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Steinberger v. McVey ex rel. County of Maricopa

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A defaulting borrower may defend against foreclosure on ground that the chain of assignments of the deed of trust is defective, and also on a variety of other theories.

Steinberger v. McVey ex rel. County of Maricopa, 2014 WL 333575 (Ariz. Court of Appeals, Jan. 30, 2014)

The residential mortgage loan in this case was originally made in 2005 to Steinberger's 87-year-old father, who died two years later, leaving her the property. By 2008, she was having difficulty making the payments, and asked IndyMac FSB to consider a loan modification. She was advised that she must first default, and she did so. There followed a period of more than two years during which she was "jerked around" by IndyMac, with successive promises to consider a loan modification, the setting of (and then vacating of) foreclosure dates, and assertions by IndyMac that she had not properly submitted all of the paperwork required for a modification.

In November 2010 she filed an action seeking a declaratory judgment that IndyMac had no authority to foreclose on the house, and upon filing a $7,000 bond, she obtained a TRO against foreclosure. The following summarizes the theories on which she obtained a favorable result.

1. Lack of a proper chain of title to the deed of trust. The Court of Appeals seems to have assumed that no foreclosure would be permissible without the foreclosing party having a chain of assignments from the originator of the loan. If one accepts this assumption, IndyMac was in trouble. The first assignment, made in 2009, was from MERS, acting as nominee of IndyMac Bank, to IndyMac Federal FSB, but it was made before IndyMac Federal FSB even existed!

A second assignment was made in 2010 by IndyMac Federal FSB to DBNTC, the trustee of a securitized trust. But Steinberger alleged that by this date, IndyMac Federal FSB no longer existed, so this assignment was void as well. She also made the familiar allegation that this assignment was too late to comply with the 90-day transfer period required by the trust's Pooling and Servicing Agreement, but the court did not pursue this theory.

The court's opinion is significant for its treatment of *Hogan v. Wash. Mut. Sav. Bank*, the 2012 case in which the Arizona Supreme Court held that "Arizona's non-judicial foreclosure statutes do not require the beneficiary [of a deed of trust] to prove its authority." The Court of Appeals, in Steinberger, read this statement to mean that the beneficiary need not prove its authority unless the borrower alleges a lack of authority in her complaint. There was no such allegation in Hogan, but there was in Steinberger. Hence, the Court of Appeals concluded that Steinberger could contest IndyMac's right to foreclose. And it felt that Steinberger's allegations about the defects in the chain of title to the deed of trust, if proven, could constitute a successful attack on IndyMac's authority to foreclose.

It's important to realize what the Court of Appeals did not do. It did not disagree with Hogan's holding that the beneficiary need not show possession of the promissory note in order to foreclose. Several commentators (including me) have criticized Hogan for this holding, but the Steinberger opinion leaves it intact. Indeed, in Steinberger, the borrower raised no issue as to whether IndyMac had the note, and seems to have conceded that it did. The discussion focuses on the legitimacy of the chain of title to the deed of trust, not on possession of the note.

Is the court correct that a valid chain of title to the deed of trust is necessary to foreclose under Arizona law? As a general proposition, one would think not. Arizona not only has adopted the common law rule that the mortgage follows the note, but even has a statute saying so: Ariz.Rev. Stat.§ 33 817: "The transfer of any contract or contracts secured by a trust deed shall operate as a transfer of the security for such contract or contracts." So if the note is transferred, no separate assignment of the deed of trust would be needed at all. And a recent unreported Court of Appeals case, *Varbel v. Bank of America Nat. Ass'n*, 2013 WL 817290 (Ariz.App. 2013), quotes the Bankruptcy Court as reaching the same conclusion: *In re Weisband*, 427 B.R. 13, 22 (Bankr.D.Ariz. 2010) ("Arizona's deed of trust statute does not require a beneficiary of a deed of trust to produce the underlying note (or its chain of assignment) in order to conduct a Trustee's Sale.").

By the way, that's the rule with respect to mortgages in virtually every state. A chain of assignments, recorded or not, is completely unnecessary to proof of the right to foreclose. The power to foreclose comes from having the right to enforce the note, not from having a chain of assignments of the mortgage or deed of trust.

However, since Hogan has told us that no showing of holding the note is necessary in order to foreclose, what is necessary? It defies common sense to suppose that a party can foreclose a deed of trust in Arizona without at least alleging some connection to the original loan documents. If that allegation is not that one holds the note, perhaps it must be the allegation that one has a chain of assignments of the deed of trust. If this is true, then the opinion in Steinberger, written on the assumption that the assignments must be valid ones, makes sense.

The ultimate problem here is the weakness of the foreclosure statute itself. Ariz. Stat. 33-807 provides, "The beneficiary or trustee shall constitute the proper and complete party plaintiff in any action to foreclose a deed of trust." Fine, but when the loan has been sold on the secondary market, who is the "beneficiary?" The statute simply doesn't say. The normal answer would be the party to whom the right to enforce the note has been transferred, but Hogan seems to have deprived us of that answer. An alternative answer (though one that forces us to disregard the theory that the mortgage follows the note) is to say that the "beneficiary" is now the party to whom the deed of trust has been assigned. But the Arizona courts don't seem to be willing to come out and say that forthrightly, either. Instead, as in the Steinberger opinion, it's an unstated assumption.

As Wilson Freyermuth put it, after graciously reading an earlier version of this comment, "The Steinberger court couldn't accept the fact that a lender could literally foreclose with no connection to the loan documents --- so if Hogan says the note is irrelevant, well then it has to be the deed of trust (which would presumably then require proof of a chain of assignments). It's totally backwards --- right through the looking glass. And totally inconsistent with Ariz. Stat. 33-817."

To say that this is an unsatisfactory situation is an understatement; it's an unholy mess. The statute was written with no recognition that any such thing as the secondary mortgage market exists, and the Arizona courts have utterly failed to reinterpret the statute in a way that makes sense. It's sad, indeed.

There are a number of other theories in the Steinberger opinion on which the borrower prevailed. Some of these are quite striking, and should give a good deal of comfort to foreclosure defense counsel. In quick summary form, they are:

2. The tort of negligent performance of an undertaking (the "Good Samaritan" tort). This applies, apparently, to IndyMac's incompetent and vacillating administration of its loan modification program.

3. Negligence per se, in IndyMac's recording of defective assignments of the deed of trust in violation of the Arizona statute criminalizing the recording of a false or forged legal instrument.

4. Breach of contract, in IndyMac's failure to follow the procedures set out in the deed of trust in pursuing its foreclosure.

5. Procedural unconscionability, in IndyMac's making the original loan to her elderly father without explaining its unusual and onerous terms, particularly in light of his failing mental health.

6. Substantive unconscionability, based on the terms of the loan itself. It was an ARM with an initial interest rate of 1%, but which could be (and apparently was) adjusted upward in each succeeding month. This resulted in an initial period of negative amortization, and once the amortization cap was reached, a large and rapid increase in monthly payments.

At the same time, some of Steinberger's other theories were rejected, including an argument that, because IndyMac had intentionally destroyed the note, it had cancelled the debt. The court concluded that, in the absence of proof of intent to cancel the debt, it remained collectable.