action.[26] A typical judicial foreclosure entails a long series of steps: filing of a foreclosure complaint and lis pendens notice; service of process on all parties whose interests may be prejudiced by the proceeding; a hearing, frequently by a master in chancery who then reports to the court; the decree or judgment; the notice of sale; a public foreclosure sale, usually conducted by a sheriff; post-sale adjudication as to the disposition of the foreclosure proceeds; and, if appropriate, the entry of a deficiency judgment.[27] In some cases, an appeal may follow. In a contested judicial foreclosure, delay is endemic, and the result is a time-consuming and costly process.[28]

The remaining states utilize "power of sale" foreclosure, a nonjudicial process that is substantially less complicated and costly than its judicial counterpart.[29] After varying degrees of notice, the mortgaged property is sold at a public sale by a disinterested third party, such as a sheriff or a

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25. *See generally* UNIF. NONJUDICIAL FORECLOSURE ACT §§ 101–703, 14 U.L.A. 131 (2005).

26. 1 NELSON & WHITMAN, *supra* note 16, at 806. Much of the text and notes in the following three sections of this paper are derived from Grant S. Nelson & Dale A. Whitman, *Reforming Foreclosure: The Uniform Nonjudicial Foreclosure Act*, 53 DUKE L.J. 1399 (2004) [hereinafter *Reforming Foreclosure*]. For a comprehensive classification of states as to their use of judicial or power of sale foreclosure, see Andra C. Ghent & Marianna Kudlyak, *Recourse and Residential Mortgage Default: Theory and Evidence from U.S. States* 41–52 (Fed. Reserve Bank of Richmond, Working Paper No. 09-10, 2009), *available at* http://www.richmondfed.org/publications/research/working_papers/2009/pdf/wp09-10pdf.

27. 1 NELSON & WHITMAN, *supra* note 16, at 807–08.

28. As the Conference stated:

> The delays and inefficiency associated with foreclosure by judicial action are costly. They increase the risks of vandalism, fire, loss, depreciation, damage, and waste. The resulting costs raise the prices of private mortgages and erode the economic value of government subsidy programs involving mortgages. They add to the portfolio of foreclosed properties held by lenders, secondary mortgage market investors, and government insurers and guarantors of mortgages.

UNIF. NONJUDICIAL FORECLOSURE ACT prefatory note, 14 U.L.A. 124.

29. 1 NELSON & WHITMAN, *supra* note 16, at 845. According to a paper by Karen M. Pence,

> Judicial procedures are substantially more time-consuming than power of sale procedures. Wood (1997) finds that judicial foreclosures, on average, take 148 days longer than nonjudicial foreclosures, while Freddie Mac's guidelines for mortgage servicers indicate that foreclosures in the most time-consuming state, Maine (a judicial foreclosure state), take almost 300 days longer than in the quickest state, Texas (a power-of-sale state).

Karen M. Pence, *Foreclosing on Opportunity: State Laws and Mortgage Credit* 5 (Bd. of Governors of the Fed. Reserve, Working Paper No. 2003-16, 2003), *available at* http://www.federalreserve.gov/pubs/feds/2003/200316/200316pap.pdf.

trustee, or by the mortgagee.[30] Because this process does not normally entail a hearing, it frequently is consummated in a matter of four to eight months.[31]

In almost half of the states the foreclosure sale is not the end of the road for the borrower. A concept commonly termed "statutory redemption" allows the mortgagor-debtor and, in many instances, junior lienholders, up to a year or longer to regain title after the foreclosure sale by paying the foreclosure purchaser the sale price plus accrued interest and other expenses.[32] In the vast majority of these states, the mortgagor will have the right to remain in possession during this post-foreclosure period.[33] Statutory redemption may be available in both judicial and power of sale foreclosure; although some states do not authorize it in the power of sale setting.[34] Proponents praise statutory redemption as "allowing time for the mortgagor to refinance and save his property, permitting additional use of the property by the hard-pressed mortgagor, and probably most important, encouraging those who do bid at the sale to bid in at a fair price."[35] For an increasing number of critics, statutory redemption is counterproductive because the fact that a foreclosure purchaser acquires a defeasible title probably suppresses bidding and results in lower sale prices.[36]

Perhaps most troubling is the varied state law treatment of borrower personal liability and post-foreclosure deficiency judgments. In the substantial majority of states, a mortgage lender may first obtain a judgment for the amount of the obligation and seek to collect it by enforcing it against the borrower's other assets.[37] If the judgment cannot be satisfied in this manner, the lender can foreclose on the mortgaged real estate for the balance.[38] Alternatively, the lender may foreclose first and sue for a deficiency judgment after the foreclosure sale.[39] The amount of this deficiency judgment is traditionally the difference between the foreclosure sale price and the mortgage debt.[40]

30. 1 NELSON & WHITMAN, *supra* note 16, at 845.

31. *Id.*

32. *Id.* at 977–78.

33. *Id.* at 978.

34. *Id.*

35. Darryl A. Hart, Comment, *The Statutory Right to Redemption in California*, 52 CAL. L. REV. 846, 848 (1964).

36. 1 NELSON & WHITMAN, *supra* note 16, at 980.

37. *Id.* at 931–32; RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 8.2 cmt. a (1997).

38. Grant S. Nelson, *Deficiency Judgments After Real Estate Foreclosure in Missouri: Some Modest Proposals*, 47 MO. L. REV. 151, 152 (1982).

39. *Id.*

40. *Id.*

However, several states reject this common law solution, adopting instead a "one-action" approach that requires the lender to use the second option mentioned above—the lender must first foreclose, and a deficiency judgment may be obtained only incident to the foreclosure proceeding.[41] A few states go further and simply prohibit any borrower personal liability on purchase-money mortgage obligations[42] or after power of sale foreclosures.[43] In that setting, the mortgage obligation is simply "non-recourse" as a matter of law. Even where deficiency judgments are permitted, some states use "fair value" legislation to limit the deficiency to the difference between the mortgage debt and the fair value of the foreclosed real estate, rather than the difference between the debt and the foreclosure sale price.[44] Moreover, in these states, the protections of these statutes may not be waived by mortgagors either ex ante or after default.[45]

In sum, this area of mortgage law is a mosaic of divergence. While, at one extreme, some states impose virtually no limitation on deficiency judgments and personal liability, the polar opposite is represented by California[46] and a few other states where personal recourse against a borrower is nearly always unavailable. Other states fall somewhere in between these doctrinal poles.

The law governing security interests in rents is yet another example of substantial and confusing variance in state approaches. Lenders on commercial and multi-family real estate not only demand a mortgage on the land and its physical improvements ("bricks and mortar"), but also a valid security interest in the rents produced by the real estate. While rents are

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41. *See, e.g.*, CAL. CIV. PROC. CODE § 726(a) (West 1980); IDAHO CODE ANN. § 6-101 (2004); MONT. CODE ANN. § 71-1-222 (2009); NEV. REV. STAT. § 40.430 (2003); UTAH CODE ANN. § 79B-6-901 (2008).

42. GRANT S. NELSON & DALE A. WHITMAN, LAND TRANSACTIONS AND FINANCE 633 (4th ed. 2004) (defining a purchase-money mortgage as "a mortgage taken by a lender, who may be either a vendor or a third party, to finance the mortgagor's acquisition of the mortgaged real estate").

43. *See, e.g.*, ARIZ. REV. STAT. ANN. § 33-729(A) (2007) (prohibiting deficiency judgments on purchase-money mortgages); CAL. CIV. PROC. CODE § 580(b) (West 1980) (same); N.C. GEN. STAT. § 45-21.38 (2008) (same). Many states prohibit deficiency judgments after power of sale foreclosure. *See, e.g.*, ALASKA STAT. § 34.20.100 (2008); ARIZ. REV. STAT. § 33-814(E) (2002); CAL. CIV. PROC. CODE § 580(d) (West 1980).

44. *See* CAL. CIV. PROC. CODE § 726(b) (West 1980); N.Y. REAL PROP. ACTS. LAW § 1371 (McKinney 2009); 42 PA. CONS. STAT. ANN. § 8103(c) (West 2009); S.D. CODIFIED LAWS § 21-47-16 (2009); TEX. CODE ANN. §§ 51.004–51.005 (Vernon 2009); 1 NELSON & WHITMAN, *supra* note 16, at 968. The statutes use a variety of terms to define the "value" of the property for purposes of a deficiency judgment, including "fair value," "true value," "true market value," "reasonable value," "appraised value," "actual value," and "market value." *See* 1 NELSON & WHITMAN, *supra* note 16, at 943 n.6.

45. *See, e.g.*, Deberard Props., Ltd. v. Lim, 976 P.2d 843 (Cal. 1999); Cadle Co. II v. Harvey, 100 Cal. Rptr. 2d 150 (Ct. App. 2000).

46. *See* 1 NELSON & WHITMAN, *supra* note 16, at 667–88. For a detailed classification of mortgagor personal liability for all the states, see Ghent & Kudlyak, *supra* note 26, at 41–52.

deemed to be "real estate" and an assignment (mortgage) of them is enforceable in every jurisdiction, there the unanimity ends. Substantial disagreement among the states exists as to when such assignments become effective between the two parties, when they become "perfected" against third parties, and at what point the mortgagee acquires the actual right to commence collection of the rents.

Some jurisdictions recognize the validity of so-called "absolute assignments" in situations where the language of the assignment is sufficiently sweeping. In such an assignment, the mortgagee is deemed to obtain a present title to rents even though the assignment itself postpones the right to collect until the mortgagor defaults.[47] Under this approach, the mortgagee obtains "present title" when the assignment is executed, it is perfected upon recording and, as one court explained, "operates to transfer the right to rents automatically upon the happening of a specified condition, such as default."[48] Absolute assignments can have an especially pernicious impact when the mortgagor files a bankruptcy petition. As one court reasoned, "When a mortgagee completes all steps necessary to enforce its rights pre-petition, all interests of the [mortgagor] in the rents are extinguished and the rents do not become property of the estate or cash collateral."[49] As a practical matter, the mortgagee in this situation will be able to defeat a reorganization plan or at least dictate its terms.

The foregoing "absolute assignment" approach is an unfortunate development that has created needless confusion. None of the decided cases involve an outright sale or transfer of the rents. Indeed, as noted above, the

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47. *See, e.g.*, Sovereign Bank v. Schwab, 414 F.3d 450 (3d Cir. 2005) (discussing Pennsylvania law); First Fid. Bank, N.A. v. Jason Realty, L.P. (*In re* Jason Realty, L.P.), 59 F.3d 423 (3d Cir. 1995); FDIC v. Int'l Prop. Mgmt., Inc., 929 F.2d 1033 (5th Cir. 1991); Fid. Bankers Life Ins. Co. v. Williams (*In re* O'Neill Enters.), 506 F.2d 1242 (4th Cir. 1974); Great W. Life Assurance Co. v. Rothman (*In re* Ventura-Louise Props.), 490 F.2d 1141 (9th Cir. 1974); First Fed. Sav. of Ark. v. City Nat'l Bank of Fort Smith, Ark., 87 B.R. 565 (W.D. Ark. 1988); *In re* Gould, 78 B.R. 590 (D. Idaho 1987); Robin Assocs. v. Metro. Bank & Trust Co. (*In re* Robin Assocs.), 275 B.R. 218, 221 (Bankr. W.D. Pa. 2001) ("[A]n assignment of rents under a document separate and apart from a mortgage . . . passes title to rents from an assignor's tenants to an assignee as of the execution date of said assignment document" (citing *In re Jason Realty, L.P.*, 59 F.3d at 427–29)); *In re* Townside Partners, Ltd., 125 B.R. 8 (Bankr. W.D. Va. 1991); *In re* Galvin, 120 B.R. 767 (Bankr. D. Vt. 1990); Provident Mut. Life Ins. Co. v. Winslow Ctr. Assocs. (*In re* Winslow Ctr. Assocs.), 50 B.R. 679 (Bankr. E.D. Pa. 1985); Great-West Life Assurance Co. v. Raintree Inn, 837 P.2d 267 (Colo. App. 1992); 801 Nolana, Inc. v. RTC Mortgage Trust 1994-S6, 944 S.W.2d 751 (Tex. App. 1997). *See generally* Patrick A. Randolph, Jr., *When Should Bankruptcy Courts Recognize Lenders' Rents Interests?*, 23 U.C. DAVIS L. REV. 833 (1990).

48. *Nolana*, 944 S.W.2d at 754.

49. Imperial Gardens Liquidating Trust v. Nw. Commons, Inc. (*In re* Nw. Commons, Inc.), 136 B.R. 215, 220 (Bankr. E.D. Mo. 1991).

documents in most cases provide that until default, the mortgagor has a "privilege," or "license," to collect the rents or designates the mortgagor as the mortgagee's "agent" or "trustee" for purposes of rent collection. The fact is that the assignment in each instance is intended for security purposes only and not to make the mortgagee absolute owner of the rents. Some courts have expressly rejected the casuistry of the "absolute assignment" theory.[50]

At the other extreme are states that adhere to what is sometimes referred to as the "American common law" view of assignments. Under this approach, an assignment of rents is presumed to create an inchoate security interest or pledge that is ineffective "until the mortgagee obtains possession of the property, or impounds the rents, or secures the appointment of a receiver, or takes some other similar action."[51] This approach is undesirable because until the foregoing step is taken, the mortgagee has no lien on the rents. As a result, such a mortgagee with a previously recorded assignment will be trumped by a subsequently recorded judgment lien. Moreover, it will often mean that mortgagee will have an inferior or no claim to the rents if the mortgagor winds up in bankruptcy.

A significant number of jurisdictions follow a broad "middle ground" approach that holds that an assignment of rents is effective ("perfected") upon execution and recording. The right to commence collection of the rents, however, requires some further action on the part of the mortgagee.[52]

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50. *See* Lyons v. Fed. Sav. Bank (*In re* Lyons), 193 B.R. 637, 648 (Bankr. D. Mass. 1996) ("The fact that the assignments are conditioned upon default and will terminate upon satisfaction of the debt indicates that they are merely additional security for the loan, and not an absolute transfer of the [d]ebtors' interest in the rents . . . .").

51. Taylor v. Brennan, 621 S.W.2d 592, 594 (Tex. 1981); Galleria Towers, Inc. v. Crump Warren & Sommer, Inc., 831 P.2d 908, 911 (Colo. App. 1991) ("Until a mortgagor defaults and a lender takes some 'effectual step' subjecting the assigned rents toward the payment of the debt, for example, by gaining rightful possession of the property or by filing a foreclosure action, the lender has only an inchoate right to the rents. This is so even if the terms in a deed of trust grant the lender the right to receive rents in the event of default. . . . An inchoate interest is an interest in real estate which is not a present interest, but which may ripen into a vested estate, if it is not barred, extinguished, or divested."); Comerica Bank-Illinois v. Harris Bank Hinsdale, 673 N.E.2d 380 (Ill. App. 1996). Texas continues to recognize both "absolute assignments" and the "inchoate lien" approach. *See In re* Spears, 352 B.R. 83 (Bankr. N.D. Tex. 2006) (finding that parties intended inchoate lien approach); Cadle Co. v. Collin Creek Phase II Assocs., Ltd., 998 S.W.2d 718 (Tex. App. 1999); Oryx Energy Co. v. Union Nat'l Bank of Tex., 895 S.W.2d 409 (Tex. App. 1995).

52. *See, e.g.*, FLA. STAT. ANN. § 697.07 (West 2008); MICH. COMP. LAWS ANN. §§ 554.231–554.232 (West 2008); MINN. STAT. ANN. § 559.17 (West 2008); TENN. CODE ANN. § 66-26-116 (2008); Midlantic Nat'l Bank v. Sourlis, 141 B.R. 826 (D.N.J. 1992); Westchase I Assocs. L.P. v. Lincoln Nat'l Life Ins. Co. (*In re* Westchase I Assocs., L.P.), 126 B.R. 692 (W.D.N.C. 1991); N.Y. Life Ins. Co. v. Bremer Towers, 714 F. Supp. 414 (D. Minn. 1989); *In re* Polo Club Apartments Assocs. Ltd. P'ship, 150 B.R. 840 (Bankr. N.D. Ga. 1993); *In re* Hall Colttree Assocs., 146 B.R. 675 (Bankr. E.D. Va. 1992); *In re* Salem Plaza Assocs., 135 B.R. 753 (Bankr. S.D.N.Y. 1992) (interpreting North Dakota law); *In re* Coventry Commons Assocs., 134 B.R. 606 (Bankr. E.D. Mich. 1991); *In re* Miller, 133 B.R. 882 (Bankr. N.D. Ohio 1991); *In re Nw. Commons, Inc.*, 136

In some instances, this additional "affirmative action" requirement can be as nominal as mailing a written demand for the rents to the mortgagor.[53] Other jurisdictions, however, hold that collection of the rents may begin only after the mortgagee has satisfied such onerous requirements as taking possession of the premises or obtaining the appointment of a receiver.[54]

The Restatement (Third) of Property: Mortgages adopts the "middle ground" approach to security interests in rents.[55] Under the Restatement, an assignment ("mortgage on rents") becomes "effective" ("perfected") against the mortgagor upon execution and delivery and, against junior lienors and other third parties, upon recordation or when they otherwise receive notice of it.[56] In the typical case, the mortgagee's right to take possession of the rents arises upon mortgagor default and delivery to him or her of a demand for the rents.[57] Delivery of the demand may be accomplished "by personal service[,] []the United States Mail, . . . [or] any other means reasonably calculated to afford actual notice" of it.[58] The foregoing provision reflects an attempt to provide an efficient means for both the creation and enforcement of a lien on rents. The "middle ground" approach has also been adopted by statute in California[59] and by the Uniform Assignment of Rents Act (UARA), promulgated by the National Conference of Commissioners on Uniform State Laws (Conference) in 2005.[60] This paper later advocates for

B.R. at 215; *In re* Rancourt, 123 B.R. 143 (Bankr. D.N.H. 1991); *In re* 163rd St. Mini Storage, Inc., 113 B.R. 87 (Bankr. S.D. Fla. 1990); *In re* Bethesda Air Rights Ltd. P'ship, 117 B.R. 202 (Bankr. D. Md. 1990); *In re* Park at Dash Point L.P., 121 B.R. 850 (Bankr. W.D. Wash. 1990); Wilhite Pure Oil Truck Stop, Inc. v. McCutchen (*In re* McCutchen), 115 B.R. 126 (Bankr. W.D. Tenn. 1990); *In re* One Fourth St. N., Ltd., 103 B.R. 320 (Bankr. M.D. Fla. 1989); *In re* Aloma Square, Inc., 85 B.R. 623 (Bankr. M.D. Fla. 1988), *aff'd*, 116 B.R. 827 (M.D. Fla. 1990), *superseded by statute*, FLA. STAT. ANN. § 697.07 (West 2008), *as recognized in* Orlando Hyatt Assocs., Ltd. v. FDIC, 629 So. 2d 975 (Fla. App. 1993); United States v. Farrell (*In re* Fluge), 57 B.R. 451 (Bankr. D.N.D. 1985); Hoelting Enters. v. Trailridge Investors, L.P., 844 P.2d 745 (Kan. Ct. App. 1993); Teachers Ins. & Annuity Ass'n of Am. v. Okla. Tower Assocs. Ltd. P'ship, 798 P.2d 618 (Okl. 1990).

53. *See, e.g.*, *In re Nw. Commons, Inc.*, 136 B.R. at 215; *In re 163rd St.*, 113 B.R. at 87; *In re McCutchen*, 115 B.R. at 126; *In re Fluge*, 57 B.R. at 451.

54. *See, e.g.*, *In re Westchase I Assocs., L.P.*, 126 B.R. at 692; Fin. Ctr. Assocs. of E. Meadow, L.P. v. TNE Funding Corp. (*In re* Fin. Ctr. Assocs. of E. Meadow, L.P.), 140 B.R. 829 (Bankr. E.D.N.Y. 1992); *In re Hall Colttree Assocs.*, 146 B.R. at 675; *In re Miller*, 133 B.R. at 882; *In re Rancourt*, 123 B.R. at 143; *In re Park at Dash Point L.P.*, 121 B.R. at 850.

55. RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 4.2 (1997). The U.S. Court of Appeals for the Fifth Circuit has endorsed the Restatement approach as likely to be adopted in Mississippi. *See* O'Neal Steel, Inc. v. E B, Inc. (*In re* Millette), 186 F.3d 638 (5th Cir. 1999).

56. RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 4.2(b) (1997).

57. *Id.* § 4.2(c).

58. *Id.* § 4.2(f).

59. CAL. CIV. CODE § 2938 (West 2008).

60. UNIF. ASSIGNMENT OF RENTS ACT §§ 1–21, 7 (Pt. IB) U.L.A. 7 (2005); *see also infra* notes

congressional adoption of UARA as a means of dealing with the current and impending crisis in commercial mortgages and mortgage-backed securities.[61]

B. *The Impact of the Secondary Market for Mortgages*

Even before the current mortgage meltdown and economic crisis, the argument for greater uniformity in mortgage law had been gathering strength. Traditionally, the state mortgage law hodgepodge described above may have been only a minor problem because most lenders, institutional or otherwise, continued to own the mortgages they originated. However, the unprecedented expansion of the secondary mortgage market (the purchase of mortgages from their original holders) over the past several decades made the argument for uniformity in mortgage law much more compelling. A variety of government-sponsored institutions—Fannie Mae (formerly Federal National Mortgage Association), Federal Home Loan Mortgage Association (Freddie Mac), and Government National Mortgage Association (GNMA)—purchase large blocks of mortgages from local lenders and thus greatly expand the amount of money available for housing purchases.[62] These federally-sponsored enterprises (FSEs) finance a portion of their activity by issuing bonds and equity for sale to the investing public.[63] For the most part, however, the mortgages they buy are "securitized"—packaged into mortgage pools to support mortgage-backed securities for sale to institutional and personal investors worldwide.[64] Because the FSEs

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195–198 and accompanying text.

61. *See infra* notes 195–198 and accompanying text.

62. *See generally* U.S. GEN. ACCOUNTING OFFICE, HOUSING ENTERPRISES: POTENTIAL IMPACTS OF SEVERING GOVERNMENT SPONSORSHIP (1996) [hereinafter HOUSING ENTERPRISES], *available at* http://www.gao.gov/archive/1996/gg96120.pdf. Traditionally, Fannie Mae and Freddie Mac have been the largest secondary market investors of residential mortgages. *See* Thomas E. Plank, *Regulation and Reform of the Mortgage Market and the Nature of Mortgage Loans*, 60 S.C. L. REV. 779, 796–804 (2009).

63. HOUSING ENTERPRISES, *supra* note 62, at 26.

64. These mortgage pools receive the interest and principal payments on the mortgages in the pools and pass them on to the investor-purchasers. *Id.* at 16. The secondary market enterprises also protect investors by guaranteeing this flow of interest and principal. *Id.* In 2001, 57.6% of all one- to four-family mortgage loans were sold to the secondary market. FANNIE MAE, A STATISTICAL SUMMARY OF MORTGAGE FINANCE ACTIVITIES 16 tbl.16 (2002). Indeed, as of 2003, Fannie Mae and Freddie Mac alone "either own[ed] or guarantee[ed] nearly half of all home mortgages, and about 75% of those less than $322,700." Gregory Zuckerman, *Finding Answers to Explain Issues Freddie Mac Faces*, WALL ST. J., June 12, 2003, at C3, *available at* http://bodurtha.georgetown.edu/FreddieMac/articles/Freddie%20Restatement%20May%20Be%20Big.htm. Foreign purchase of mortgage securities is substantial. For example, foreign ownership of Freddie Mac's long-term debt financing stood at over thirty-three percent as of the end of 2002. *See* Leland C. Brendsel, Chairman and Chief Executive Officer, Fed. Home Loan Mortgage Corp., Remarks at Annual Northeast Regional Conference of Mortgage Bankers Associations (Mar. 19, 2003). At Fannie Mae, foreign ownership in 2001 of its noncallable benchmark securities was at 32.5%. *See Trends in Foreign Central Bank Activity in Fannie Mae's Debt Securities*, FUNDINGNOTES (Fannie Mae, Washington,

guarantee the payment of the principal and interest on these securities, they are especially attractive to the investment community.

During this period, a parallel private securitization regime for commercial loans developed and flourished—that is, those secured by multifamily apartments, retail and office buildings, and other income-producing real estate. Beginning in the mid-1980s, these "commercial mortgage-back securities" grew exponentially and became increasingly sophisticated. Professor Whitman and I described this commercial securitization as follows:

> The early issues typically took the form of "collateralized mortgage obligations" or CMOs. Like GNMA-guaranteed securities, they were backed by pools of mortgages (or in a few cases, by a single large mortgage loan), but they were not of the pass-through type. Instead, they typically paid interest semiannually, but principal payments from the mortgages were restructured so as to produce several groups of bond-like securities with varying maturities. For example, a CMO might consist of three packages of securities, with maturities of approximately 3, 5 and 10 years. All payments of principal on all of the mortgages would be applied in the early years to retire the first group of bonds, then to the second group, and so on. The result was a security that was backed by mortgages but closely resembled an industrial bond—an instrument which is attractive to some types of investors who would be disinterested in a pass-through of mortgage payments . . . .
>
> During recent years CMBSs have become far more complex than the early CMOs. They are often issued with large numbers of specialized classes. The principal and interest payments expected on the underlying mortgages can be restructured in a variety of ways, producing, for example, interest-only and principal-only securities. Some classes may be subordinated to others with respect

D.C.), July/Aug. 2001, at 5 fig.5, *available at* http://www.fanniemae.com/markets/debt/pdf/fundingnotes_7_8_01.pdf. More recently, the size of the secondary market for mortgages exploded. *See* FATEN SABRY & CHUDOZIE OKONGWU, NERA ECON. CONSULTING & AM. SECURITIZATION FORUM, STUDY OF THE IMPACT OF SECURITIZATION ON CONSUMERS, INVESTORS, FINANCIAL INSTITUTIONS AND THE CAPITAL MARKETS 16 (2009), *available at* http://www.americansecuritization.com/uploadedFiles/ASF_NERA_Report.pdf ("Before the abrupt decline of securitization volume in 2007, the annual issuance of mortgage-backed securities (MBS) alone has increased from $259 billion to $2,018 billion between 1990 and 2006, a 678% increase or 13% on an annually compounded basis. At the end of 2007 there were more than $7 trillion of MBS . . . .").

> to priority of payout in the event of mortgage default. Private mortgage insurance, bank letters of credit, or other facilities may be called upon to enhance the creditworthiness of some classes. Some classes may carry adjustable-rate coupons indexed to some external interest rate, such as the London Interbank Offered Rate (LIBOR). The underlying mortgages may have fixed or adjustable rates.[65]

The secondary mortgage market has been and continues to be a major factor in a vibrant national housing and commercial real estate economy.[66] Notwithstanding being placed in federal conservatorship,[67] Fannie Mae and Freddie Mac continue to purchase large quantities of mortgages from originators.[68] This allows capital to flow indirectly into real estate from investors who would never consider direct mortgage lending.[69] It permits the flow of funds from capital-rich areas of the nation to areas in which a large amount of real estate investment is needed.[70] It gives mortgage borrowers access to money at highly competitive interest rates.[71]

However, even before the current economic crisis, "there [was no] doubt that legal differences from state to state act[ed] as a serious impediment to the carrying out of these business arrangements."[72] For example, when a default occurs in a pool mortgage, the speed and efficiency with which the mortgaged real estate is liquidated depends upon its location. Thus, if the mortgage is on land in Texas, where foreclosure is nonjudicial and occurs quickly,[73] the money will be returned to the pool promptly and

65. 2 NELSON & WHITMAN, *supra* note 16, at 97–98.

66. *See, e.g.*, SABRY & OKONGWU, *supra* note 64, at 9 n.5.

67. *See, e.g.*, U.S. GEN. ACCOUNTING OFFICE, FANNIE MAE AND FREDDIE MAC: ANALYSIS OF OPTIONS FOR REVISING THE HOUSING ENTERPRISES' LONG-TERM STRUCTURES 7 (2009), *available at* http://www.gao.gov/new.items/d09782.pdf; Jim Puzzanghera, *Financial System in Crisis*, L.A. TIMES, Sept. 21, 2008, at A26; *see also infra* notes 173–180 and accompanying text.

68. Kevin Kingsbury, *Delinquencies Rise Further in Fannie's Portfolio*, WALL ST. J., Sept. 29, 2009, http://online.wsj.com/article/BT-CO-20090929-707079.html ("Fannie's book of business, which includes mortgage-backed securities and other guarantees, rose $10 billion to $3.23 trillion. It's annualized growth rate was 3.7% for August.").

69. *See* HOUSING ENTERPRISES, *supra* note 62, at 22 ("Because multiclass securities bring new investors who wish to avoid unpredictable cash flows into the market, they improve the market's liquidity and help ensure continuing funding for home mortgages. The new investors that multiclass securities have attracted include banks, thrifts, pension funds, insurance companies, and other financial institutions as well as individuals who originate, buy, hold, or sell whole mortgages.").

70. *See id.* at 54 ("It is widely accepted that the enterprises, through portfolio investments and securitization, have generated many benefits to mortgage borrowers. These benefits include the reduction of regional disparities in interest rates and mortgage availability, spurring innovations in mortgage standardization and transaction technology, and lowering of mortgage interest rates.").

71. *See id.*; *see also id.* at 50 ("Freddie Mac officials also said that . . . any financial benefits flow to homebuyers in the form of lower mortgage interest rates.").

72. RESTATEMENT (THIRD) OF PROP.: MORTGAGES 3 (1997).

73. *See* Debra Pogrund Stark, *Foreclosing on the American Dream: An Evaluation of State and Federal Foreclosure Laws*, 51 OKLA. L. REV. 229, 266 (1998).

inexpensively. On the other hand, if the mortgaged real estate is in Kansas, where foreclosure is by a costly and cumbersome judicial action,[74] the cost to the pool is increased.

State anti-deficiency legislation raises similar issues, at least in the home mortgage context. For example, relatively affluent Missouri mortgagors who recently saw the value of their houses drop substantially face the prospect of a deficiency judgment if foreclosure ensues and the property yields less than the mortgage obligation.[75] Their California counterparts, however, are immune from such personal liability because of that state's pervasive anti-deficiency legislation.[76] While these legal disparities probably have only modest impact on commercial mortgage-backed securities because many, if not most commercial mortgages traditionally have been non-recourse by contract, investors in home mortgage securities may be more inclined to demand higher interest rates and lower loan amounts in pool mortgages in anti-deficiency jurisdictions.[77]

C. *Efforts to Achieve Uniformity*

The past nine decades have witnessed numerous efforts to create national uniformity in mortgage law. First, the Conference promulgated three acts designed to achieve uniformity in foreclosure law, but none were adopted by any state.[78] More recently, in 2002, it promulgated the Uniform Nonjudicial Foreclosure Act (UNFA), which also is finding no acceptance.[79] Second, in 1997, the American Law Institute issued the Restatement (Third) of Property: Mortgages, which seeks to unify a wide variety of mortgage law and procedure.[80] Third, Fannie Mae and Freddie Mac, the nation's two largest secondary market institutions, have published dozens of note and mortgage forms designed to create mortgage law uniformity by contract.[81] Finally, over the past four decades, Congress has enacted legislation on a

74. *See id.* at 260.

75. Ahmad Safi, *Low-Ball Offers Increase in Buyer's Market*, ST. JOSEPH NEWS-PRESS, Sept. 26, 2009, http://www.stjoenews.net/news/2009/sep/26/low-ball-offers-increase-buyers-market/ (referring to a twelve percent drop in existing home values in three years).

76. *See, e.g.*, DENNIS L. GREENWALD & MICHAEL ASIMOW, CALIFORNIA PRACTICE GUIDE: REAL PROPERTY TRANSACTIONS § 6:560 (2008).

77. *Reforming Foreclosure*, *supra* note 26, at 1407, 1509–10.

78. *See infra* notes 83–88 and accompanying text.

79. *See infra* notes 90–103 and accompanying text.

80. *See infra* notes 104–05 and accompanying text.

81. *See infra* notes 106–11 and accompanying text.

wide variety of substantive and procedural mortgage law issues.[82] These efforts at uniformity have found only modest success, as the following material illustrates.

1. The Uniform Laws Approach

While there have been several attempts to achieve mortgage law uniformity through state legislative adoption of uniform acts, they all have been singularly unsuccessful. In 1927, the Conference promulgated the Uniform Real Estate Mortgage Act and, in 1940, they proposed the Model Power of Sale Foreclosure Act.[83] Neither of these proposals was adopted by a single state.[84] A similar fate has befallen more recent initiatives by the Conference to achieve uniformity in state real estate security law, such as the 1985 Uniform Land Security Interest Act (ULSIA).[85] Intended to be the real estate equivalent of U.C.C. Article 9 for personalty, it received a good deal of scholarly attention and praise.[86] Under ULSIA the preferred foreclosure method was by power of sale.[87] Only "protected parties" were immune from deficiency judgments and statutory redemption was abolished for all mortgagors, protected or otherwise.[88] However, ULSIA proved to be a dismal political failure; no state adopted it.

In 2002, following four years of drafting, the Conference promulgated the Uniform Nonjudicial Foreclosure Act (UNFA).[89] The UNFA is the product of years of drafting and reflects the contributions of some of the

82. *See infra* notes 113–39 and accompanying text.

83. Michael H. Schill, *Uniformity or Diversity: Residential Real Estate Finance Law in the 1990s and the Implications of Changing Financial Markets*, 64 S. CAL. L. REV. 1261, 1278 (1991); Jo Anne Bradner, *The Secondary Mortgage Market and State Regulation of Real Estate Financing*, 36 EMORY L.J. 971, 1001 n.139 (1987); Harold L. Reeve, *The New Proposal for a Uniform Real Estate Mortgage Act*, 5 LAW & CONTEMP. PROBS. 564, 570 (1938). Moreover, the Central Housing Committee, a federally sponsored committee, proposed a revised Uniform Real Estate Mortgage Act in 1937 that was equally unsuccessful. *See* ROBERT H. SKILTON, GOVERNMENT AND THE MORTGAGE DEBTOR (1929 TO 1939) 203–04 (1944).

84. Schill, *supra* note 83, at 1278.

85. UNIF. LAND SEC. INTEREST ACT (ULSIA) §§ 101–603 (1985), *available at* http://www.law.upenn.edu/bll/archives/ulc/fnact99/1980s/ulsia85.pdf. ULSIA was carved out of an earlier effort of the Commissioners, the Uniform Land Transactions Act (ULTA), adopted in 1974. *Id.* prefatory note. It, too, received no adoptions.

86. *See, e.g.*, Patrick A. Randolph, Jr., *The Future of American Real Estate Law: Uniform Foreclosure Laws and Uniform Land Security Interest Act*, 20 NOVA L. REV. 1109 (1996); Norman Geis, *Escape from the 15th Century: The Uniform Land Security Interest Act*, 30 REAL PROP. PROB. & TR. J. 289 (1995); Curtis J. Berger, *ULSIA and the Protected Party: Evolution or Revolution*, 24 CONN. L. REV. 971 (1992); Marc B. Friedman, *Rentals Roulette: The Mortgagee's Rights to Rent Under Connecticut Law and ULSIA*, 24 CONN. L. REV. 1093 (1992); Roger Bernhardt, *ULSIA's Remedies on Default—Worth the Effort?*, 24 CONN. L. REV. 1001 (1992).

87. *See* UNIF. LAND SEC. INTEREST ACT prefatory note & § 509.

88. *Id.* § 113.

89. UNIF. NONJUDICIAL FORECLOSURE ACT §§ 101–703, 14 U.L.A. 131 (2005).

nation's leading real estate finance practitioners and scholars.[90] It is designed to make American foreclosure law uniform by providing for the prompt and efficient nonjudicial liquidation of real estate collateral while affording substantial safeguards for defaulting borrowers. Residential borrowers receive special protection under UNFA.[91]

UNFA represents a major innovation in thinking about the foreclosure process. Not only does it provide for conventional foreclosure by public auction sale,[92] it also authorizes foreclosure by appraisal.[93] Perhaps more important, it endorses foreclosure by negotiated sale, a process that is designed to duplicate how real estate is sold outside of the foreclosure setting.[94] "Such a sale will be consummated in much the same way as other real property sales; the property may be listed with a real estate broker and advertised extensively."[95] The negotiated sale as an alternative to conventional foreclosure has long been advocated by land finance scholars and is designed to produce a higher foreclosure price than the usual auction sale, a result that would benefit both the borrower and junior lienholders.[96]

UNFA also rejects statutory redemption—it simply provides that persons who have redemption rights "may not redeem after the time of foreclosure."[97] UNFA thus endorses the notion of finality and predictability in the foreclosure process. While it endorses a fair period for mortgagors to redeem their real estate after default, it takes the position that this period ought to run before the date of foreclosure, not after.[98]

UNFA gives numerous substantial protections to "residential debtors."[99] Of the ten or so "residential debtor" distinctions in UNFA, two stand out as most significant. The first is the exemption from deficiency liability for residential debtors who have acted in good faith.[100] The other, believed to be

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90. The drafting committee consisted of Carl H. Lisman, Chair, John H. Burton, Lani Liu Ewart, Dale G. Higer, Reed L. Martineau, Robert L. McCurley, Jr., Lisa Kelly Morgan, Willis E. Sullivan (who regrettably died before completion of the act), and Dale Whitman, Reporter. Ira Waldman served as the American Bar Association Advisor and Grant Nelson served as a representative from the American College of Real Estate Lawyers.

91. *Reforming Foreclosure*, *supra* note 26, at 1447–67.

92. UNIF. NONJUDICIAL FORECLOSURE ACT §§ 201–210, 14 U.L.A. 151–66.

93. *Id.* §§ 501–505, 14 U.L.A. 182–87.

94. *Id.* §§ 401–405, 14 U.L.A. 176–81.

95. *Id.* prefatory note, 14 U.L.A. 125.

96. *Reforming Foreclosure*, *supra* note 26, at 1402.

97. UNIF. NONJUDICIAL FORECLOSURE ACT § 209, 14 U.L.A. 165.

98. *Id.* § 202(e), (g), (h), 14 U.L.A. 152.

99. *Reforming Foreclosure*, *supra* note 26, at 1447–67.

100. *Id.* at 1489–98.

unique in American foreclosure law, is the "meeting to object to foreclosure," a right available only to residential debtors.

There were two underlying reasons for the development by the drafters of the "meeting to object" concept. The first was the conviction that some unwarranted foreclosures of residential mortgage loans occur simply because consumers are unable to establish a clear line of communication with their lenders.[101] A second factor motivating the drafters was a desire to create a foreclosure procedure that would withstand an attack based on Due Process grounds, an issue that is considered in substantial detail later in this paper.[102]

Over five years ago, Professor Whitman and I endorsed UNFA as follows:

> UNFA represents an innovative, flexible, and efficient foreclosure procedure. As such, it should be especially appealing to lenders. At the same time, however, it carefully assures fairness to borrowers. Residential debtors are afforded a variety of special safeguards including substantial grace periods and, if they act responsibly, immunity from deficiency judgments. In short, UNFA reflects a careful balancing of the legitimate interests of both lenders and debtors and represents a major advance in conceptualizing the foreclosure process.[103]

Like its predecessor uniform acts, UNFA unfortunately has found no acceptance by the states. Indeed, in over seven years since its promulgation by the Conference, not one state has adopted it.

2. The Restatement Approach

The American Law Institute's recent attempt to achieve uniformity in the law of mortgages has been marginally more successful. The Restatement (Third) of Property: Mortgages, promulgated by the Institute in 1997, seeks to "unif[y] the law of real property security by identifying and articulating legal rules that will meet the legitimate needs of the lending industry while at the same time providing reasonable protection for borrowers."[104] Indeed, in the past several years numerous state courts have

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101. *Id.* at 1450–51.

102. *See infra* notes 158–92 and accompanying text.

103. *Reforming Foreclosure*, *supra* note 26, at 1509. Professor Nelson, however, now has severe misgivings about the deficiency judgment immunity conferred on residential debtors by UNFA. Perhaps federal legislation limiting the non-recourse status of home loans is warranted. *See infra* notes 239–247 and accompanying text.

104. *See* RESTATEMENT (THIRD) OF PROP.: MORTGAGES 3 (1997).

adopted various provisions of the Restatement.[105] But because state court adoption of Restatement provisions is voluntary, achieving national uniformity via this route is difficult to achieve and is a painfully slow and piecemeal process. Moreover, even courts that are willing to follow the Restatement can do nothing about existing state statutes that impose inefficiencies and eccentric rules on the foreclosure process.

3. Uniformity Through Contract

Both Fannie Mae and Freddie Mac have sought to create mortgage law uniformity through the law of contract. Both entities promulgate mortgage and note forms and mandate their use by lenders who wish to sell their mortgage loans to either of these secondary market enterprises.[106] While Fannie Mae and Freddie Mac use distinct forms containing language uniquely applicable to each state, every form incorporates twenty-one uniform provisions.[107] These "Uniform Mortgage and Deed of Trust Covenants" have undeniably created a great deal of nationwide uniformity in a variety of substantive mortgage law contexts.[108] For example, these forms

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105. *See, e.g.*, Land Holdings (St. Thomas) Ltd. v. Mega Holdings, Inc., No. 1998-078, 1999 WL 1044836 (D. V.I. Nov. 8, 1999) (adopting Restatement section 8.5—merger); Krohn v. Sweetheart Props., Ltd., 52 P.3d 774 (Ariz. 2002) (adopting Restatement section 8.3—adequacy of foreclosure price); New Milford Sav. Bank v. Jajer, 708 A.2d 1378 (Conn. 1998) (adopting Restatement section 8.6—marshaling); E. Boston Sav. Bank v. Ogan, 701 N.E.2d 331 (Mass. 1998) (adopting Restatement section 7.6(a)—subrogation); Sutton Funding, LLC v. Mueller, 278 S.W.3d 702 (Mo. App. 2009) (adopting Restatement section 7.2—purchase-money priority); Houston v. Bank of Am. Fed. Sav. Bank, 78 P.3d 71 (Nev. 2003) (adopting Restatement section 7.6—subrogation); Cadle Co. v. Bourgeois, 821 A.2d 1001 (N.H. 2003) (adopting Restatement section 5.1, comment 1—land remains encumbered when transferred); Westmark Commercial Mortgage Fund IV v. Teenform Associates, L.P., 827 A.2d 1154 (N.J. Super. Ct. 2003) (adopting Restatement section 6.2, comment c—prepayment); Kim v. Lee, 31 P.3d 665 (Wash. 2001) (adopting Restatement section 7.3—mortgage modification and subrogation). Many other courts have cited provisions of the Restatement favorably without formally adopting them. *See, e.g.*, *In re* Smink, 276 B.R. 156 (Bankr. N.D. Miss. 2001) (citing Restatement section 2.4—dragnet clauses); Baskurt v. Beal, 101 P.3d 1041 (Alaska 2004); Am. Gen. Fin. Servs., Inc. v. Carter, 184 P.3d 273 (Kan. Ct. App. 2008) (citing Restatement section 7.2(b)—purchase-money priority); Bankers Trust Co. v. Collins, 124 S.W.3d 576 (Tenn. Ct. App. 2004) (citing Restatement section 7.6—subrogation); Burney v. McLaughlin, 63 S.W.3d 223 (Mo. Ct. App. 2001) (citing Restatement section 7.3—mortgage modification); Coleman v. Hoffman, 64 P.3d 65 (Wash. Ct. App. 2003) (citing Restatement section 4.1—duty of care of a mortgagee in possession).

106. GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE TRANSFER, FINANCE, AND DEVELOPMENT 1237 (8th ed. 2009).

107. *See id.* at 1240.

108. *See* Wilborn v. Bank One Corp., 906 N.E.2d 396, 406 (Ohio 2009) ("[T]hese uniform mortgage forms are the result of sophisticated parties, all with competing interests and wielding significant bargaining power, freely entering discussions, compromises, and negotiations for the

have been highly effective in the casualty insurance context. State default rules governing whether the lender or the mortgagor controls the disposition of insurance proceeds after a casualty loss are in substantial conflict.[109] Absent specific language in the mortgage, many states give the lender the right to prepay the mortgage obligation with insurance proceeds,[110] while others generally allow the mortgagor to use the proceeds to rebuild unless the lender's security would be impaired.[111] The Fannie Mae-Freddie Mac uniform covenant language mandates that the insurance proceeds "shall be applied to restoration or repair of the [p]roperty [damaged], if the restoration or repair is economically feasible and [the] [l]ender's security is not lessened."[112] As a practical matter, because the use of these forms in residential transactions is pervasive, the foregoing language has become a national norm.

However, there are clear limits to this contract law approach. Uniformity can be achieved only to the extent that state law permits lenders and borrowers to vary state mortgage law by agreement. On most important questions, such as foreclosure method, deficiency judgments, and statutory redemption, statutes generally govern and state courts are unwilling to permit the parties to use form language to avoid the impact of state law.

4. Congressional Intervention

Beginning in the late 1960s, Congress became actively involved in the issue of mortgage law uniformity. In 1973, the Nixon Administration proposed the adoption of the Federal Mortgage Foreclosure Act.[113] Under this far-reaching proposal, foreclosure by power of sale would have been mandated for any mortgage made, owned, insured, or guaranteed by any federal instrumentality.[114] Moreover, it would have invalidated state

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purpose of creating 'what the law of mortgages will be in 50 States in most of the home buying transactions for the next several decades.'").

109. 1 NELSON & WHITMAN, *supra* note 16, at 245–46.

110. *See, e.g.*, Sanroman v. Atlantic Mut. Ins. Co., 250 A.D.2d 585 (N.Y. App. Div. 1998); First State Bank v. State Farm Fire & Cas. Co., 840 P.2d 1267 (Okla. App. 1992); English v. Fischer, 660 S.W.2d 521 (Tex. 1983); 1 NELSON & WHITMAN, *supra* note 16, at 245–49.

111. *See, e.g.*, Schoolcraft v. Ross, 81 Cal. App. 3d 75 (Ct. App. 1978); Starkman v. Sigmund, 446 A.2d 1249 (N.J. Super Ct. 1982); RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 4.7(b) (1997); 1 NELSON & WHITMAN, *supra* note 16, at 245–49.

112. Fannie Mae/Freddie Mac Single-Family Security Instrument, Clause 5 (2001), *reprinted in* NELSON & WHITMAN, *supra* note 106, at 1246.

113. *See* S. 2507, 93d Cong. §§ 401–419 (1st Sess. 1973), *reprinted in Administration's 1973 Housing Proposals: Hearings Before the Comm. on Banking, Housing, and Urban Affairs*, 93d Cong. 483–505 (1973).

114. *Id.* § 404, 93d Cong. at 487.

statutory redemption rights.[115] This effort, part of the Housing Act of 1973, failed to win congressional approval.[116]

During this same period, however, Congress enacted federal legislation focusing on two specific residential borrower consumer issues. The first of these statutes, the Truth-in-Lending Act of 1968,[117] mandates that lenders disclose to home borrowers a wide variety of information including the amount of the loan, the finance charges stated in terms of "the annual percentage rate," the payment schedule, delinquency charges, and prepayment penalties.[118] The second statute, the Real Estate Settlement and Procedures Act of 1974 (RESPA),[119] requires lenders in federally-related mortgage loans to deliver to mortgagors prior to settlement forms detailing all charges that the mortgagor will incur at the settlement or closing of the home loan transaction.[120] It also regulates the amounts borrowers are required to pay into mortgage escrow accounts.[121] Finally, RESPA restricts the payment of fees and "kickbacks" in connection with settlement services.[122] Neither of these statutes, however, significantly supplants state law.[123]

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115. *Id.* § 415(d), 93d Cong. at 502.

116. Schill, *supra* note 83, at 1282.

117. 15 U.S.C. §§ 1601–1665 (2006).

118. *See id.* § 1638.

119. 12 U.S.C. §§ 2601–2617.

120. *Id.*

121. *Id.* § 2609. The definition of "federally-related loan" is so broad that it encompasses almost all home mortgage loan transactions. *See id.* § 2602(1); Schill, *supra* note 83, at 1283 n.111.

122. 12 U.S.C. § 2607(a).

123. Similarly, Congress attempted to deal with "predatory lending" by the enactment in 1994 of the Home Ownership and Equity Protection Act (HOEPA). *See* 15 U.S.C. § 1601–1647. HOEPA imposes numerous requirements on lenders of "high cost" mortgage loans, but is not preemptive of state law. For an analysis of HOEPA and the practices it prohibits as well as a definition of "predatory lending," see 2 NELSON & WHITMAN, *supra* note 16, at 155–58. As a result of the mortgage meltdown of the past two years, HOEPA has been strengthened to deal with a wider variety of mortgage loans. *Id.* Amendments to Regulation Z, which implements the Act, were promulgated on July 14, 2008 and will become effective on October 1, 2009. *Id.* They apply to first mortgage loans with an APR that is three percent higher than the yield on a Treasury security of comparable maturity or five percent for junior mortgage loans, and they apply to purchase money loans. *Id.* They also apply to a wider variety of lender "patterns or practices." *Id.* Thus, lenders cannot make a cover loan without considering the borrower's ability to repay the loan from sources other than the home's value and the lender must verify the borrower's ability to repay. *Id.* They also restrict prepayment penalties and require an escrow account for taxes and insurance for first mortgages. *Id.* Also, in 2008, Congress enacted the Secure and Fair Enforcement for Mortgage Licensing Act (SAFE Act) in part to combat predatory lending; SAFE Act requires all residential mortgage originators, including mortgage brokers to be licensed and to satisfy certain educational and financial requirements. *See* Housing and Economic Recovery Act of 2008, Pub. L. No. 110-

In the 1980s, Congress went farther, adopting three statutes that preempt state mortgage law in a direct and forceful manner. Each statute was the product of the extremely high interest rates and the crisis that afflicted savings and loan associations during the late 1970s and the early 1980s. The first, the Depository Institutions Deregulation and Monetary Control Act, effective in 1980, preempted state usury laws for all "federally-related" loans secured by first liens on residential real estate.[124] Interest rate ceilings, as well as restrictions on discount points and other finance charges, were covered.[125] This legislation was especially aimed at preempting usury limitations that were enshrined in state constitutions and thus impervious to legislative change. Second, Congress enacted the Garn-St. Germain Depository Institutions Act of 1982,[126] which makes enforceable the due-on-sale clause, a pervasively used mortgage provision that enables a lender to accelerate the debt and foreclose if the real estate is transferred without the lender's permission. Conflicting state case law and legislation of this period had created enormous turmoil over due-on-sale enforcement[127] and Congress directly intervened to preempt (with certain minor exceptions) this state law labyrinth.[128]

The Alternative Mortgage Transactions Parity Act of 1982[129] was the third part of this preemptive effort. It authorized state-chartered financial institutions to make mortgage loans using alternative formats—such as adjustable rate, graduated payment, and reverse annuity mortgages—that were approved by federal regulatory agencies for federally-chartered lenders, even though such loans would otherwise violate state law.[130] It was designed to equalize federal and state institutions' powers to experiment with new mortgage formats. Ironically, several federal decisions have gone beyond this equal footing principle to hold that *all* aspects of alternative mortgages, including features having nothing to do with their "alternative" character, are preempted from state regulation.[131]

289, § 2122(a), 122 Stat. 2654, 2837.

124. 12 U.S.C. § 1735f-7. For regulations issued under this statute, see Preemption of State Usury Laws, 12 C.F.R. pt. 590 (2009).

125. 12 U.S.C. § 1735f-7.

126. *See id.* § 1701j-3. *See generally* Grant S. Nelson & Dale A. Whitman, *Congressional Preemption of Mortgage Due-on-Sale Law: An Analysis of the Garn-St. Germain Act*, 35 HASTINGS L.J. 241 (1983).

127. *See* 1 NELSON & WHITMAN, *supra* note 16, at 476–77, 481–82.

128. *Id.* at 335–56.

129. 12 U.S.C. §§ 3801–3806. For the applicable regulations, see 12 C.F.R. § 560.220.

130. *See* 2 NELSON & WHITMAN, *supra* note 16, at 134–38.

131. *See* Nat'l Home Equity Mortgage Ass'n v. Face, 239 F.3d 633 (4th Cir. 2001) (holding Virginia limitation on prepayment charges preempted); Shinn v. Encore Mortgage Servs., Inc., 96 F. Supp. 2d 419 (D.N.J. 2000) (holding that New Jersey limitation of prepayment charges preempted). *Contra* Glukowsky v. Equity One, Inc., 821 A.2d 485 (N.J. Super. 2003) (authorizing state-chartered lenders to impose prepayment charges held to be ultra vires).

Congress in 1995 considered, but—as was the case in 1973—failed to enact a comprehensive federal power of sale foreclosure proposal that would have applied to all federally owned, insured, or guaranteed loans. Nonetheless, the 1980s and 90s saw the enactment of two less sweeping federal foreclosure statutes. Each provides for nonjudicial foreclosure of residential mortgages held by the Housing and Urban Development Department (HUD). The Multifamily Mortgage Foreclosure Act of 1981[132] (Multifamily Act) authorizes nonjudicial power of sale foreclosure for federally insured and certain other mortgages on property other than one- to four-family dwellings held by the Secretary of HUD. The Single Family Mortgage Foreclosure Act of 1994[133] (Single Family Act) does the same for HUD-held mortgages on one- to four-family residences. The two acts are substantially similar and both preempt state anti-deficiency and statutory redemption legislation.[134] Regulations implementing both acts were consolidated in one regulation in 1996.[135]

A nonjudicial procedure employing a power of sale may be utilized foreclosure under these acts even though the mortgage contains no express power of sale. After a default occurs and the decision to foreclose is made, the Secretary of HUD designates a Commissioner to conduct the foreclosure and sale. Foreclosure is initiated by the service of a Notice of Default and Foreclosure Sale containing information concerning the property being foreclosed, the date and place of sale, and related information.[136] This notice must be published once a week for three consecutive weeks and posted on the property for at least seven days prior to the sale.[137] In addition, it must be sent by certified mail, return receipt requested, at least twenty-one days before the date of foreclosure sale, to the original mortgagor, to those liable on the mortgage debt, and to the "owner" of the property and, at least ten days before the sale, to all persons having liens thereon.[138] On the other hand, neither the acts nor the regulations require mailed notice to lessees, holders of easements and others holding interests junior to the mortgage being foreclosed. Although the acts themselves do not mandate a hearing, the regulations require one with respect to multifamily foreclosures, "HUD

132. 12 U.S.C. §§ 3701–3717 (1981).

133. 12 U.S.C. §§ 3751–3758 (1994).

134. *See id. See generally* Patrick A. Randolph, Jr., *The New Federal Foreclosure Laws*, 49 OKLA. L. REV. 123 (1996); Stark, *supra* note 73, at 238–40.

135. *See* 24 C.F.R. §§ 27.1–27.123 (1996).

136. 12 U.S.C. §§ 3706, 3757 (1981); 24 C.F.R. §§ 27.15, 27.103 (1996).

137. 12 U.S.C. §§ 3708, 3758(3); 24 C.F.R. §§ 27.15, 27.103 (1996).

138. 12 U.S.C. § 3708(1); 24 C.F.R. §§ 27.15(c), 27.103.

will provide to the mortgagor [and current owner] an opportunity informally to present reasons why the mortgage should not be foreclosed. Such opportunity may be provided before or after the designation of the foreclosure commissioner but before service of the notice of default and foreclosure."[139]

One should not be tempted to overemphasize the foregoing efforts to foster uniformity. Mortgage law and especially the rules governing foreclosure remain largely the province of the states. Local divergence is still the norm.

D. *The Case for Federalizing Mortgage Foreclosure Law*

Five years ago Professor Whitman and I observed that "the enormous impact of mortgage financing on the national economy and the dramatic growth of the secondary market for mortgages, the current hodgepodge of state foreclosure law and its attendant inefficiencies make a compelling case for national uniformity."[140] As a result, we advocated congressional legislation that would confer on most, if not all lenders, in the United States the option to use UNFA as a nonjudicial foreclosure remedy. We did so because we characterized UNFA's chances of adoption by the states as "slim indeed."[141] The failure of even one state to adopt UNFA during this period and the ensuing economic crisis caused by the mortgage meltdown only reinforces our view that congressional action is needed.

The empirical argument for uniformity. Our view at that time, however, was not unanimous. Professor Michael Schill, for example, argued that the case for uniformity had not yet been convincingly made.[142] In his view, "non-uniform mortgagor protection laws in the context of residential real estate [are] likely to generate only modest costs."[143] In any event, he

139. 24 C.F.R. § 27.5(b). For an analysis of the acts and post-1994 congressional attempts to expand their coverage to other federally-held mortgages, see Randolph, *supra* note 134. While the Multifamily Act is sometimes used by HUD, *see* Lisbon Square v. United States, 856 F. Supp. 482 (E.D. Wis. 1994), the Single Family Act currently is not. This is so because HUD may only foreclose under either act mortgages that it "holds." Single family mortgages are currently rarely held by HUD because federal law prohibits HUD from taking an assignment of such mortgages for purposes of forbearance, loss modification and deeds in lieu of foreclosure. *See* 12 U.S.C. § 1715u(a) (1959). Since it is unlikely that HUD will acquire ownership of a single family mortgage in other circumstances, the Single Family Act has fallen into disuse.

140. *Reforming Foreclosure*, *supra* note 26, at 1509.

141. *Id.*

142. Michael H. Schill, *The Impact of the Capital Markets on Real Estate Law and Practice*, 32 J. MARSHALL L. REV. 269, 286–87 (1999).

143. *Id.* at 286. In two earlier articles, Professor Schill found that "the effect of anti-deficiency laws was statistically insignificant and that an eleven month statutory right of redemption was associated with an increase in interest of only seven basis points." *Id.*; *see* Schill, *supra* note 83, at 1261; Michael H. Schill, *An Economic Analysis of Mortgagor Protection Laws*, 77 VA. L. REV. 489 (1991).

concluded in 1999: "[E]ven if the laws were costly and inefficient, there [is] no reason for the federal government to supplant the judgment of the citizens of states that had [enacted] these laws, at least in the absence of significant externalities."[144]

On the other hand, a 2003 impressive study by Karen Pence for the Federal Reserve System points to significant externalities.[145] Even though she concludes that statutory redemption laws "do not appear to affect the mortgage market substantively,"[146] and her findings about the impact of deficiency prohibitions are inconclusive, she establishes "a robust inverse relationship between a judicial foreclosure requirement and mortgage loan size."[147] Overall, she finds that "defaulter-friendly" foreclosure laws "are correlated with a four percent to six percent decrease in loan size," suggesting that defaulter-friendly foreclosure laws "may assist homeowners experiencing hard times, but they also impose costs on a much larger pool of borrowers at the time of loan origination."[148]

We concluded then that Congress should act to create uniformity, but suggested that congressional adoption of UNFA could take a variety of forms. The most far-reaching approach would be for Congress to make it applicable to every mortgage transaction in the United States. Every lender in the country would then have the option to utilize UNFA as a nonjudicial foreclosure remedy. Note that this approach would mainly affect only state foreclosure *procedure* and would not alter *substantive* mortgage law. For example, such a congressional enactment of UNFA would have no impact

144. Schill, *supra* note 142, at 286–87.

145. *See generally* Pence, *supra* note 29.

146. *Id.* at 27.

147. *Id.*

148. *Id.* at 1, 28. Other studies had found higher interest rates in defaulter-friendly states. *See* Mark Meador, *The Effect of Mortgage Laws on Home Mortgage Rates*, 34 J. ECON. & BUS. 143–48 (1982); Claudia Elaine Wood, *The Impact of Mortgage Foreclosure Laws on Secondary Market Loan Losses* (1997) (unpublished Ph.D. dissertation, Cornell University) (on file with Albert R. Mann Library, Cornell University). In a later version of her paper, Karen Pence concentrates more heavily on judicial foreclosure and estimates that "loan sizes are 3% to 7% smaller in states that require judicial foreclosure processes." Karen M. Pence, *Foreclosing on Opportunity: State Laws and Mortgage Credit*, 88 REV. ECON. & STAT. 177, 180 (2006). She concludes that

> it seems clear that the mortgage market reaches a different equilibrium in judicial foreclosure states. In these states, borrowers may pay more for their mortgages, purchase smaller houses, or have difficulty becoming homeowners. But borrowers are not necessarily worse off; they may value the insurance provided by the laws. Homeownership might even increase if the judicial protections help borrowers remain in their homes. Although judicial requirements seem to impose costs on borrowers, a full welfare assessment will also require estimates of the law's benefits.

Id. at 182.

on local law governing priorities, subrogation, mortgage modification, future advances, payment and discharge, and countless other substantive law issues. A less sweeping approach would be for Congress to make UNFA applicable simply to the foreclosure of mortgages sold on the secondary market. An even less dramatic option would entail applying UNFA only to the foreclosure of mortgages held by federal agencies and the government-sponsored secondary market entities (Fannie Mae, Freddie Mac, and GNMA). Such an approach would assure secondary market investors that the time and cost of mortgage foreclosure would not vary by the location of the mortgaged real estate.[149]

Impact of the national economic crisis of 2008–09. The national economic crisis of the past two years, in large measure caused by the mortgage meltdown, has, if anything, made the case for congressional action in the foreclosure arena more compelling. For the federal government, the crisis has come with a trillion dollar price tag. The cost is breathtaking and will continue to grow. Fannie Mae and Freddie Mac are now wards of the federal government and receiving billions of dollars in federal cash infusions.[150] Congress's enactment of the Emergency Economic Stabilization Act of 2008, which contained the Troubled Assets Relief Program (TARP), provided up to seven hundred billion dollars to enable the Secretary of Treasury to purchase troubled mortgages and mortgage-backed securities from financial institutions.[151] In March 2009, the U.S. Department of Treasury announced the "Making Home Affordable" program, a seventy-five billion dollar initiative that is aimed at refinancing and modifying millions of home loans.[152] The PPIP, a Treasury plan to make private investors and the government partners in purchasing toxic mortgage-backed securities from troubled financial institutions, will cost perhaps as much as five hundred billion dollars.[153] As a practical and economic matter, the federal government has taken ownership of the mortgage crisis.

149. *Reforming Foreclosure*, *supra* note 26, at 1510.

150. In early 2009, the federal government allocated more than one hundred billion dollars each for Fannie Mae and Freddie Mac, "but some analysts have said they may need more." Zachary A. Goldfarb, *Freddie Will Ask for More U.S. Funds*, WASH. POST, Jan. 24, 2009, at D1. By August 2009, Freddie Mac had received almost fifty-one billion dollars in government aid and Fannie had drawn down forty-six billion dollars from the federal government. Nick Timiraos, *Freddie Turns Profit, but Issues Caution*, WALL. ST. J., Aug. 8, 2009, at A2. On August 6, 2009, Fannie Mae indicated that the money allocated to it "may not be enough to keep the company out of receivership." *Id.*; *see also Fannie Mae Seeks Extra $10.7 Billion in U.S. Aid*, L.A. TIMES, Aug. 7, 2009, at B4.

151. Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, §§ 101–136, 122 Stat. 3765, 3767–3800.

152. Press Release, U.S. Department of the Treasury, Making Home Affordable: Updated Detailed Program Description (Mar. 4, 2009), *available at* http://www.treas.gov/press/releases/reports/housing_fact_sheet.pdf.

153. *See supra* note 13 and accompanying text.

Contrast this enormous federal involvement with the strikingly limited financial response by the states. Few, if any, states have appropriated significant sums to rewrite mortgages or provide support for lending institutions.[154] This relative financial inactivity is not surprising, of course, because with foreclosure, job losses, and the inability to engage in deficit spending, the state tax base shrinks, and money available for crisis mitigation is constrained substantially.[155]

Where there has been intervention by states in the mortgage crisis, it has largely been regulatory and, in the long run, arguably financially counterproductive for federal taxpayers. For example, numerous state legislatures have opted in favor of temporary foreclosure delays or moratoria.[156] To be sure, in the short run, this approach may be desirable because it may mean less homelessness and other social disruption at the local level. Ultimately, however, such legislation creates a transfer payment from lenders to defaulting borrowers in the form of free rent for the moratoria period. Because the federal government is engaged in a massive underwriting of lender losses and acquiring ownership of millions of mortgages and mortgage-backed securities, it is ultimately the federal government that will bear the financial consequences from foreclosure delay.

154. *See* State of California Franchise Tax Board, Tax Credit for New Home Purchases, http://www.ftb.ca.gov/individuals/New_Home_Credit.shtml (last visited June 12, 2009) (describing a California tax relief program for buyers purchasing a previously unoccupied new home, which states that California has set aside $100,000,000 for this incentive program).

155. *See, e.g.*, Erica Alini, *State Income-Tax Revenues Sink*, WALL ST. J., June 18, 2009, at A4 ("State income-tax revenues fell 26% in the first four months of 2009 compared to the same period last year . . . . States are required by law to balance the budget, so lower tax revenues will translate in service cuts, rather than red ink."); Jonathan Weisman, *States' Budget Gaps Are Another Test for Washington*, WALL ST. J., June 15, 2009, at A2 ("States face a cumulative shortfall of $230 billion from this year through 2011 . . . ."); Abby Goodnough, *States Turning to Last Resorts in Budget Crisis*, N.Y. TIMES, July 22, 2009, at A1 ("With state revenues in a free fall and the economy choked by the worst recession in 60 years, governors and legislatures are approving program cuts, layoff and, to a smaller degree, tax increases that were previously unthinkable.").

156. *See, e.g.*, CAL. CIV. CODE § 2923.52 (West 2009) (stating that a foreclosure sale may not take place unless it is scheduled ninety days after the expiration of three months from the original notice of default—provision applies to first liens on an owner-occupied principal place of residence unless the foreclosure is by a loan servicer licensed by the state to do approved loan modifications); 735 ILL. COMP. STAT. 5/15-1502.5 (2009) (stating that after a residential mortgage has been delinquent for at least thirty days, mortgagor is entitled to a thirty-day grace period for housing counseling prior to commencement of foreclosure); N.Y. REAL PROP. ACTS. LAW § 1304 (McKinney 2009) (addressing sub-prime and other high cost mortgages in default by entitling mortgagor to a ninety-day period after default for counseling and modification negotiations before mortgagee may commence foreclosure).

In the last analysis there is something surreal about a mortgage foreclosure system that allows state governments to mandate a foreclosure regime that places substantial roadblocks and inefficiencies in the path of a satisfactory federal resolution of the mortgage crisis. To be sure, in the short run, the state and federal interests in modification of home mortgages are congruent. In the long run, however, hundreds of thousands of home mortgages will have to be foreclosed in spite of these good faith mitigation attempts. It is then that the federal interest will be served by a uniform foreclosure process, like UNFA, that is both efficient for the government and fair to borrowers. The snapshot of the Lee County, Florida foreclosure mess contained in the introduction to this paper may be emblematic of the situation in hundreds of populous counties in states that mandate judicial foreclosure.[157] It seems bizarre that such states should have the ability to impose costly procedures on the federal government when the latter is picking up the tab. Ultimately, however trite or hackneyed it may sound, one who pays the piper should be able to dictate the tune.

Does Fifth Amendment due process require federal legislation or regulation? Even if Congress finds the foregoing case for federal enactment of UNFA unpersuasive, there are constitutional considerations that may compel some type of federal foreclosure legislation or regulation. As this paper noted earlier, lenders in the majority of the states foreclose nonjudicially by power of sale, a foreclosure method that is clearly less time-consuming and more efficient than its judicial counterpart. However, assuming that state or federal action is triggered by power of sale foreclosure, a substantial body of case law has developed in the last three or four decades, finding that many state power of sale statutes violate the notice and hearing requirements contained in the Due Process clauses of the Fifth and Fourteenth Amendments to the United States Constitution.[158] Thus, those statutes that require only notice to mortgagors or owners by publication and posting fail to satisfy constitutional standards.[159] Such persons are entitled to at least mailed notice.[160] Moreover, statutes that fail to provide for notice by mail or personal service to junior lienors are likely

157. *See supra* notes 18–19 and accompanying text.

158. *See* U.S. CONST. amend. V; U.S. CONST. amend. XIV, § 1.

159. *See* 1 NELSON & WHITMAN, *supra* note 16, at 890; Rau v. Cavenaugh, 500 F. Supp. 204 (D.S.D. 1980); Ricker v. United States, 417 F. Supp. 133 (D. Me. 1976), *order supplemented* 434 F. Supp. 1251 (1976); Roberts v. Cameron-Brown Co., 410 F. Supp. 988 (S.D. Ga. 1975); Turner v. Blackburn, 389 F. Supp. 1250 (W.D.N.C. 1975). *See also* Law v. U.S. Dep't of Agric., 366 F. Supp. 1233 (N.D. Ga. 1973); Fed. Land Bank of Columbia v. Lackey, 380 S.E.2d 538 (N.C. Ct. App. 1989). *Cf. In re* Strawberry Commons Apartment Owners Ass'n 1, 356 N.W.2d 401 (Minn. Ct. App. 1984). *Contra* FDIC v. Morrison, 747 F.2d 610 (11th Cir. 1984), *reh'g denied* 763 F.2d 419 (1985).

160. 1 NELSON & WHITMAN, *supra* note 16, at 890.

also defective.[161] The same constitutional considerations also probably doom state statutes that provide for notice by mail or personal service both for the mortgagor and the owner, but for other junior interests only if they have previously recorded a request to receive it.[162] According to one court:

> [Such request notice legislation] protects the due process rights of those parties whose interests and addresses are not "reasonably ascertainable," by providing a mechanism through which such parties can be assured that they will receive notice. If an interest of a party is reasonably ascertainable, however, the minimum requirements of due process dictate that actual notice be given without a formal request for notice being filed.[163]

Thus, in the latter setting probably the only notice provisions that are clearly constitutional are those that closely approximate the notice provided to interested parties under judicial foreclosure: at least notice by mail to all parties who have a record interest in the foreclosed property junior to the mortgage being foreclosed. In the last analysis perhaps a finding of constitutionality is justified only as to this latter type of notice provision.[164]

Most state power of sale statutes make no provision for a hearing for the mortgagor or other junior interests. This is hardly surprising because their intent was to avoid the procedural complexities of judicial foreclosure. Nevertheless, several federal decisions in the 1970s took the position that power of sale foreclosure violates Fifth Amendment Due Process unless it requires "a hearing at which [mortgagors] could challenge both the legal right of [the mortgagee] to foreclose and the propriety of the decision to do

161. Island Fin., Inc. v. Ballman, 607 A.2d 76, 80 (Md. Ct. Spec. App. 1992). *See* USX Corp. v. H.H. Champlin, 992 F.2d 1380 (5th Cir. 1993) (finding that the second mortgagee was entitled to notice by mail because the junior lien, "even though terminable by foreclosure of the superior loan[,] was sufficient to trigger due process"); Teschke v. Keller, 650 N.E.2d 1279 (Mass. App. Ct. 1995) (holding that neither junior mortgagee's commercial sophistication nor its ability to protect itself by periodic checks of the registry records diminished the obligation to provide actual notice of senior sheriff's sale when the name and address of the junior mortgage were reasonably ascertainable). *Cf.* Davis Oil Co. v. Mills, 873 F.2d 774 (5th Cir. 1989), *reh'g denied* 877 F.2d 972 (1989).

162. 1 NELSON & WHITMAN, *supra* note 16, at 892–93.

163. *Ballman*, 607 A.2d at 82. *See* Henderson v. Kingpin Dev. Co., 859 So.2d 122 (La. Ct. App. 2003) ("[The request notice statute] acts as a supplement to notice by publication, allowing otherwise unascertainable parties to make themselves known. It does not relieve the responsible state actor in a particular case from exercising the reasonable diligence appropriate in the circumstances to ascertain, reasonably, the identity of an individual or entity subject to the deprivation of his or its property. Accordingly, a party with an interest in property does not waive its due process rights by failing to request notice under [the request notice statute]." (citations omitted)).

164. 1 NELSON & WHITMAN, *supra* note 16, at 893.

so."[165] However, the hearing need not be judicial. As one court stated, a hearing before a "clerk or a similar neutral official" will suffice.[166] Moreover, there is authority that a federal administrative hearing procedure can be used to supplement state power of sale legislation that itself fails to satisfy due process hearing requirements.[167]

While both the Fourteenth and Fifth Amendments require sufficient notice and an opportunity for a hearing, it is also fundamental that either state action (Fourteenth Amendment) or federal action (Fifth Amendment) must be found before either amendment is applicable. Unless sufficient state or federal action is found in connection with power of sale foreclosure, a court will not reach the notice or hearing issues, no matter how deficient a statute may be in those respects. Interestingly, some of the early power of sale Fourteenth Amendment cases resolved the constitutional issues without a consideration of state action.[168] However, the issue became increasingly important, and most of the cases held that state or federal government statutory authorization of power of sale foreclosure did not entail sufficient governmental action to trigger the application of constitutional due process concerns.[169] This trend is significant because, as a practical matter, it means

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165. Ricker v. United States, 417 F. Supp. 133, 139 (D. Me. 1976), *order supplemented* 434 F. Supp. 1251 (1976). *See* Turner v. Blackburn, 389 F. Supp. 1250 (W.D.N.C. 1975); Garner v. Tri-State Development Co., 382 F. Supp. 377 (E.D. Mich. 1974); Northrip v. Fed. Nat'l Mortgage Ass'n, 372 F. Supp. 594 (E.D. Mich. 1974), *rev'd on other grounds* 527 F.2d 23 (6th Cir. 1975); Valley Dev. at Vail v. Warder, 557 P.2d 1180 (Colo. 1976). *Cf.* Johnson v. U.S. Dep't of Agric., 734 F.2d 774 (11th Cir. 1984) (substantial probability *Fuentes* violated). *Contra* Guidarelli v. Lazaretti, 233 N.W.2d 890 (Minn. 1975).

166. *Blackburn*, 389 F. Supp. at 1259.

167. United States v. Ford, 551 F. Supp. 1101 (N.D. Miss. 1982). Nor are the notice or hearing objections readily waived. *See* 1 NELSON & WHITMAN, *supra* note 16, at 900–03.

168. *See* Young v. Ridley, 309 F. Supp. 1308 (D.D.C. 1970); Huggins v. Dement, 187 S.E.2d 412 (N.C. Ct. App. 1972)

169. Pappas v. E. Savings Bank, FSB, 911 A.2d 1230 (D.C. Cir. 2006) (finding that power of sale foreclosure does not constitute governmental action subject to due process requirements); AgriBank FCB v. Cross Timbers Ranch, Inc., 919 S.W.2d 263 (Mo. Ct. App.1996); Cheff v. Edwards, 513 N.W.2d 439 (Mich. Ct. App. 1994) ("[F]oreclosure by advertisement is not a judicial action and does not involve state action for purposes of the Due Process Clause, but rather is based on contract between the mortgagor and the mortgagee."); Charmicor v. Deaner, 572 F.2d 694 (9th Cir. 1978); Barrera v. Sec. Bldg. & Inv. Corp., 519 F.2d 1166 (5th Cir. 1975); Northrip v. Fed. Nat'l Mortgage Ass'n, 527 F.2d 23 (6th Cir. 1975); Bryant v. Jefferson Fed. Sav. & Loan Ass'n, 509 F.2d 511 (D.C. Cir. 1974); Kenly v. Miracle Props., 412 F. Supp. 1072 (D. Ariz. 1976); Lawson v. Smith, 402 F. Supp. 851 (N.D. Cal. 1975); Y Aleman Corp. v. Chase Manhattan Bank, 414 F. Supp. 93 (D. Guam 1975); Global Indus., Inc. v. Harris, 376 F. Supp. 1379 (N.D. Ga. 1974); Faith Cathedral Church of God in Christ v. Booker T. Washington Ins. Co., Inc., 481 So.2d 369 (Ala. 1985); Homestead Sav. v. Darmiento, 230 Cal. App. 3d 424 (Ct. App. 1991); Leininger v. Merchants & Farmers Bank, Macon, 481 So.2d 1086 (Miss. 1986); Fed. Nat'l Mortgage Ass'n v. Howlett, 521 S.W.2d 428 (Mo. 1975) (en banc); Wright v. Assocs. Fin. Servs. Co. of Or., Inc., 651 P.2d 1368 (Or. Ct. App. 1982); Kennebec Inc. v. Bank of the West, 565 P.2d 812 (Wash. 1977); Dennison v. Jack, 304 S.E.2d 300 (W. Va. 1983); Kottcamp v. Fleet Real Estate Funding Corp., 783 P.2d 170 (Wyo. 1989). *Contra* Island Fin., Inc. v. Ballman, 607 A.2d 76 (Md. Ct. Spec. App. 1992); *Blackburn*, 389 F. Supp. at 1250.

that power of sale statutes continue to provide an effective foreclosure method for nongovernmental mortgagees even where the statutes are noticeably deficient on notice or hearing grounds.

However, the above governmental action decisions provide little comfort to state or federal governmental entities. As Professor Whitman and I have stated:

> Where power of sale constitutional litigation involves a direct instrumentality of the state or federal government as the mortgagee, courts cannot avoid the constitutional issues of notice and hearing. Even though a court would find that a particular state power of sale statute lacks the requisite state action when a private party is the mortgagee, the presence of the government as a mortgagee provides the "governmental action" necessary to reach the constitutional issues. If the foreclosing mortgagee is a direct instrumentality of the state, the fourteenth amendment [sic] state action requirement is readily satisfied. If the foreclosing mortgagee is a direct federal instrumentality, then the requisite "federal action" exists, and a court will apply fifth amendment [sic] due process standards to test the constitutionality of the foreclosure.
>
> It is a relatively common practice for a direct instrumentality of the federal government to foreclosure under state power of sale statutes. This situation will arise, for example, where direct loans made by the Veterans Administration (VA) or the Farmers Home Administration (FmHA) under various government programs are foreclosed. It also could occur where the Federal Housing Administration (FHA) opts to take an assignment of an FHA insured mortgage that is in default and then forecloses.
>
> Normally one would assume that federally-owned corporations utilizing power of sale foreclosure will be treated as the federal government for Fifth Amendment purposes.... GNMA[] presumably, should be similarly treated because it is a corporation wholly-owned by the United States government that purchases federally-insured or guaranteed mortgages on the secondary market. However, the United States Court of Appeals for the Eighth Circuit, in *Warren v. Government National Mortgage Association*, held that GNMA as a foreclosing mortgagee under Missouri power of sale legislation should not be considered the federal government for purposes of the Fifth Amendment. While the reasoning is unclear, the court could be saying simply that GNMA, because of its unique role as a corporation dealing on the secondary mortgage market,

acts, for the most part, like a private corporation and therefore should not be treated as a direct federal instrumentality. Indeed, this view was adopted by a concurring judge. On the other hand, the opinion can easily be read more broadly for the proposition that even a direct instrumentality of the United States can foreclose without "federal action" being triggered so long as the agency simply follows state power of sale statutes and "neither mandate[s] nor approve[s] the method of foreclosure to be followed in the event of default." Finally, perhaps the court was suggesting that even the United States can act in a proprietary or commercial, as opposed to governmental, fashion and that foreclosure of mortgages can be classified as proprietary or commercial activity. If either of these latter interpretations is accurate and either was to be accepted by other circuits, then even FmHA, the VA, and HUD could be deemed nongovernmental and insulated from the requirements of Fifth Amendment due process. Such a view would surely come as a surprise to the numerous federal courts that routinely either expressly find or assume the presence of federal action in federal agency cases.

> . . . .
>
> [In any event, i]n an important 1995 "federal action" decision, the United States Supreme Court held 8-1, in *Lebron v. National R.R. Passenger Corp.*, that Amtrak should be treated as the federal government for First Amendment purposes. In *Lebron*, a Vice President of Amtrak had rescinded a contract for a billboard in Penn Station because the proposed billboard was political in nature. Justice Scalia's opinion for the Court held that "where, as here, the Government creates a corporation by special law, for the furtherance of governmental objectives, and retains for itself permanent authority to appoint a majority of the directors of that corporation, the corporation is part of the Government for purposes of the First Amendment."
>
> *Warren* may be dubious authority in light of *Lebron.* Note that while Amtrak's preferred stock is wholly owned by the United States, railroads and other private entities own common shares. GNMA, on the other hand, is wholly owned by the United States.[170]

As one analysis states:

> If the *Lebron* test were used to analyze the facts in *Warren*, for example, it is likely that the court would reach a different result.

170. 1 NELSON & WHITMAN, *supra* note 16, at 911–13, 916 (footnotes omitted).

> The first prong of the test would easily be satisfied by the declaration of purpose in the statute. As for the second prong, when Congress partitioned GNMA and FNMA in 1968, GNMA stayed with the government when FNMA was established as a private corporation. As part of the government, GNMA is controlled by the Secretary of Housing and Urban Development. Therefore, if the *Lebron* test is to be expanded beyond the First Amendment, GNMA is certain to be considered a federal actor for Fifth Amendment purposes, thereby invalidating *Warren*.[171]

However, according to the foregoing commentator, *Lebron* did not have a similar impact on Fannie Mae and Freddie Mac:

> Both [Fannie Mae] and [Freddie Mac] will satisfy the first prong of the [*Lebron*] test, because they were both formed by the government to further governmental objectives. The second prong, however, is probably not met by either [Fannie Mae] or [Freddie Mac]. [Fannie Mae] is entirely owned by the private sector and has only a minority of directors appointed by the government. [Freddie Mac] is also owned by the private sector and also has only a minority of directors appointed by the government.[172]

In sum, it is fair to say that prior to the summer of 2008, Freddie Mac and Fannie Mae were probably not acting as the federal government when they foreclosed mortgages under state power of sale legislation.

Impact of the mortgage meltdown on the federal action issue. The foregoing analysis has probably been rendered obsolete by the mortgage crisis of the past year and a half and the federal government's reaction to it. The Housing and Economic Recovery Act of 2008, signed into law on July

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171. Daniel E. Blegen, *The Constitutionality of Power of Sale Foreclosures by Federal Government Entities*, 62 MO. L. REV. 425, 445–46 (1997) (footnotes omitted).

172. *Id.* In *American Bankers Mortgage Corporation v. Federal Home Loan Mortgage Corporation*, the court applied the *Lebron* test. 75 F.3d 1401 (9th Cir. 1996). *American Bankers* involved a corporation (ABM) that serviced mortgages for Freddie Mac. *Id.* After an audit determined that ABM had failed to comply with Freddie Mac's requirements, Freddie Mac terminated its relationship with ABM. *Id.* ABM then sued Freddie Mac alleging a violation of its Fifth Amendment Due Process rights. *Id.* The Ninth Circuit, however, found no federal action for Fifth Amendment purposes. *Id.* Although Freddie Mac qualified under the governmental objectives prong of the *Lebron* standard, it failed the "control" prong because the "current governance structure of Freddie Mac affords the government far less control over that corporation's operations than it had over Amtrak's operations in *Lebron*." *Id.* The court emphasized that the government appointed fewer than one-third of the Freddie Mac directors, and that Freddie Mac had issued substantially more stock than Amtrak. *Id.*

30, 2008,[173] expanded federal regulatory control over Fannie Mae and Freddie Mac and established the Federal Housing Finance Agency (FHFA) for that purpose.[174] A few weeks later, after the economic condition of Fannie Mae and Freddie Mac became more precarious, the Secretary of the Treasury announced on September 7, 2008 that both Fannie Mae and Freddie Mac had been placed under federal conservatorship and that FHFA was the conservator.[175] As conservator, the FHFA assumed the power of the board of directors and management of both corporations.[176] New CEOs were appointed who reported to FHFA.[177] In exchange for massive monetary infusions, senior preferred shares in each corporation were issued to the federal government with a ten percent coupon.[178] More important, the government received warrants to obtain stock for a few cents per share.[179] If the warrants are exercised, the federal government will receive a 79.9% ownership stake in each corporation.[180]

It seems clear that at the present time, Fannie Mae and Freddie Mac satisfy the second prong of the *Lebron* test in that the federal government controls each entity for the foreseeable future. The upshot is that when either forecloses mortgages under state power of sale statutes, it is treated as a federal actor under the Fifth Amendment and therefore must satisfy the norms of procedural due process. Few state statutes satisfy constitutional criteria. How then should Fannie Mae, Freddie Mac, and other federal agencies deal with this issue?

∘ Should they use only judicial foreclosure to foreclose mortgages? This option would be a potential disaster for Fannie Mae and Freddie Mac as institutions that together hold or guarantee almost half of the outstanding mortgages in the nation. Simply imagine the Lee County, Florida situation described earlier in this paper writ large.[181]

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173. 12 U.S.C. § 4501 (2006 & Supp. 2009).

174. *Id.* § 4511.

175. Press Release, Henry M. Paulson, Jr., Treasury Secretary, U.S. Department of the Treasury, Statement on Treasury and Federal Housing Finance Agency Action to Protect Financial Markets and Taxpayers (Sept. 7, 2008), *available at* http://www.treas.gov/press/releases/hp1129.htm.

176. Press Release, U.S. Department of the Treasury, Fact Sheet: FHFA Conservatorship (Sept. 7, 2008), *available at* http://www.treas.gov/press/releases/hp1129.htm.

177. *Id.*

178. Press Release, U.S. Department of the Treasury, Fact Sheet: Treasury Senior Preferred Stock Purchase Program (Sept. 7, 2008), *available at* http://www.treas.gov/press/releases/reports/pspa_factsheet_090708%20hp1128.pdf.

179. *Id. See, e.g.*, Press Release, U.S. Department of the Treasury, Fannie Mae Warrant to Purchase Common Stock; Freddie Mac Warrant to Purchase Common Stock (Sept. 7, 2009), *available at* http://www.treas.gov/press/releases/hp1129.htm.

180. Press Release, U.S. Department of the Treasury, Fact Sheet: Treasury Senior Preferred Stock Purchase Program (Sept. 7, 2008), *available at* http://www.treas.gov/press/releases/reports/pspa_factsheet_090708%20hp1128.pdf.

181. *See supra* note 19 and accompanying text.

• Should they rely on *Warren* and simply continue to use state power of sale legislation? *Lebron* probably precludes this option.[182] Unless federal courts are willing to hold that whenever a federal agency is foreclosing it is acting in a proprietary fashion as a normal private market player, reliance on *Warren* seems misplaced. On the other hand, Fannie Mae, Freddie Mac and other federal agencies surely should refocus on this case as a potential theory to salvage their use of nonjudicial foreclosure in states that have otherwise constitutionally defective power of sale foreclosure statutes.

• Should Congress, by legislation, make the UNFA available to Fannie Mae and Freddie Mac? This paper recommends that Congress take this action. UNFA requires mailed notice to all whose property rights are put at risk by foreclosure.[183] Thus, UNFA clearly meets the notice requirements of the Fifth Amendment. The hearing issue is less clear-cut.[184] It provides residential debtors the right to an informal hearing with a responsible representative of the mortgagee to present reasons why the foreclosure should not go forward.[185] There are several potential problems with this hearing provision, but they all seem remediable. First, the hearing right is not extended to nonresidential mortgagors or to other junior interest holders whose interests are prejudiced by foreclosure.[186] Congress can remedy this by making the hearing right more inclusive to encompass those parties. Second, the person who conducts the hearing need not be neutral and, as suggested earlier in this paper, neutrality may be a constitutional requirement where a federal agency is involved.[187] However, as Professor Whitman and I noted in our commentary on UNFA, "[T]here is nothing in [UNFA] to preclude the use of a neutral person who has no other duties in connection with the mortgage loan."[188] In short, with modest amendments to the UNFA to solve these constitutional issues, its enactment by Congress for use by Fannie Mae, Freddie Mac, and other government agencies would clearly be desirable.

• Should they request that Congress extend the Multifamily Act and the Single Family Act[189] to include foreclosures by Fannie Mae, Freddie Mac, and other federal government agencies? Federal policymakers may find the

182. Lebron v. National R.R. Passenger Corp., 513 U.S. 374, 400 (1995).

183. *See Reforming Foreclosure*, *supra* note 26, at 1456–67.

184. *See id.* at 1450–56.

185. *See generally* UNIF. NONJUDICIAL FORECLOSURE ACT § 206, 14 U.L.A. 162–63 (2005).

186. *Id.*

187. *See Reforming Foreclosure*, *supra* note 26, at 1452–54.

188. *Id.* at 1453.

189. *See supra* notes 132–35 and accompanying text.

UNFA, with its three methods of foreclosure, too complex and too much of a radical departure from the status quo. Why experiment, they may reason, when two federal statutes already exist that, with modest changes, are ready for use by federal agencies? In short, the Multifamily and Single Family Acts could be combined to foreclose mortgages held by any federal agency. Nevertheless, several changes will probably be necessary to satisfy constitutional concerns. Neither the acts nor their regulations require mailed notice to lessees, easement holders, or others holding interests junior to the mortgage being foreclosed.[190] The combined Act would need to be revised to remedy this due process notice concern. There currently is also a hearing problem. A regulation under the Multifamily Act currently affords the mortgagor and current owner an "opportunity informally to present reasons why the mortgage should not be foreclosed."[191] While one court has found this hearing provision to suffice constitutionally when the challenge was by a mortgagor,[192] neither act currently makes such a hearing available to other junior interests prejudiced by foreclosure. A combined Act could contain language expanding hearing rights to those parties. In sum, this approach is a viable option for Fannie Mae, Freddie Mac, and other federal agencies.

E. *The Case for a Federal Assignment of Rents Statute*

Until very recently, the national mortgage crisis has largely been driven by defaulting single family mortgages. Now the spotlight is beginning to focus on the commercial real estate market—office buildings, shopping centers, hotels and apartment buildings. Recently the country has witnessed substantial defaults in commercial mortgages and commercial mortgage-backed securities, as well as predictions of greater troubles to come.[193] As

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190. *See supra* notes 138–39 and accompanying text.

191. 24 C.F.R. § 27.5 (2009).

192. *See* Lisbon Square v. United States, 856 F. Supp. 482, 489 (E.D. Wis. 1994) ("By offering a mortgagor a chance to explain the failure to make mortgage payments, HUD provides all of the due process required by the Fifth Amendment.").

193. *See* Christina S.N. Lewis, *Maguire Warns of Loan Defaults*, WALL ST. J., Aug. 10, 2009, at B1 ("Maguire Properties, Inc., one of the largest office-building owners in Southern California, is planning to hand over control of seven buildings with some $1.06 billion in debt to creditors, the latest sign that rising vacancies and falling rents are causing stress in the commercial real estate sector."); Francesco Guerrera & Greg Farrell, *Property Woes Hit Two Big US Banks*, FIN. TIMES, July 23, 2009, at 1 ("Mr. Bernanke[, Chairman of the Federal Reserve,] warned that a continued deterioration in commercial property, where prices have fallen by about 35 per cent since the market's peak and defaults have been rising sharply, would present a 'difficult' challenge for the economy. . . . [and] one of the main problems was that the market for securities backed by commercial mortgages had 'completely shut down'."); Lingling Wei & Maurice Tamman, *Commercial Loans Failing at Rapid Pace*, WALL ST. J., July 20, 2009, at C1 ("U.S. banks have been charging off soured commercial mortgages at the fastest pace in nearly 20 years . . . ."); Aline van Duyn, *Worries over Systemic Risk in CMBS*, FIN. TIMES, June 23, 2009, at 21 ("If the Fed cannot unblock the market for securities backed by commercial mortgages, there are concerns that another

this paper noted earlier, virtually every commercial mortgage transaction encompasses not only a mortgage on the land and improvements, but also an assignment of (or security interest in) the rents produced by that real estate. This paper also described the disarray in the law governing rental assignments. In 2005 the Conference aptly described the current landscape and the need for uniformity:

> State law generally governs the creation and enforcement of security interests in rents. Unfortunately, most states do not have detailed statutory provisions dealing with the creation, perfection, and enforcement of security interests in rents (by contrast to the comprehensive provisions in Uniform Commercial Code Article 9 governing the creation, perfection, and enforcement of security interests in accounts and other personal property payment rights). Thus, the creation and enforcement of security interests in rents tends to be governed by the common law of real property. Not surprisingly, this has produced undesirable variation in the rules governing the creation and enforcement of security interests in rents. Perhaps more significantly, disagreements regarding security

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wave of losses could be unleashed on the fragile US banking system."); Lingling Wei & Kris Hudson, *Key Investor Stands in Hotel Rubble*, WALL ST. J., June 16, 2009, at B1 (noting that monthly default rate for commercial-mortgage-backed securities on hotel properties has risen from .025% in late 2008 to 2% in June 2009); Annys Shin, *Economic Decline Slows in Some Regions*, WASH. POST, June 11, 2009, at A17 ("The decline in commercial real estate, which is just beginning, drove up vacancy rates for commercial properties in many parts of the country. Developers also report having an increasingly hard time finding financing for new properties."); Lingling Wei & Kris Hudson, *Relief for Commercial Real-Estate Debt? It Seems Possible*, WALL ST. J., June 10, 2009, at C6 (noting deterioration in the commercial real estate market); Anton Troianovski, *Big-City Skyscraper Burns Ozark Town*, WALL ST. J., June 4, 2009, at A1 (identifying some consequences of "today's commercial-property collapse"); Ben Johnson, *The Tsunami Effect*, NAT'L REAL ESTATE INVESTOR, May 1, 2009, at 47 ("When Boston's landmark John Hancock Tower sold at auction in late March for a little more than half of the $1.3 billion that private equity firm Broadway Partners paid for it only two years earlier, many analysts pointed to the sales price as a new gauge of property values. But more likely it was the precursor to a tidal wave of commercial real estate foreclosures and auctions in the coming months."); Edward C. Hagerott, Jr., *Curing the Mortgage Loan Blues*, NAT'L REAL ESTATE INVESTOR, May 1, 2009, at 64 ("The signs for commercial real estate are ominous. . . . Multiple factors, including tight credit, declining property values and rising vacancy rates, suggest many borrowers will be unable to refinance or sell their projects for amounts sufficient to repay maturing loans."); Sibley Fleming, *Maturing Loans Head for a Troubled Market*, NAT'L REAL ESTATE INVESTOR, Apr. 1, 2009, at 13 ("A potential recipe for disaster is brewing in the commercial real estate market, according to a new report from research firm Foresight Analytics. An extremely tight credit market coupled with $814 billion in maturing loans over the next three years could prove to be a toxic mix that delays recovery and puts downward pressure on valuations.").

interests in rents tend to be resolved in the federal bankruptcy courts, after the owner of mortgaged real property has resorted to bankruptcy to obtain a stay from creditor collection efforts. Bankruptcy courts have proven exceptionally adept at creatively interpreting (or misinterpreting) state law principles—in some cases to disencumber a lender's security interest in rents altogether, or in other cases to exclude post-bankruptcy rents from the bankruptcy estate.[194]

Just as this paper advocates federal foreclosure legislation for both residential and commercial mortgagees, so too it endorses a similar approach to assignments of rents. Just as the secondary market in residential mortgages and the current residential mortgage crisis are driving forces for greater uniformity in mortgage foreclosure, the expanding secondary market for commercial mortgages and mortgage-backed securities and the impending likelihood for substantial delinquencies in that market also present a compelling case for federalization of rent assignments.

Luckily, for a Congress inclined to create national uniformity in the assignment of rents context, it need look no further than the UARA promulgated by the Conference in 2005.[195] Congress could either enact the UARA and, in doing so, preempt all state assignment of rents law, or it could simply make it applicable only in bankruptcy proceedings. Of course, because most litigation concerning assignments arises in the bankruptcy context, the "bankruptcy only" approach would go a long way to achieve the desired national uniformity. The UARA provides a superbly drafted and thoughtful resolution of most of the pressing issues that have confounded this area of the law. Professor Wilson Freyermuth, the reporter for the UARA, describes its scope as follows:

> [The UARA] provides a comprehensive framework to govern the creation, perfection, and enforcement of security interests in rents arising from mortgaged real property. Without such a comprehensive statutory framework, courts (particularly bankruptcy courts) have struggled to establish clear and consistent rules governing security interests in rents—thereby encouraging needless and wasteful litigation over control of rents arising from mortgaged real property. Enactment of UARA in each state will provide much-needed clarity by establishing the following rules:
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> *"Rents" include sums payable for the right to possess or occupy the real property of another person, even if the occupant does not technically constitute a "tenant" under real property law. . . .*

194. UNIF. ASSIGNMENT OF RENTS ACT prefatory note, 7 (Pt. IB) U.L.A. 2 (2005).

195. *Id.* §§ 1–21, 7 (Pt. IB) U.L.A. 7 (2005).

A mortgage automatically creates a security interest in rents. Under the title theory of mortgages, a mortgage automatically effected an assignment of rents from the mortgaged real property. Under the lien theory of mortgages, however, a mortgage did not automatically create an assignment of rents. . . . UARA provides that an effective mortgage automatically creates a security interest in rents arising from the mortgaged real property, unless the mortgage expressly provides otherwise.

A security interest in rents is perfected (and thus enforceable against creditors and purchasers) upon recording of the document creating an assignment of rents. Under Article 9, the filing of a financing statement is sufficient to perfect a security interest in most forms of personal property. By contrast, some courts have held that even if a creditor held a recorded assignment of rents, the creditor held only an "inchoate" lien until the creditor actually collected the rents after default. Many of these courts further held that if the debtor filed for bankruptcy before the creditor took effective steps to collect the rent after default, the creditor's interest was unperfected and the bankruptcy trustee could set aside the creditor's interest in rents using the trustee's strong-arm power. UARA overrules these decisions, providing that the recording of a document creating an assignment of rents is sufficient to perfect the creditor's security interest in rents and thereby make that interest enforceable against subsequent creditors and purchasers.

A security interest in rents is separate and distinct from a security interest in the underlying real property. . . . Most courts have treated these rents as a source of collateral that is separate and distinct from the underlying land. A few notorious bankruptcy court decisions, however, have held that rents are "subsumed within the land" such that a debtor need not provide adequate protection of the assignee's security interest in rents. UARA would overrule these decisions (to the extent that they rely upon state law), providing that a security interest in rents is an additional source of collateral that is distinct from the underlying real estate.

There is no such thing as an "absolute assignment of rents" in the context of a mortgage transaction; an assignment of rents creates only a security interest in the rents. . . .

In a mortgage or assignment of rents, a provision granting the assignee the right to obtain a receiver following the assignor's default is enforceable. In many states, statutes provide few (if any) standards to inform a court's exercise of discretion whether to appoint a receiver to collect rents from mortgaged real property. UARA establishes consistent standards to govern the appointment of a receiver for mortgaged real property. In particular, UARA establishes the enforceability of a clause by which the assignor has agreed that the assignee can obtain the appointment of a receiver after the assignor's default.

Upon default by the assignor (or as otherwise agreed by the assignor), the assignee may collect all rents that have accrued but remain unpaid and all rents that accrue thereafter. . . .

The assignee may enforce an assignment of rents by obtaining the appointment of a receiver, by notification to the assignor, by notification to the assignor's tenants, or by any other method permitted by other law. UARA provides specific rules governing the collection of rents by receivership, by notification to the assignor, and by notification to tenants. . . .

The assignee's enforcement of its rights and remedies under UARA does not render the assignee as a "mortgagee in possession" or trigger other adverse statutory consequences. . . . UARA provides that the assignee's mere exercise of UARA's statutory remedies does not render the assignee as a mortgagee in possession. Further, it does not constitute an election of remedies, render the mortgage debt unenforceable, violate a state's "one-action" principle, or trigger the application of a state's anti-deficiency statute.

An assignor that collects rents after it receives notification that the assignee has enforced its security interest in rents must turn over to the assignee the rents collected; if the assignor fails to do so, it is liable to the assignee for the amount not turned over. . . . UARA provides that the assignor that fails to turn over collected rents following a proper demand by the assignee is liable to the assignee for all sums collected by the assignor. Any damages recovered by the assignee in an action under § 14, however, constitute security for the mortgage debt and must therefore be applied to the mortgage debt.

Most tenants that receive notification to make rent payments to the assignee cannot thereafter discharge their rental obligation by paying the assignor. . . . UARA primarily tracks existing common law, providing that a tenant that receives notification to pay the assignee can only discharge its obligation by paying the assignee. UARA does provide an exception for a tenant that occupies the premises as its primary residence, permitting such a tenant to satisfy its rental obligation by payment to either the assignee or the assignor. . . .

. . . .

> *. . . UARA establishes priority rules that govern disputes between interests created by real property law (a security interest in the cash proceeds of rents) and interests in the same property created under Article 9.* A perfected security interest in rents extends to the identifiable proceeds of those rents—typically, cash collections. Because cash monies—and the deposit accounts in which cash is typically maintained—are personal property in which a competing security interest can be created under Article 9, UARA provides coordinating priority rules to govern such priority disputes.[196]

As this paper describes earlier, there are numerous contentious and conflicting issues in the law of assignments of rents, due in large part to the fact that much of this body of law is court-made and state-centric.[197] UARA does a superb job of resolving those issues and, for the first time, organizes this area of the law into a cohesive whole. Thus far only Nevada and Utah have enacted UARA.[198] Moreover, if the past is prologue, uniform acts dealing with real estate have a sad track record for state acceptance. It simply seems to make sense that an area of the law that is so crucial to the functioning of our national economy and its bankruptcy courts should represent a national priority for Congress and the federal government.

F. Is Congressional Adoption of Uniform Acts Inconsistent with the Values of the Conference?

This paper advocates congressional enactment of two uniform acts—UNFA and UARA and, in doing so, some may argue that such a course of action threatens the underlying values of the Conference. To be sure, the Conference's main *raison d'etre* since the late nineteenth century has been to "promote uniformity in the law among the several states on subjects as to which uniformity is desirable and practicable."[199] Nevertheless, because Professor Whitman and I have had substantial involvement with the

196. R. Wilson Freyermuth, *Modernizing Security in Rents: The New Uniform Assignment of Rents Act*, 71 MO. L. REV. 1 app. (2006) (citations omitted).

197. *See supra* notes 47–61 and accompanying text.

198. UNIF. ASSIGNMENT OF RENTS ACT, 7 (Pt. IB) U.L.A. 1 (2009) (indicating that the UARA was effectively passed by Nevada on May 22, 2007 and Utah on May 12, 2009); *see also* Utah Uniform Assignment of Rents Act, ch. 139, 2009 Utah Laws 116 (to be codified at UTAH CODE ANN. §§ 57-26-101 to -119 (West 2009)).

199. NAT'L CONFERENCE OF COMM'RS ON UNIF. LAWS, CONSTITUTION AND BYLAWS § 1.2, *available at* http://www.nccusl.org/nccusl/DesktopDefault.aspx?tabindex=3&tabid=18.

Conference,[200] we can attest to the fact that, "however desirable the goal of uniformity, it is secondary to a more compelling concern—the threat of federal preemption."[201] The Conference commonly argues that "unless we act, Congress will do it for us."[202] This view seems to reflect an underlying federalist ideology, dictating that uniformity should only be achieved by the individual assent of each of the several states.[203]

As a practical matter, why should this always be the case? At least as to commercial issues, if uniformity is so important, why not let Congress do it? After all, with the exception of such major projects as the Uniform Commercial Code, uniform acts are rarely adopted by all of the states.[204] Even well-received products such as the Uniform Fraudulent Transfer Act, the Uniform Transfers to Minors Act, and the Uniform Probate Code have failed to achieve unanimous adoption.[205] Thus, the promulgation of most so-called "uniform" acts fails to achieve the desired uniformity.[206]

Professor Whitman and I argued in 2005 that perhaps it's time for the Conference to adopt a new perspective.[207] A strong case can be made that uniform acts dealing with commercial transactions *ought* to be enacted by Congress under its Commerce Clause power.[208] Under this approach, future versions of the U.C.C. would be enacted by Congress. So too would be the UNFA. Only acts dealing primarily with local social and cultural concerns, such as the Uniform Marriage and Divorce Act and the Uniform Probate Code, would continue to be produced for adoption by state legislatures.[209]

This "bifurcated function" approach for the Conference is hardly a radical suggestion. Uniform acts undergo a time-consuming, deliberate, multi-draft process that generally takes at least three or four years, and the result is almost always a high quality product—often higher in quality than typical acts of Congress.[210] State influence on uniform acts is substantial. They are drafted and considered by a body that is largely supported

200. Grant Nelson was a Commissioner from Missouri from 1982–1991 and Dale Whitman served as Reporter for UNFA from 1997–2002.

201. *Reforming Foreclosure*, *supra* note 26, at 1512.

202. *Id.*

203. *Id.*

204. *Id.*

205. The Uniform Fraudulent Transfer Act has been adopted by forty-three states and the District of Columbia, the Uniform Transfers to Minors Act by forty-eight states, the District of Columbia and the Virgin Islands and the Uniform Probate Code by eighteen states. *See* UNIF. FRAUDULENT TRANSFER ACT, 7A (Pt. II) U.L.A. 1–2 (Supp. 2009); UNIF. TRANSFERS TO MINORS ACT, 8C U.L.A. 1–2 (Supp. 2009); UNIF. PROBATE CODE, 8 (Pt. II) U.L.A. 1 (Supp. 2009). Even the Uniform Commercial Code, as adopted by all of the states, is not totally uniform.

206. *Reforming Foreclosure*, *supra* note 26, at 1512.

207. *Id.*

208. *Id.*

209. *Id.* at 1512–13.

210. *Id.*

financially by state governments.[211] Perhaps more important, the membership of the Conference is comprised of leading lawyers, judges and academics who are appointed by the political process in each of the states.[212] Indeed, uniform acts probably receive much more local and state input than the usual legislation enacted by Congress. Consequently, if uniformity in commercial matters is desirable, why not let it come in the form of a congressionally enacted uniform act produced by the Conference's careful deliberative process that reflects state concerns in a substantial manner? If the Conference and Congress adopted this approach, the Conference could achieve an impact in the new millennium that would far exceed its influence on the development of the law in the past century.[213]

G. Does Congress Have the Power to Enact UNFA and UARA?

Professor Whitman and I concluded then that congressional adoption of UNFA in any of the above variants clearly would survive a Commerce Clause challenge. Under current Supreme Court jurisprudence, Congress can reach "those activities that substantially affect interstate commerce."[214]

> To be sure, unlike the UCC, which focuses on the sale and mortgaging of moveable property, [UNFA] deals with [real estate], which, by its very nature, remains in one place. Nevertheless, under the Court's current approach, even though an isolated local mortgage foreclosure may not substantially affect commerce in more than one state, a rational Congress surely could conclude that

211. Uniform Law Commissioners, Financial Support, http://www.nccusl.org/nccusl/aboutus.asp#financial (last visited Oct. 26, 2009) ("The major portion of financial support for the Conference comes from state appropriations. Expenses are apportioned among the states by means of an assessment based on population.").

212. While the method of appointment of commissioners to the Conference varies among the states, three patterns are discernable. In some states, they are appointed by the governor and confirmed by the senate. In other states, the sole appointing authority is the legislature. In a third approach, some states give both the governor and the legislature the exclusive authority to appoint a fixed number of commissioners. Telephone Interview with John M. McCabe, Legislative Dir. and Legal Counsel, Nat'l Conference of Comm'rs on Unif. State Laws (June 4, 2002).

213. *Reforming Foreclosure*, *supra* note 26, at 1513.

214. United States v. Lopez, 514 U.S. 549, 558–59 (1995). *See also* Grant S. Nelson & Robert J. Pushaw, Jr., *Rethinking the Commerce Clause: Applying First Principles to Uphold Federal Commercial Regulations but Preserve State Control over Social Issues*, 85 IOWA L. REV. 1, 4–5, 168 (1999); Grant S. Nelson, *A Commerce Clause Standard for the New Millennium: "Yes" to Broad Congressional Control over Commercial Transactions; "No" to Federal Legislation on Social and Cultural Issues*, 55 ARK. L. REV. 1213, 1248 (2003).

the cumulative impact of such transactions on the national mortgage market does so.[215]

If anything, the UARA presents an even stronger case for congressional Commerce Clause power. Rents from real estate, while treated as real estate,[216] nevertheless represent money and, therefore, are portable and pervasively cross state lines. Because rent assignments in commercial transactions occur nationwide, there is little doubt that the cumulative impact of these assignments substantially affects commerce in more than one state. In any event, there is no doubt that Congress can use its bankruptcy power to make UARA applicable in bankruptcy courts.[217]

H. The Retroactivity Question

This paper advocates congressional enactment of UNFA and UARA and application of those acts to all mortgage transactions in the United States.[218] Assuming Congress is unwilling to take such an all-encompassing course of action, this paper suggests that there are a variety of less pervasive approaches available to it. Thus, Congress could choose to limit UNFA to federal agencies only[219] and to make UARA applicable only in bankruptcy.[220] An even more limited approach would be to extend the current federal Multifamily and Single Family Acts to all federally-held mortgages.[221]

Should it choose any of the foregoing options, Congress should state its intention to make its action applicable to all mortgages in existence at the time of enactment. The beneficial impact of such federal legislation on the current mortgage crisis will be substantially lost unless it can be applied to the hundreds of thousands of mortgages that are currently in default and will inevitably be foreclosed. After all, for many mortgagors, modifications will ultimately fail and for many others, their situations will be too hopeless to justify a modification agreement in the first place. Indeed, Congress needs

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215. Nelson & Pushaw, *supra* note 214, at 168.

216. *See supra* note 35 and accompanying text. The treatment of rents as real estate has been subject to substantial criticism. *See, e.g.*, 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) (suggesting that rents when pledged as security in commercial real estate transactions be treated as personalty, with liens upon such income being governed by Article 9 of the Uniform Commercial Code). Professor Wilson Freyermuth, in a superb 1993 article, advocated that rents be treated as personalty for security purposes. *Id.* at 1467, 1536–42.

217. *See* U.S. CONST. art. I, § 8, cl. 4 (giving Congress the power to establish uniform laws of bankruptcy).

218. *See supra* notes 149–91, 193–98 and accompanying text.

219. *See supra* notes 183–88 and accompanying text.

220. *See supra* note 195 and accompanying text.

221. *See supra* notes 188–92 and accompanying text.

to be specific on the retroactivity issue, because the Supreme Court has made it clear that "the presumption against retroactive legislation is deeply rooted in our jurisprudence, and embodies a legal doctrine centuries older than our Republic."[222]

Assuming Congress opts in favor of retroactivity, will such a course of action be constitutional? This question requires analysis of the degree to which new federal foreclosure legislation upsets the prior expectations of the parties. For mortgagees, whether private or governmental, there is almost no prejudice caused by retroactivity. In judicial foreclosure states, enacting federal power of sale foreclosure will significantly benefit mortgagees because the cost and delay of judicial foreclosure will be obviated. In power of sale states, federal legislation will have little impact on private mortgagees, because there will be minimal change in the status quo. Moreover, for federal mortgagees, legislation that is modified to correct due process notice and hearing problems will enhance their ability to use nonjudicial foreclosure where the status quo raises difficult constitutional questions.

For mortgagors, the impact of retroactivity is more profound. To be sure, in power of sale states, substituting one form of power of sale foreclosure for another will generally result in little prejudice. For many mortgagors in states that have relatively summary nonjudicial foreclosure, new federal legislation of the types described above probably expands rather than contracts mortgagor rights. The major retroactivity issue arises in almost forty percent of the states where judicial foreclosure must be used. All of the proposals considered in this paper, if applied retroactively, would deprive a mortgagor of a right to a judicial proceeding that was guaranteed by state law at the time the mortgage was executed.

When *states* enact retroactive commercial legislation, they are constrained by the Contract Clause that mandates that "[n]o state shall . . . pass any . . . [l]aw impairing the [o]bligation of [c]ontracts."[223] However, the foregoing provision restricts only the states, and protection against impairment and retroactivity against the *federal government* must be found in the Due Process clause of the Fifth Amendment.[224] Moreover, the Fifth Amendment due process restrictions are not coextensive with prohibitions on state regulations imposed by the contract clause.

222. Landgraf v. USI Film Prods., 511 U.S. 244, 265 (1994); *see also* CFCU Cmty. Credit Union v. Hayward, 552 F.3d 253, 262 (2nd Cir. 2009).

223. U.S. CONST. art. I, § 10.

224. *See* JOHN E. NOWAK & RONALD D. ROTUNDA, CONSTITUTIONAL LAW 487 (7th Ed. 2004); ERWIN CHEMERINSKY, CONSTITUTIONAL LAW: PRINCIPLES AND POLICIES 629 (3d ed. 2006).

To the extent that federal legislation proposed by this paper deals with private mortgagees, the standard of due process review is strongly deferential to Congress. As the Supreme Court stated in 1984:

> Provided that the retroactive application of a statute is supported by a legitimate legislative purpose furthered by rational means, judgments about the wisdom of such legislation remain within the exclusive province of the legislative and executive branches.... [R]etroactive legislation does have to meet a burden not faced by legislation that has only future effects.... But that burden is met simply by showing that the retroactive application of the legislation is itself justified by a rational legislative purpose.[225]

Applying federal foreclosure legislation retroactively to existing privately-held mortgages should be easy to justify under the foregoing standard. Clearly, even though there may be successful modifications of thousands of mortgages, many of those mitigation attempts will fail and the situation of numerous other mortgagors will be too hopeless to justify modification.[226] Ultimately the backlog will mean the foreclosure of hundreds of thousands of mortgages. Enactment of an efficient and fair mechanism for foreclosure of those remaining mortgages surely is a rational congressional action in attempting to bring the current economic crisis to a successful conclusion. A similar analysis would justify retroactive application of federal enactment of the UARA or other assignment of rents legislation. If, as seems likely, defaults in commercial mortgages and mortgage-backed securities create a flood of new Chapter 11 bankruptcy filings of debtors with buildings in more than one state, one uniform rule governing security interests in rents will substantially facilitate efficient bankruptcy reorganizations.

However, a higher standard of review will be applied to acts of Congress that retroactively modify the government's own contracts than to federal legislation that has a retroactive impact on private contracts.[227] In the latter situation, courts will "require more than a rational relationship between the modifying statutes and a governmental purpose before it will sustain the measure."[228] Indeed, in a significant Contracts Clause case involving a state interference with its own contract, the Supreme Court stated:

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225. Pension Benefit Guar. Corp. v. R.A. Gray and Co., 467 U.S. 717, 729–30 (1984).

226. *See* Robin Sidel, *Loan Redos Get Tangled in Thicket of Red Tape*, WALL ST. J., June 17, 2009, at A1 ("[A]bout four million [home] loans[] were delinquent in the first quarter of 2009 . . . [and] just 518,155 home loans had been modified . . . .").

227. NOWAK & ROTUNDA, *supra* note 224, at 494.

228. *Id.*

> As with laws impairing the obligation of private contracts, an impairment may be constitutional if it is reasonable and necessary to serve an important public purpose. In applying this standard, however, complete deference to a legislative assessment of reasonableness and necessity is not appropriate because the State's self-interest is at stake.[229]

At least one commentator has suggested that this standard should apply to federal attempts to modify its own contractual obligations.[230] Thus, for example, it is arguable that to apply federal nonjudicial foreclosure legislation to a mortgagor who otherwise would have a right to judicial foreclosure under state law requires a serious judicial examination of the legislation's reasonableness and necessity.

There are several responses to this argument. First, where the original mortgage transaction is between a mortgagor and a private lender, but the note and mortgage is subsequently assigned to the federal government, it is plausible that a simple rational basis standard of review of retroactivity may be justified because the original transaction was private. In one case where state law otherwise required judicial foreclosure, the mortgagor challenged on Fifth Amendment due process grounds the retroactive application of the federal Multifamily Act to a note and mortgage that had been assigned from the original mortgagee to the federal government.[231] The court rejected this challenge, albeit without mentioning the fact the government was an assignee of the mortgage:

> Congressional legislation "adjusting the burdens and benefits of economic life" is presumed constitutional, and the burden is on the complaining party to establish that the legislation is arbitrary and irrational. This applies to the retroactive application of a statute as well as long as it is "supported by a legitimate legislative purpose furthered by a rational means." This is so even if the legislature's readjusting of rights and burdens "upsets otherwise settled expectations." Moreover, contractual arrangements, including those to which the United States is a party, remain subject to subsequent legislation.[232]

229. U.S. Trust Co. v. New Jersey, 431 U.S. 1, 25–26 (1977).
230. NOWAK & ROTUNDA, *supra* note 224, at 495 n.46.
231. Lisbon Square v. United States, 856 F. Supp. 482, 490 (E.D. Wis. 1994).
232. *Id.* (citations omitted).

Another argument for sustaining retroactivity under a limited scope of review is that the federal foreclosure legislation advocated by this paper is based on a "right-remedy" distinction. For example, a famous depression-era Contract Clause case sustained Minnesota legislation that authorized state courts to extend the post-foreclosure redemption period.[233] As one commentator has described this decision, "[T]he state could alter remedies for debts if the legislation reasonably related to a public purpose and protected the basic value of creditor claims; the states were not permitted to significantly impair the basis of creditors' accrued rights in order to improve the economic position of debtors."[234] None of the federal foreclosure legislation proposed by this paper changes the substantive rights of the parties under the debt obligation—rather, it makes foreclosure (the remedy after default) occur earlier than under state judicial foreclosure procedure. Of course, the depression case dealt with pro-debtor legislation while the legislation considered in this paper often strengthens mortgagee remedies and courts may therefore be less sympathetic to the "right-remedy" distinction when it benefits creditors rather than debtors.

An "emergency" situation also sometimes justifies judicial deference for federal retroactive legislation where the federal government is a party. For example, the Supreme Court upheld on a due process challenge World War II legislation that allowed the federal government to renegotiate any pre-war contract it had with private parties to prevent conferring excessive profits on those parties.[235] The Court deferred to the judgment of Congress on the need to prevent wartime profiteering.[236] Given the flood of foreclosures that have and will occur during an economic crisis that is the most severe since the Great Depression of the 1930s, it is hardly unjustified to characterize the current foreclosure crisis as an "emergency." Thus, if Congress decides to enact any of the federal foreclosure legislation proposed by this paper and to make it retroactive, it would be advisable for it to include a preamble that emergency conditions justify acting retroactively.

In the last analysis, even if courts were to reject the foregoing arguments for a relaxed standard of review for federal foreclosure legislation being applied retroactively, there still is a significant likelihood that such legislation can be sustained under a heavier burden of proof. Surely, once the federal government is satisfied that modification efforts have run their course, there is a strong governmental interest in the efficient foreclosure of federally-held defaulted mortgages and the return of the underlying real estate into the marketplace. If judicial foreclosure is necessary for such

233. Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398 (1934).

234. NOWAK & ROTUNDA, *supra* note 224, at 479.

235. Lichter v. United States, 334 U.S. 742 (1948).

236. *Id.*

mortgages, the cost to the federal taxpayers will be enormous. This is especially the case if all mortgages now held by Fannie Mae or Freddie Mac are subject to constitutional notice and hearing requirements considered earlier in this paper.[237] If so, unless new federal power of sale legislation is validly retroactive, all federal foreclosures of existing mortgages may have to be judicial. Even worse, if judicial foreclosure is the only option, the federal government may be prohibited from hiring local attorneys to represent it. This is because under current law, when the federal government forecloses judicially, it must be represented by the United States Attorney.[238] Thus, even though the retroactive application of federal foreclosure legislation will deprive some mortgagors of time in possession of their real estate fostered by state law, that interest in continued possession is surely outweighed by the federal government's enormous interest in liquidating billions of dollars worth of real estate and putting it back into the stream of commerce.

Finally, even if, in the worst case scenario, retroactivity cannot constitutionally be achieved for federally-held mortgages, a partial solution may be available to Congress. It could amend existing mortgage modification legislation so that future modifications are conditioned upon mortgagors' agreement that future foreclosures will be under federal foreclosure statutes. The willingness of mortgagees to agree to modifications should be sufficient consideration for mortgagors' agreement that any future foreclosure be under federal legislation.

Of course, even if retroactivity is impossible, it is still desirable that Congress federalize mortgage foreclosure and assignment of rents law for future application. In the event of another national real estate crisis or meltdown, legislation will be in place to deal with the problem with efficiency and fairness.

I. An Aside: Federal Preemption of State Anti-Deficiency Legislation

Although not a primary focus of this paper, another potential candidate for federal preemption are state laws prohibiting deficiency judgments against mortgagors after foreclosure. Indeed, in over twenty percent of the

237. *See supra* notes 158–92 and accompanying text.

238. *See* 28 U.S.C. § 516 (2006) ("Except as otherwise authorized by law, the conduct of litigation in which the United States, an agency, or officer thereof is a party, or is interested, and securing evidence therefor, is reserved to officers of the Department of Justice, under the direction of the Attorney General."). Of course, Congress could enact legislation permitting Fannie Mae and Freddie Mac to hire its own outside counsel.

states, including such major jurisdictions as California, Arizona and North Carolina, most home mortgages are, as a practical matter, non-recourse—the defaulting mortgagor is simply not personally liable on the mortgage debt.[239] A June 2009 paper by Professor Luigi Zingales and others found that twenty-six percent of current mortgage defaults are by homeowners who choose to default even though they could afford to continue paying on their loans.[240] Because their homes were worth less than their mortgage debts, they made "strategic" decisions to walk away from their obligations.[241] Another recent commentator argues that "by far, the most important factor related to foreclosures is the extent to which the homeowner now has or ever had positive equity in a home."[242] Moreover, a convincing 2009 empirical study by Andra Ghent and Marianna Kudlyak makes a strong case that "recourse decreases the probability of default when there is a substantial likelihood that a borrower has negative home equity."[243] While they are unable to conclude that personal liability deters default in mortgages held by government agencies, they find a robust correlation between recourse and default as to privately-held mortgages:

> Our model predicts that we do not need to actually observe lenders frequently pursuing deficiency judgments to conclude that recourse alters borrowers' behavior. The threat of a deficiency judgment deters would-be strategic defaulters under many combinations of negative equity and the degree of lender's recourse. In other situations, if the borrower does default, allowing lenders to pursue a deficiency judgment changes how borrowers default. In particular, in states that allow lenders recourse, default occurs more frequently by deeds in lieu [of foreclosure] and short sales as recourse gives lenders a better negotiating position.
>
> Empirically, we find that, at the mean value of the default option at the time of default, the probability of default is 20% higher in non-recourse states than in recourse states. The deterrent effect on default is significant only for borrowers with appraised property values of $200,000 or more. At the mean value of the default option at the time of default and for homes appraised at $300,000 to $500,000, borrowers in non-recourse states are 59% more likely to default than borrowers in recourse states. For homes appraised at $500,000 to $750,000, borrowers in non-recourse states are almost

239. *See supra* notes 38–46 and accompanying text.

240. Luigi Guiso et al., *Moral and Social Constraints to Strategic Default on Mortgages* 10 (Nat'l Bureau of Econ. Research, Working Paper No. 15145, 2009).

241. *Id.*

242. Stan Liebowitz, *New Evidence on the Foreclosure Crisis*, WALL ST. J., July 3, 2009, at A13.

243. Ghent & Kudlyak, *supra* note 26, at 1.

twice as likely to default as borrowers in recourse states while for homes appraised at $750,000 to $1 million, borrowers in non-recourse states are 66% more likely to default.[244]

The upshot seems to be that "[m]any defaults could be mitigated if homeowners with financial resources know they can't just walk away."[245] At a time when federal taxpayers are picking up the tab for billions of dollars of defaulted mortgages, is it sound national policy to permit mortgagors of means to avoid liability in states such as California, when their counterparts in other states are prohibited from doing so?[246] In any event, federal legislation preempting or limiting state anti-deficiency protections is surely worth serious consideration.[247]

CONCLUSION

This paper has argued for federal preemption of state procedures governing the foreclosure of mortgages and security interests in rents. While it also suggests that federal action limiting or prohibiting state anti-deficiency legislation may be appropriate, it leaves this issue to future consideration. Thus, its major focus is to advocate the congressional adoption of both UNFA and UARA to make them available to all lenders nationwide.[248] However, the federal government has a special stake in

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244. *Id.* at 29. In view of the fact that UNFA bars deficiency judgments against most residential debtors, if Congress chooses to adopt this Act, it arguably should be amended to authorize deficiency liability for those debtors. *See supra* note 100 and accompanying text.

245. Liebowitz, *supra* note 242, at A13. One scholar suggests, however, that more borrowers should be "walking away" from underwater loans and that "it is time to put to rest the assumption that a borrower who exercises the option to default is somehow immoral or irresponsible." Brent T. White, *Underwater and Not Walking Away: Shame, Fear and the Social Management of the Housing Crisis* 7, 52 (Ariz. Legal Studies, Discussion Paper No. 09-35, 2009), *available at* http://www.sacbee.com/static/weblogs/real_estate/SSRN-id1494467.pdf.

246. *See supra* notes 76–77 and accompanying text.

247. *See* Liebowitz, *supra* note 242, at A13; *see also* Martin Feldstein, *How to Save an 'Underwater' Mortgage*, WALL ST. J., Aug. 8, 2009, at A13 (advocating a plan of modification of existing mortgages in default, but advocating federal legislation to impose personal liability on mortgagors who accept a modification). Of course, applying any federal preemption approach to existing mortgages would probably violate due process retroactivity norms because its impact in creating personal liability where none existed previously would alter substantive, rather than procedural, rights of mortgagors. *See supra* notes 218–38 and accompanying text. On the other hand, this obstacle would not bar federal preemptive legislation that is prospective only. Nor would it be a problem if the legislation is applied to existing mortgages where a borrower accepts a loan modification. *See supra* notes 237–39 and accompanying text.

248. While beyond the purview of this paper, there is another mortgage law area of state law that may also be suitable for congressional preemption. The law of equitable subrogation as applied to

greater uniformity for its own account. This is especially the case as to mortgages on real estate. The fallout of the economic crisis of the past year and a half has made it the owner or guarantor of millions of mortgages. It will be confronted with an overwhelming number of foreclosures that will survive all attempts at modification. Given the fact that Fannie Mae and Freddie Mac are now wards of the federal government, the federal stake in efficient and fair foreclosure procedures has become compelling. Forcing the federal government to foreclose possibly hundreds of thousands of mortgages judicially in many states seems almost surreal. Given the enormous cost of this crisis to the federal taxpayers, the government should not be held hostage to arcane and outmoded foreclosure procedures. Even in nonjudicial foreclosure states, the federalization of Fannie Mae and Freddie Mac probably necessitates changes in some statutes to comply with constitutional due process mandates. At the very minimum, the federal Single Family and Multifamily Acts with minor modifications should be made available to all federal agencies.

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mortgage refinancing represents another important example of how state law is far from uniform and how this absence of uniformity significantly increases the cost of mortgage refinancing. *See* Grant S. Nelson & Dale A. Whitman, *Adopting Restatement Mortgage Subrogation Principles: Saving Billions of Dollars for Refinancing Homeowners*, 2006 BRIG. Y. L. REV. 305 (2006). In the typical mortgage refinancing the mortgagor requests the refinancing lender to pay off the prior mortgage loan—commonly a first mortgage. In conventional thinking, this discharges the prior mortgage, leaving the refinancing lender's mortgage as the new first mortgage. Of course, this result follows if there are no intervening liens or other interests in the land sandwiched in priority between the old and new mortgages. The reason the refinancing lender usually orders a title examination and a new title insurance policy (paid for by the mortgagor) is to ensure that no such intervening interests exist. *Id.* at 305. If intervening interests exist, the refinancing lender is concerned that, when the prior mortgage is paid, these interests will be promoted in priority, and will trump the refinancing mortgage. If the old mortgage can be assigned by operation of law to the refinancing lender (and the latter be treated as "subrogated" to old lender) intervening liens or other interests are far less threatening to the refinancing lender. In such a scenario, those liens will remain subordinate to the refinanced mortgage because the refinancing mortgagee will "inherit" or be subrogated to the mortgage being paid off. The more a refinancing lender can be subrogated to the loan being refinanced, the less likely a preexisting junior lienholder can claim a windfall of advanced priority. *Id.* Currently, the law in many states gives insufficient protection to the refinancing lender. Should Congress choose to preempt state law to give maximum protection to that lender, title insurance premiums paid by refinancing mortgagors should be substantially reduced and refinancing by homeowners at lower current market interest rates will be encouraged. *Id.* at 366 ("In such an environment [federal legislation] we believe that title insurers would either substantially reduce premiums . . . or run the risk that major institutional lenders would eliminate the need for title insurance completely . . . . Either way, American homeowners would be the major beneficiaries.").