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No. 66527-8-I

COURT OF APPEALS, DIVISION I
OF THE STATE OF WASHINGTON

DONALD COLLINGS and BETH COLLINGS, husband and wife,

Plaintiffs/Defendants in Intervention/Respondents,

v.

CITY FIRST MORTGAGE SERVICES, LLC,

Defendant/Appellant

U.S. BANK NATIONAL ASSOCIATION AS TRUSTEE FOR THE GREENPOINT MORTGAGE FUNDING TRUST MORTGAGE PASS-THROUGH CERTIFICATES, SERIES 2007-ARI,

Plaintiff in Intervention/Appellant.

APPEAL FROM THE SUPERIOR COURT
FOR KING COUNTY
THE HONORABLE RICHARD EADIE

BRIEF OF RESPONDENTS COLLINGS IN RESPONSE TO BRIEF OF U.S. BANK NATIONAL ASSOCIATION AS TRUSTEE FOR THE GREENPOINT MORTGAGE FUNDING TRUST MORTGAGE PASS-THROUGH CERTIFICATES, SERIES 2007-AR1

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I. INTRODUCTION

Appellant U.S. Bank, as trustee for a securitized mortgage trust, attempts to enforce a note and deed of trust that was the product of equity skimming perpetrated on respondents Donald and Beth Collings by defendants Robert Paul Loveless and his employer appellant City First Mortgage Services, LLC, ("City First"). While not challenging the trial court's determination that the Collings are the true owners of the property, U.S. Bank nonetheless argues that the Collings lack standing to challenge its claimed right to foreclose on the deed of trust wrongfully taken on their home. Based on detailed factual findings that are supported by substantial evidence, the trial court quieted title in the Collings' favor, finding that U.S Bank had no right to enforce the deed of trust that it had acquired through the Mortgage Electronic Registration System ("MERS"), that U.S. Bank was not a holder in due course, or even a holder in possession of the Note it seeks to enforce, and rejecting U.S Bank's equitable claim that it was a bona fide purchaser for value. The trial court's carefully reasoned decision should be affirmed.

II. RESTATEMENT OF ISSUES RELATING TO ASSIGNMENTS OF ERROR

A. Whether homeowners have standing to challenge the foreclosure of a deed of trust signed by a grantor who held the property in constructive trust for the homeowners?

B. Must a beneficiary of a deed of trust also be entitled to payment of the obligation that it secures in order to enforce the deed of trust?

C. Does substantial evidence support the trial court's findings that U.S. Bank did not own the obligation it sought to enforce because it failed to establish when it acquired the promissory note with an indorsement in blank?

D. Does substantial evidence support the trial court's findings that U.S. Bank did not own the obligation that it sought to enforce because it failed to establish the chain of title to the note based on mortgage securitization documents?

E. Does substantial evidence support the trial court's findings that U.S. Bank, which obtained an assignment to the deed of trust from the beneficiary after this action was commenced and the homeowners had recorded a lis pendens asserting the illegality of the obligation secured by

the deed of trust, took the deed of trust subject to the homeowners' defenses to enforcement?

III. RESTATEMENT OF THE CASE

The trial court entered findings of fact and conclusions of law after a jury made detailed advisory findings on the equitable claims before the court. The jury's findings, which U.S. Bank selectively cites when convenient and ignores when they refute its factual contentions, were advisory only. CR 39(c). Because the trial court had the discretion and responsibility to review and assess the evidence independently, this court reviews the Findings of Fact and Conclusions of Law, CP 2150-57, and not the jury's advisory verdict. *See* ***State ex rel. Dept. of Ecology v. Anderson***, 94 Wn.2d 727, 731-32, 620 P.2d 76 (1980). This restatement of the case is based on the trial court's unchallenged findings and the substantial evidence supporting those findings, which U.S. Bank ignores in its opening brief.

A. The Equity Skim.

The Collings' responsive brief in the City First appeal describes in detail the City First equity skim that culminated in U.S. Bank attempting to foreclose on the Collings' Redmond home. (City First Resp. 3-15) That recitation is incorporated here. Briefly, after receiving a mail solicitation from City First offering mortgage debt relief, and after months

of misrepresentations that their loan had been approved (9/15 RP 12, 21-22), the Collings, desperate to keep their family home, agreed to quit claim the home to City First manager Loveless, to pay him a fee of $78,540 (characterized as an illegal nonrefundable rental deposit) in order for Loveless to take out a $510,000 "investment" mortgage on their home, and then to pay Loveless "rent" equal to his monthly mortgage payment for a minimum of three years, when the Collings would have the right to repurchase their home. (9/14 RP 28-33; Ex. 5)

As part of the underwriting process for an investment loan, City First required a copy of the lease on the property, as proof of Loveless' anticipated investment income. (9/14 RP 64; 9/15 RP 140-41, 192-93; Ex. 33; CP 768-69) The lease option contract the Collings signed specifically forbade Loveless from placing any other lien on the home, or from obtaining a home equity line of credit (HELOC). (Ex. 5)[1]

[1] U.S. Bank now argues for the first time on appeal that the Collings failed to introduce a fully executed copy of the lease-option agreement. (U.S. Bank Br. at 1, 7-8, 36-41) But the trial court necessarily found credible the Collings' unrebutted testimony (9/15 RP 39) that Ex. 5 was the agreement that they signed, and that it was in City First's loan file. (FF 13, CP 2153) (*See* Argument at § IV.C.5, *infra.*)

In December 2006, Loveless refinanced and obtained a $52,500 HELOC from City First, signing a promissory note ("Note") and deed of trust ("Deed of Trust"), without the Collings' consent or knowledge and in clear breach of the lease option. (9/14 RP 67-68; Exs. 12, 13, 151) In April 2008, Loveless defaulted on these obligations. (9/14 RP 65; Ex. 11)

B. The Divergent Paths Of The December 2006 Refinance Note And Deed Of Trust.

The trial court found that U.S. Bank failed to provide satisfactory proof of ownership of the obligation that its Deed of Trust allegedly secured – the Note executed by Loveless. The trial court found that the Note was payable to someone other than the beneficiary of the Deed of Trust, that the beneficiary of the Deed of Trust was never the owner of the Note, and that U.S. Bank failed to "establish the date on which the alleged indorsement in blank was placed on the allonge or that the indorsement in blank was placed on the allonge with the authority and knowledge of GreenPoint Mortgage Funding Inc., to whom the Note was specially endorsed." (FF 8, 19, CP 2152, 2155)

U.S. Bank argues on appeal that it established its rights to the Note in its capacity as a trustee for the GreenPoint Mortgage Funding Trust, alleging that the Loveless loan passed, along with thousands of other loans, by assignment from City First, the originator and nominal lender,

then to GreenPoint Mortgage Funding, Inc., then to Lehman Brothers, the sponsor, then to the Structured Asset Securities Corporation, as depositor, and then to the Trust, the investment vehicle for securitized mortgages. (U.S. Bank Br. at 8-9, citing Exs. 151-60, 164) The trial court found that U.S. Bank failed to establish the "chain of ownership" of the Loveless loan by virtue of the securitization documents. (FF 8, 16, CP 2152, 2154) Substantial evidence supports this finding:

1. City First Split Ownership Of The Note And The Deed Of Trust, Which Was Assigned To MERS.

Loveless executed the $420,000 promissory Note and Deed of Trust on the Collings' property as part of the December 2006 refinancing. (Exs. 12, 151)

The Deed of Trust listed MERS as the "nominal" beneficiary of the security interest, while reserving to City First the right to repayment of the loan:

> (E) "MERS" is Mortgage Electronic Registration Systems, Inc. MERS is a separate corporation that is acting solely as a nominee for Lender and Lender's successors and assigns. MERS is the beneficiary under this Security Instrument.
>
> * * * *
>
> TRANSFER OF RIGHTS IN THE PROPERTY

> The beneficiary of this Security Instrument is MERS (solely as nominee for Lender and Lender's successors and assigns) and the successors and assigns of MERS. This Security Instrument secures to Lender (i) the repayment of the loan . . . .

(Ex. 12 (emphasis added))

The MERS system is designed to allow financial institutions to securitize mortgage loans without complying with the burdens of recording real estate transactions in state and county land records. (9/16 80-81) (Supp. CP __, Sub No. 56E (Ex. A at 11-12, Ex. B at 4, Ex. W)) As the Deed of Trust demonstrates, MERS does not purport to own the beneficial interest of any deed of trust, mortgage or note, but instead allows its name to be used by MERS members for recording purposes, while maintaining a non-public electronic registry to keep track of ownership of the various mortgages and deeds of trust as they are traded among MERS members. (9/16 80-81; Supp. CP __, Sub No. 56E (Ex. A at 8-10)) While the Deed of Trust purports to grant MERS legal title to the interests granted by the borrower, in fact MERS members agree among themselves to respect the legal ownership rights of the loans as they are reflected in MERS' electronic registry. (Supp. CP __, Sub No. 56E (Ex. A at 12, Ex. B at 3))[2]

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[2] *See generally*, Christopher L. Peterson, *Foreclosure, Subprime Mortgage Lending, and The Mortgage Electronic Registration System*, 78 Univ. of Cin. L. Rev. 1359 (2010).

Here, MERS was never designated the payee of the Loveless Note that U.S. Bank sought to enforce. (Ex. 151; 9/16 RP 98) By designating MERS as "nominee" for the lender, the trial court found that City First attempted to transfer the Deed of Trust separately from the Note. (9/16 RP 80-81, 100-103)

2. The Note That U.S. Bank Sought To Enforce Was Not Indorsed To U.S. Bank, Or In Blank.

The Loveless Note is dated December 6, 2006, and payable to City First. City First indorsed the Note to Green Point Mortgage Funding Inc., but did not date its indorsement, or offer any evidence when that indorsement was executed. (Ex. 151) U.S Bank contends that Green Point Mortgage Funding Inc. indorsed the Note in blank on an "allonge" – a piece of paper physically attached to a promissory note, which is sometimes used for indorsements.[3] The trial court found that U.S. Bank failed to establish the date on which the alleged indorsement in blank was made, or that it was made with the authority of GreenPoint Mortgage Funding, Inc. (FF 8, CP 2152)

Some versions of the Note that U.S. Bank swore were true and complete contain no indorsement in blank. (Ex. 72) Others have no prepayment addendum. (CP 2191-96) Another version of the Note has

[3] Black's Law Dictionary 70 (5th ed. 1979).

both a prepayment addendum and a specific indorsement to GreenPoint Mortgage Funding, Inc. ("GreenPoint"), but no indorsement in blank. (Ex. 82; 9/16 RP 88-94)

At trial, U.S. Bank, submitted a version of the Note that included an "allonge" with an indorsement in blank. (Ex. 151) But David Duclos, U.S. Bank's vice president and trust manager, also authenticated a note "front and back" at trial, and on summary judgment, that did not include the indorsement in blank. (9/16 RP 89-94; Ex. 82). Neither Duclos nor U.S. Bank's other witness, Christopher DiCicco, could state when or by whom the indorsement in blank was placed on the allonge, or when U.S. Bank came to possess this indorsement. (9/16 RP 50, 94-97) Mr. DiCicco admitted he never saw the "original" Note until sometime in 2010, well after the Collings started this action, and that he had no personal knowledge of the operations of GreenPoint Mortgage Funding, Inc., to whom City First had specially indorsed the Note. (9/16 RP 33-34, 50-51)

City First's only witness had no personal knowledge of indorsing the Note to GreenPoint Mortgage Funding, Inc. after it was signed by Loveless. (9/15 RP 43, 183) U.S. Bank failed to call as a witness the "Robo-Signer" who purported to authenticate the Note (without the indorsement in blank) on behalf of GreenPoint Mortgage Funding, Inc.,

and whose affidavit supported its motion to intervene. (*See* CP 142-44, 176)

The trial court adopted the advisory jury's finding that U.S. Bank did not prove by a preponderance of the evidence that (1) the allonge was at all times physically attached to the Note, or (2) when GreenPoint Mortgage Funding, Inc. indorsed the Note. (FF 8, CP 2152-53) The trial court concluded that U.S. Bank was not a holder of the Note and, therefore, that its security interest in the property could not be "superior to the interests of" the Collings. (CL 22-24, CP 2155)

3. The Mortgage Securitization Documents Did Not Establish That U.S Bank Owned The Loveless Loan.

Because its witnesses lacked any firsthand knowledge of the Note itself, U.S. Bank claims it "owns" the Loveless loan by virtue of the mortgage securitization documents for the GreenPoint Mortgage Funding Trust Mortgage Pass-Through Certificates, Series 2007-AR1 ("Trust"), for which U.S. Bank is the trustee. (U.S. Bank Br. at 9-10, 22-26) U.S. Bank argues that in February 2007, the "Loveless loan" passed into the Trust by virtue of the combination of the Trust Agreement (Ex. 156); a Mortgage Loan Schedule (Ex. 157); the Form of Initial Certification (Ex. 161); the Certification of Custodian (Ex. 162); the Exception Report of the Custodian (Ex. 163), and Custodial Agreement (Ex. 164). The trial court

properly rejected this argument because these documents were not what U.S. Bank claimed they were and because its witness, who "authenticated" different and inconsistent versions of the Note, was not credible. (9/16 RP 88-94)

The Trust Agreement (Ex. 156) states that Structured Asset Securities Corporation ("SASC") as Depositor owns the loans to be securitized, and that it will transfer them into the Trust "but, in each case, only to the extent assigned under the Mortgage Loan Sale Agreement." (Ex. 166 at 815, 894) But there was no evidence that SASC owned any loans, including the Loveless loan, which according to the allonge was indorsed by City First to the separate entity GreenPoint Mortgage Funding, Inc. (Ex. 151) U.S. Bank did not and does not now explain how SASC came to "own" the Loveless loan, or how it could make warranties and representations about the transferred loans that it "owned" (and transferred) within a single day. (*Compare* Ex. 155 (dated 2/1/07) *with* Ex. 156 (dated 2/1/07))

The Trust Agreement names U.S. Bank as both the trustee and the custodian of the GreenPoint trust. The Trust Agreement requires a series of certifications by the custodian as to the completeness of the loans and loan files. (Ex. 156 at 897-898) U.S Bank executed only the Initial

Certification. (Ex. 161) U.S. Bank failed to present any evidence of the additional certifications required by Section 2.02 of the Trust Agreement, requiring U.S. Bank to "review each Mortgage File to ascertain that all required documents . . . have been received and appear on their face to contain the requisite signatures." (Ex. 156 at 897; *see also* Ex. 156 at 1033-34) There was no evidence that U.S. Bank engaged in any investigation at all, before or after the Initial Certification was signed.

Duclos, who signed the Trust Agreement for U.S. Bank, had no personal knowledge of what actually happened in 2007, when loans were allegedly taken into "trust." (9/16 RP 63, 117-118) He testified that the pertinent mortgage loan schedule to the Trust Agreement that listed the Loveless loan, Exhibit 157, was at some point attached to the Trust Agreement. (9/16 RP 63-64) But there is no evidence it was attached to Exhibit 156, the Trust Agreement, when U.S. Bank as trustee allegedly took control of the Loveless loan, along with thousands of other loans. (Ex. 156 at 1074; 9/16 RP 63-64)

Relying on Duclos' testimony, U.S Bank also argues that it must have reviewed the Loveless loan and found it to be acceptable, because the Loveless loan was not listed in an Exception Report, which allegedly lists those loans that had identified problems. (Ex. 163; 9/16 RP 71-74)

However, Duclos testified that he did not review any loan documents, did not know whether anyone else did (his office was in a different state from that of the custodian), and never saw the Note until well after U.S. Bank had intervened in this lawsuit. (9/16 RP 60, 67, 77-78; 87) His testimony was premised entirely on unverified assumptions. (9/16 RP 118)

U.S. Bank also could not show that the Exception Report (Ex. 163) was related in any way to the Note, because Exhibit 163 lists loans *not* included in the Mortgage Loan Schedule to the Trust Agreement, which purported to list the loans in the Trust. (Ex. 157; 9/16 RP 28-29, 64)[4] U.S Bank did not establish that it had actually reviewed the Loveless loan in 2007, that it in fact owned both the Note and the Deed of Trust in 2007, or that it had ever engaged in any meaningful review concerning the loan.

4. U.S. Bank Never Gave Any Value In Return For The Loveless Loan.

The trial court also found that U.S. Bank gave no value in return for the Note and Deed of Trust. (FF 16, CP 2154) U.S. Bank claims that

[4] As an example, the loan listed on the third page of Exhibit 163, identified as Account No. 114-584913, Pool No. 584913, and Collateral Id. No. 70029588, which has the comment "Document is a copy" (the 16th loan listed from the top), is not listed in Exhibit 157. More importantly, no loans with a pool number of 584913 are listed in Exhibit 157. Rather, Exhibit 157 lists loans with pool numbers beginning with 617 and 618. The Loveless loan, for example, has a pool number of 618053 and account number of 114-618053.

it issued "certificates" for loan "tranches," which were then sold to investors, who in turn shared the money paid by mortgagors on the certificated tranche of pooled loans. (9/16 RP 108-09) But U.S. Bank incurred no detriment with regard to its ostensible "purchase" of the Loveless loan. U.S. Bank was not liable to redeem any certificates issued as part of the securitization. (9/16 RP 109-10) It cost U.S. Bank nothing to issue the certificates. (9/16 RP 110-12) U.S. Bank paid nothing for the Loveless loan. (9/16 RP 108) U.S. Bank's loan servicer is required to pay U.S. Bank any loan payments missed as a result of Loveless' default (9/16 RP 52-53, 110-112; Ex. 156 at 944), and U.S. Bank did not introduce any evidence at trial that it was owed *any* amount under the Note. The trial court found that U.S. Bank had failed to prove that the Loveless loan was still due and payable given the contractual obligations of the loan servicer to advance installment payments on Loveless's behalf. (FF 18, CP 2154)

5. U.S. Bank Obtained The Note And Deed Of Trust By Assignment From MERS After The Collings Notified MERS Of Loveless's Fraud, Recorded A Lis Pendens, Sued To Quiet Title, And The Court Enjoined The Trustee's Sale.

In July 2008, the Collings' daughter came home to find a notice of trustee's sale tacked to the front door. (Ex. 11; 9/15 RP 29) The Collings hired legal counsel, who wrote to MERS, City First, and Loveless on

November 15, 2008, alleging various statutory violations and demanding that MERS cease the foreclosure proceedings, which it had commenced as City First's "nominee." (Ex. 15) The Collings filed this action on March 19, 2009, to quiet title, to enjoin the trustee's sale, and for damages against City First and its employees. The Collings recorded a lis pendens asserting their ownership of the Property. (CP 1-17; Ex. 18)

On April 24, 2009, the trial court entered an order enjoining the trustee's sale pending trial. (CP 2182-86) MERS, still acting on behalf of City First, ignored the injunction, taking affirmative steps to resume the foreclosure. (CP 61-76) MERS eventually canceled the trustee's sale, but only after the trial court found MERS in contempt. (CP 2201-03)

On July 22, 2009, three months after the Collings filed their lis pendens, GMAC employee Jeffrey Stephan executed an Assignment of Deed of Trust on behalf of MERS, purporting to assign and transfer to appellant U.S. Bank "all beneficial interest" in the Deed of Trust, along with the "Note." (Exs. 23, 154; 9/16 RP 104) U.S. Bank offered no evidence that it gave any value when it received the assignment from MERS of the Deed of Trust in 2009, which it claimed was only so U.S. Bank could "enter the litigation." (9/16 RP 83, 99-103)

U.S. Bank moved to intervene in this action, seeking a declaration that its alleged security interest in the Property "remains a viable, first priority encumbrance of record . . . superior to the interests of all Defendants in Intervention." (CP 137-41, 2178-79) The trial court granted the motion, and U.S Bank filed its complaint in intervention on August 4, 2009. (Supp. CP __, Sub No. 86B; CP 2176-80)

6. The Trial Court Quieted Title In Favor Of The Collings And After Trial Entered Findings That U.S. Bank Failed To Establish A Valid Lien On The Property.

On March 3, 2010, the trial court entered partial default judgment quieting title to the Property in the Collings' favor, "subject to the court determining subsequently in this litigation whether there are any valid and subsisting liens on the Property." (CP 248)

U.S. Bank's declaratory judgment action was tried at the same time as the Collings' claims for damages against City First. The jury deciding the Collings' legal claims against City First also considered on an advisory basis under CR 39 the validity of U.S. Bank's claimed interest in a special verdict. While U.S. Bank quotes the jury's answers that favor its arguments on appeal, it ignores others, including the jury's finding that U.S. Bank knew that Loveless was not in possession of the property, that foreclosure was not necessary to collect on the Loveless note, that the

allonge was not at all times physically attached to the note, and that U.S. Bank could not establish when GreenPoint Mortgage Funding, Inc. indorsed the $420,000 promissory note. (CP 891-96)

The trial court entered findings of fact and conclusions of law on U.S. Bank's equitable claims, finding that U.S. Bank had not established when the indorsement in blank was placed on the allonge to the Note, that MERS assigned the Note and the Deed of Trust to U.S Bank in July 2009, after the Collings provided notice of their claims to MERS and recorded their lis pendens, that U.S. Bank failed to prove the chain of ownership of the Loveless loan, and that there was no evidence that the Deed of Trust was transferred from MERS to U.S. Bank for value. (FF 8-16, CP 2152-54) The trial court also found that the "deed of trust encumbering the Property was separated from the Note," (FF 19, CP 2155), and that U.S. Bank had inquiry notice of the Collings' lease and the HELOC prohibition before accepting ownership of the Loveless loan. (FF 13-14, CP 2153-54)

The trial court concluded that U.S. Bank was neither a holder nor a holder in due course, and that it could not establish a chain of title for the loan. (CL 22-23, CP 2155) The court held that U.S. Bank was not a bona fide purchaser for value and that "Loveless held the Property in

constructive trust for the Collings that is superior to the lien interest claimed by U.S. Bank." (CL 24, CP 2155)

IV. ARGUMENT

A. The Collings Have Standing In Equity To Challenge U.S. Bank's Claim To The Property And To Quiet Title To The Property.

1. The Trial Court Quieted Title Based On An Unchallenged Determination That Loveless Held The Property In Constructive Trust For The Collings.

By the time of trial, the Collings were the unquestioned record owners of the Property. (CP 245-54, 259-64; 9/14 RP 13) This fact alone confers their standing to oppose U.S. Bank's attempt to assert the priority of a deed of trust in order to foreclose on the Collings' Property. (FF 6, CP 2152; 2179) In an unchallenged conclusion, the trial court determined that U.S. Bank's Complaint in Intervention sounds in equity. (CL 21, CP 2155) The court conducted the trial of U.S Bank's claims and the Collings' defenses in equity. "Standing to assert a claim in equity resides in the party entitled to equitable relief; it is not dependent on the legal relationship of those parties." ***Smith v. Monson***, 157 Wn. App. 443, 445, 236 P.3d 991 (2010).

The trial court quieted title to the Collings after finding that they were fraudulently induced into transferring their Property to Loveless in 2006, and that Loveless held the property at all times in constructive trust

for the Collings. (FF 5, CP 2152) U.S. Bank does not appeal the partial default judgment that quieted legal title to the Property to the Collings; nor does it assign error to Finding of Fact No. 5, which is a verity on appeal.

A constructive trust is established "when property is acquired under circumstances such that the holder of legal title would be unjustly enriched at the expense of another interested party." ***Huber v. Coat Inv. Co. Inc.***, 30 Wn. App. 804, 810, 638 P.2d 609 (1981). The trial court's finding that Loveless held the property in constructive trust for the Collings "amounts to a holding that the wrongdoer ought to be treated as if he had been a trustee for the beneficiary from the time he began to hold the property unconscionably." ***Huber***, 30 Wn. App. at 810; ***Smith***, 157 Wn. App. at 447-48. In ***Smith***, for instance, the plaintiff conveyed property to a relative, so that the relative could borrow money to buy a mobile home, on the condition that the property was to be re-conveyed to the plaintiff thereafter. But the relative-assignee instead conveyed the land to a third party. 157 Wn. App. at 445. This court held that the plaintiff had standing to quiet title. 157 Wn. App. at 448-49.

That Loveless later refinanced the purchase loan by signing a second (unauthorized) refinance note with City First does not affect the Collings' standing. Loveless continued to hold the Property for the benefit

of the Collings, and the Collings continued to indirectly pay the loan that U.S. Bank sought to enforce. (9/14 RP 30-31, 9/15 RP 27) ***Johnson v. Novastar Mortgage, Inc.***, 698 F.Supp.2d 463 (D.N.J. 2010), is illustrative. In ***Johnson***, the plaintiff had standing to sue a lender after she was lured into two sale transactions designed to protect her home. The first was a sale lease-back arrangement with her daughter. In the second, the plaintiff was persuaded to sell the home to a third party investor; her daughter deeded the property to the investor, with whom plaintiff entered into a lease purchase agreement. 698 F.Supp.2d at 466. The district court held that plaintiff had alleged sufficient facts to show that both transactions were equitable mortgages and that even though she was not a party to the loan paperwork she had standing to assert violations of the Truth in Lending Act and the New Jersey Consumer Fraud Act against the lender. 698 F. Supp 2d. at 468, 471-73.

2. U.S. Bank Had The Burden Of Establishing An Interest In The Property Superior To The Collings' Interest And That It Was The Holder Of The Obligation Secured By The Deed Of Trust.

Because the Collings stood to lose their home if U.S. Bank prevailed on its claims, they had every right to question U.S. Bank's claimed ownership of the Note and Deed of Trust, and to assert upon U.S. Bank's intervention that its "proof" of ownership was lacking. In

Washington, a foreclosing party must in addition to being the beneficiary of the deed of trust be the beneficial holder of the *obligation* that the deed of trust secures. RCW 61.24.030(7)(a) (requiring trustee to have proof that "beneficiary is the owner of any promissory note or other obligation secured by the deed of trust," prior to serving, recording or transmitting notice of trustee's sale); RCW 61.24.005(2)(defining "Beneficiary" under a deed of trust as, "the holder of the instrument or document evidencing the obligations secured by the deed of trust . . ."); *see also* ***In re Jacobson***, 402 B.R. 359, 367, 370 (Bankr. W.D.Wash. 2009) (denying motion to lift stay to foreclose on standing grounds). In other words, the foreclosing party must be both the owner of the promissory note and the owner of the deed of trust securing the note.

By relying on its mortgage securitization agreements to establish its ownership of the Note and Deed of Trust, U.S. Bank opened the door to the Collings' examination and challenge of those agreements. The Collings were entitled to question U.S. Bank's assertion that the securitization upon which it relied in fact included the Loveless loan and whether U.S. Bank had followed the transfer requirements of those agreements. *See* ***State v. Gefeller***, 76 Wn.2d 449, 455, 458 P.2d 17 (1969) (party opens door to inquiry regarding subject matter that party places at issue).

U.S. Bank's argument that the Collings cannot assert defenses belonging to Loveless or claims belonging to the parties to the mortgage securitization agreements relies exclusively on non-Washington law that does not support its position because the Collings had equitable standing. Neither ***In re Cook***, *cited as* ***Rogan v. Bank One N.A.***, 457 F.3d 561 (6th Cir. 2006), ***Liu v. T & H Machine., Inc.***, 191 F.3d 790 (7th Cir. 1999), nor ***Blackford v. Westchester Fire Ins. Co.***, 101 F. 90 (8th Cir. 1900) (all cited by U.S. Bank at 20), mandate a different rule. ***Lui*** does not involve a matter in equity or a constructive trust, but is a simple contract case, as is the century-old ***Blackford*** case, which involves the assignment of proceeds from an insurance contract in Indian Territory. 101 F. at 90. In ***Rogan*** the court addressed on the merits defenses alleged by the trustee of debtors that went to the validity of a promissory note, including whether the bank "actually possesses the promissory note." 457 F.3d at 567-66.

This court should also reject U.S. Bank's assertion that only Loveless, the nominal obligor of the Note that U.S. Bank seeks to enforce against the Collings' property, has standing under the law of negotiable instruments. U.S. Bank argues that the Collings lacked standing to assert that U.S. Bank was not a holder in due course under Article Three of the UCC because the doctrine only protects against the claims of a "party to

the instrument with whom the holder has not dealt," and the Collings were not "parties to the Loveless loan." (U.S. Bank Br. at 26, *quoting* ***Wesche v. Martin***, 64 Wn. App. 1, 8, 822 P.2d 812 (1992)). But the Collings were not asserting UCC defenses as "obligors" or as "payees." Instead, they contended that U.S. Bank did not "own" the Note that provided the basis for its asserted equitable right to defeat the Collings' title. U.S. Bank cites no authority that prohibits a third party from defending against a claim to real property by challenging the validity of the claimant's note or security.

By definition, under the UCC a "security interest" does not include an interest in real property. RCW 62A.1-201(37) ("'Security interest' means an interest in personal property or fixtures which secures payment or performance of an obligation, except for lease-purchase agreements under chapter 63.19 RCW."). Article Three likewise by definition does not pertain to real property. RCW 62A.3-102(a) ("This Article applies to negotiable instruments."). Article Three cannot limit the defenses of a third party to enforcement of a deed of trust securing a promissory note. RCW 61.24.020 ("a deed of trust is subject to all laws relating to mortgages on real property."); *see also* Ann M. Burkhart, *Third-Party Defenses to Mortgages*, 1998 BYU L. Rev. 1003, 1011 (1998) (noting that

Article Three's legislative history "does not indicate that the drafters considered the issue of third party defenses.").

The Collings had standing to make each of the arguments upon which the trial court relied in denying U.S. Bank's equitable claim to impose a deed of trust upon the Collings' title to the Property based upon its asserted interest in the Loveless loan. And as discussed below, each of the alternative grounds on which the trial court relied independently supports its decision denying U.S. Bank's claim.

B. Transfer Of The Deed Of Trust To MERS Split The Note From The Deed Of Trust.

1. Separating A Note From Deed Of Trust Renders The Deed Of Trust Unenforceable.

U.S Bank's predecessors intentionally split the Note from the Deed of Trust by denominating MERS rather than City First as the beneficiary of the Deed of Trust. Separating a note from deed of trust renders the deed of trust unenforceable. In Washington, a mortgage loan consists of a promissory note and deed of trust. Under the Deed of Trust Act, the lender or its assignee must own both the note and the deed of trust in order to foreclose on the property in the event of a default. RCW 61.24.030(7) (beneficiary must be owner of note secured by deed of trust); RCW 61.24.005 (defining "beneficiary" as the "holder of the instrument or

document evidencing the obligations secured by the deed of trust, excluding persons holding the same as security for a different obligation").

U.S. Bank contends that it is nevertheless entitled to foreclose on the Deed of Trust because the security for a debt always "follows" the debt. But MERS, U.S. Bank's predecessor, never owned the Note (Ex. 151), and it did not transfer the beneficial interest in the Deed of Trust to U.S. Bank until 2009 (Ex. 154; FF 12, CP 2153). While the transfer of a promissory note may carry with it the security interest without any formal assignment, that is not true where the promissory note and deed of trust are intentionally split, as they were here. *Restatement (Third) of Property: Mortgages* § 5.4(a) (1997) ("A transfer of an obligation secured by a mortgage also transfers the mortgage *unless the parties to the transfer agree otherwise*.") (emphasis added).

The beneficiary of a deed of trust cannot enforce its security interest by foreclosure if it has no right to enforce the underlying obligation. *See* ***Walcker v. Benson and McLaughlin, P.S.***, 79 Wn. App. 739, 904 P.2d 1176 (1995) (beneficiary could not foreclose on deed of trust where statute of limitations on enforcement of note has run), *rev. denied* 129 Wn.2d 1008 (1996). Similarly, where ownership of a note and

deed of trust are intentionally separated, as they were here by City First, the note becomes unsecured and the deed of trust unenforceable:

> This section deals with transfers of mortgages and their associated obligations by an original mortgagee to a successor, or from one successor to another. Such transfers occur in what is commonly termed the secondary mortgage market, as distinct from the primary mortgage market in which mortgage loans are originated by lenders to borrowers.
>
> The essential premise of this section is that it is nearly always sensible to keep the mortgage and the right of enforcement of the obligation it secures in the hands of the same person. This is so because separating the obligation from the mortgage results in a practical loss of efficacy of the mortgage . . . . When the right of enforcement of the note and the mortgage are split, the note becomes, as a practical matter, unsecured.

Restatement (Third) of Property: Mortgages § 5.4, Comment a.

The Washington Supreme Court is currently considering whether MERS can enforce the rights of the beneficiary of a deed of trust if it never had any interest in the promissory note that the deed of trust secures. ***Bain v. Metropolitan Mortgage Group, Inc.***, Case No. C09-0149-JCC, Order Certifying Question to Wash. Sup. Ct., at 3-4 (filed 6/27/11) (certifying the question: "Is [MERS] a lawful "beneficiary" within the terms of Washington's Deed of Trust Act, Revised Code of Washington section 61.24.005(2), if it never held the promissory note secured by the deed of trust?") (Appendix A). Should this court consider this issue

before the Court answers the certified question in ***Bain***, it should follow those courts in Washington, as well as elsewhere, that have held that MERS may not foreclose by itself, or through an assignee, if it is not also the holder of the note.[5]

In ***Bellistri v. Ocwen Loan Servicing, LLC***, 284 S.W.3d 619 (Mo. Ct. App. 2009), for example, the court ruled that MERS' assignment of a deed of trust and note were ineffective. There, as here, the lender named MERS as beneficiary of the deed of trust while retaining possession of the note. The borrower did not pay the taxes and the property was sold in a tax sale at which the purchaser received a "collector's deed." After that deed was issued, MERS "as nominee" for the lender assigned the deed of trust to Ocwen, which then asserted MERS's right to foreclose because its interest in the property pre-dated that of holder of the collector's deed. 284 S.W.3d at 621. The assignment recited that MERS was assigning both the note and deed of trust, as did the assignment to U.S. Bank here.

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[5] *See, e.g.*, ***In re Jacobson***, 402 B.R. 359 (Bankr. W.D. Wash. 2009) (in Washington, having assignment of deed of trust is insufficient to foreclose and evidence is required of identity of holder of note); ***In re Mitchell***, 2009 WL 1044368, *aff'd on other grounds,* 423 B.R. 914 (Bankr. D.Nev. 2009) (MERS is not beneficiary as it has no rights to payments, servicing rights or properties; having assignment of deed of trust is insufficient to foreclose; when note is split from deed of trust, holder lacks power to foreclose and purported recipient of deed of trust has worthless piece of paper); ***In re Vargas***, 396 B.R. 511 (Bankr. C.D. Cal. 2008) (MERS has no standing where it failed to show it is holder of note or had authority to act on behalf of holder); ***Bank of New York v. Silverberg***, 86 A.D.3d 274, 926 N.Y.S.2d 532 (2011) (same).

(Ex. 154) The ***Bellistri*** court nevertheless held that Ocwen as assignee lacked a legally cognizable interest in the property: "MERS never held the promissory note, thus its assignment of the Deed of Trust to Ocwen separate from the note had no force."[6] 284 S.W.3d at 623-624.

Here, as in ***Bellistri***, MERS purported to "assign" both the Note and Deed of Trust to U.S. Bank. But a mere nominee of the purported owner of a note and deed of trust "may not effectively assign the note and mortgage to another for want of an ownership interest in said note and mortgage by the nominee." ***Landmark Nat'l Bank v. Kesler***, 216 P.3d 158, 166 (Kan. 2009) (quotation omitted); *see also* ***In re Vargas***, 396. B.R. at 517 ("[I]f FHM has transferred the note, MERS is no longer an authorized agent of the holder unless it has a separate agency contract with the new undisclosed principal."); ***Saxon Mortg. Services, Inc. v. Hillery***, 2008 WL 5170180, at *5 (N.D.Cal. 2008) ("[F]or there to be a valid assignment, there must be more than just assignment of the deed alone; the

[6] U.S. Bank cites a related decision, ***Mortgage Electronic Registration Systems, Inc. v. Bellistri***, 2010 WL 2720802 (E.D. Mo. 2010), but it does not change this result. The issue before the court in that case was whether MERS, who was named in the Deed of Trust, should have been notified of the right to redemption before the issuance of the collector's deed. The court said yes because the law required notice to any party who may appear to have an interest or lien on the land. 2010 WL 2720802 at *10-12. Whether MERS could actually state a claim or assert a lien was not at issue in the case.

note must also be assigned . . . MERS purportedly assigned both the deed of trust and the promissory note . . . there is no evidence of record that establishes that MERS either held the promissory note or was given the authority . . . to assign the note.").

Carpenter v. Longan, 83 U.S. 271, 21 L. Ed. 313, 16 Wall 271 (1872) (cited by U.S. Bank at 32), also supports this rule. The Court in ***Carpenter*** held that "[t]he note and mortgage are inseparable; the former as essential, the latter as an incident. An assignment of the note carries the mortgage with it, while an assignment of the latter alone is a nullity." 83 U.S. at 274. But the Court also noted that "[t]he case is a different one from what it would be if the mortgage stood alone, or the note was non-negotiable, or had been assigned after maturity." 83 U.S. at 273. It thus recognized, as does the *Restatement*, that circumstances may exist where ownership of a mortgage is affirmatively separated from a note.

Moreover, in ***Carpenter***, the note and mortgage were transferred by the lender to the same assignee. 83 U.S. at 272-73 ("It is proved and not controverted that the note and mortgage were assigned to the appellant for a valuable consideration before the maturity of the note. . . . The question presented for our determination is, whether an assignee, under the circumstances of this case, takes the mortgage as he takes the note, free

from the objections to which it was liable in the hands of the mortgagee."). The ***Carpenter*** Court did not consider the situation here, where the lender intentionally transfers possession of a note to one entity and the deed of trust to another, or where a "nominee" of the purported beneficiary is assigned the beneficial interest in the deed of trust.[7]

This Court should hold that U.S. Bank may not enforce a Deed of Trust where City First deliberately split ownership of the Note from ownership of the security for the Note. At a minimum, it should defer ruling on this issue until the Washington Supreme Court answers the certified question in ***Bain.***

2. U.S. Bank Did Not Become The Beneficiary Of The Deed Of Trust Until July 2009.

For U.S. Bank to claim any right to enforce the Deed of Trust, it first had to obtain the beneficial interest in the Deed of Trust. U.S. Bank obtained its interest with notice of the Collings' claims to the property.

The Collings notified MERS of their claim to the property and the illegality of the Deed of Trust in November 2008. (FF 9, CP 2153

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[7] U.S. Bank cites several federal district court cases where courts have approved MERS as nominee for the actual beneficiary. (U.S. Bank Br. at 30, 35) (citing ***Daddabbo v. Countrywide Home Loans, Inc.***, 2010 WL 2102485 (W.D. Wash. 2010); ***Vawter v. Quality Loan Service Corp. of Washington***, 707 F.Supp.2d 1115 (W.D. Wash. 2010). But these federal cases purport to predict how the Washington Supreme Court will decide this controlling issue of state law. They do not bind this court.

(unchallenged); Ex. 15) MERS was required by its own rules to forward the Collings' notice to the "appropriate Member or Members." (FF 10, CP 2153 (unchallenged); 9/16 RP 48-49) U.S. Bank obtained its interest by assignment from MERS in July 2009 (Ex. 23; 8/16 RP 100), after MERS assigned to itself for itself the entire beneficial interest of the Deed of Trust. (Ex. 17)[8] The trial court's finding that U.S. Bank did not acquire the beneficial interest in the Deed of Trust until after it had notice of the Collings' claims is supported by substantial evidence.

C. U.S. Bank "Owned" The Loveless Loan Subject To The Collings' Defenses That The Loveless Loan Was Void.

The trial court followed established Washington law that in order to obtain a judicial declaration *in equity* that its interest was superior to all other interests in the Property, U.S. Bank had to establish that it owned both the obligation and the Deed of Trust securing it. RCW 61.24.030(7)(a) (requiring trustee to have proof that "beneficiary is the owner of any promissory note or other obligation secured by the deed of trust," prior to serving, recording or transmitting notice of trustee's sale); RCW 61.24.005(2) (defining "beneficiary" under a deed of trust as, "the

[8] U.S. Bank challenges Finding of Fact No. 8 that MERS as the nominal beneficiary of the Deed of Trust transferred all beneficial interest in the Deed of Trust to itself. It argues that the Notice of Trustee's Sale, Exhibit 17, which affirmatively states that MERS has been assigned and holds all beneficial interest in the Deed of Trust, as of February 6, 2009, was "erroneous." (U.S. Bank Br. at 29) But Exhibit 17 itself supports this finding.

holder of the instrument or document evidencing the obligations secured by the deed of trust . . ."). Even if the "security followed the debt," as U.S. Bank argues, the trial court found that U.S. Bank could not establish as a matter of fact that it "owned" the Loveless debt under the law of negotiable instruments. (FF 8, 16, CP 2152, 2154) The trial court's factual determination that U.S. Bank failed to prove its right to enforce the Note that the Deed of Trust purported to secure is an independent basis for affirming the trial court's judgment.

The trial court's factual findings that U.S. Bank could not prove its rights under the Note are supported by substantial evidence. The trial court found, as a matter of fact, that U.S. Bank failed to establish that it was a holder or that it had the right to enforce the Note by virtue of its possession of the Note indorsed in blank on an "allonge." (FF 8, CP 2152) It also rejected U.S. Bank's contention that U.S. Bank "owned" the Loveless loan by virtue of the mortgage securitization documents, finding as a matter of fact that U.S. Bank failed to prove its chain of ownership. (FF 16, CP 2154) Because it was not a holder in due course, U.S. Bank acquired possession of the Note subject to all defenses of any party, including the defense that the Note was void for City First's fraud and

violations of consumer protection laws against fraudulent home lending practices.

1. U.S. Bank Had No Right To Enforce The Note Under Washington's Law Of Negotiable Instruments.

While Article Three does not apply to determine the validity of a security interest in real property, the trial court correctly looked to Washington law of negotiable instruments to conclude that U.S. Bank could not enforce the Note because it was not a "holder of the instrument" as required by RCW 61.24.005(2). The trial court found that U.S. Bank was not a "holder" and that it did not prove "possession" of the Note. (FF 16, CL 22-23, CP 2154-55)

RCW 62A.3-301 defines the "person entitled to enforce" a promissory note as a "(i) holder of the instrument; (ii) a nonholder in possession who has the rights of a holder; and (iii) a person not in possession of the instrument who is entitled to enforce the instrument" because the note once was in his or her possession, but has been lost, stolen, or accidentally paid as allowed by RCW 62A.3-309 or RCW 62A.3-418(d).[9] "Holders" are those "persons in possession if the instrument is payable to bearer or, in the case of an instrument payable to an identified person, if the identified person is in possession." RCW

[9] U.S. Bank did not assert that the Note was lost, stolen or accidentally paid under RCW 62A.3-301(iii).

62A.1-201(20). A "bearer" is the person in possession of an instrument payable to bearer or indorsed in blank. RCW 62A.1-201(5).

A "holder in due course" is defined as a "holder" who takes an instrument if "[t]he instrument when issued or negotiated does not bear such apparent evidence of forgery or alteration or is not otherwise so irregular or incomplete as to call into question its authenticity; and (2) the holder took the instrument (i) for value, (ii) in good faith, . . . (iv) without notice . . . that the instrument contains an unauthorized signature or has been altered, (v) without notice of any claim to the instrument described in RCW 62A.3-306, and (vi) without notice that any party has a defense or claim in recoupment described in RCW 62A.3-305(a)." RCW 62A.3-302(a)(1),(2). "There need not be any 'connection between the defense or claim which the party on the instrument is attempting to assert and the flaw which . . . deprives one of holder in due course status.'" ***Wesche v. Martin***, 64 Wn. App. 1, 12, 822 P.2d 812, 819 (1992), *quoting* J. White & R. Summers, *1 Uniform Commercial Code* § 14-6 at 717 (3d ed. 1988); *accord* ***Central Washington Bank v. Mendelson-Zeller, Inc.***, 113 Wn.2d 346, 358, 779 P.2d 697 (1989).

Apart from its arguments regarding standing, U.S. Bank does not challenge the trial court's factual determinations that it failed to establish

that it was a holder in possession of a note indorsed in blank because the allonge was not attached to the Note. Instead, it argues these findings are irrelevant because it became a holder by virtue of its mortgage securitization documents. The trial court rejected this argument, finding as a matter of fact that U.S. Bank did not acquire the Loveless loan for value, and that the securitization agreements did not establish its ownership of the Loveless loan. Finally, the trial court found that U.S. Bank was not a holder in due course because it did not take the Loveless loan in good faith, but with knowledge of its deficiencies and the Collings' claims. These findings, any one of which support the trial court's judgment, are all based on substantial evidence.

2. U.S. Bank Failed To Establish That It Was A Holder Because The Note It Sought To Enforce Was Not Indorsed In Blank.

U.S. Bank failed to establish that it owned the Loveless loan "by virtue of its possession of the Note indorsed in blank on an 'allonge,'" (FF 7, CP 2152) because it failed to show that the allonge containing the indorsement in blank was physically attached to the Note. U.S. Bank cites the jury's finding that it obtained a promissory note in February 2007, but the jury also found that U.S. Bank failed to prove the date upon which the Note was indorsed in blank. (CP 894) The trial court adopted this

finding. (FF 8, CP 2152) Without the indorsement in blank on the allonge, U.S. Bank cannot be a "holder" because the Note also had a special indorsement from City First to GreenPoint Mortgage Funding, Inc. (Ex. 82; 9/16 RP 88-94)

An "indorsement" is a "signature, other than that of a signer as maker, drawer, or acceptor, that alone or accompanied by other words is made on the instrument for the purpose of (i) negotiating the instrument . . . ." RCW 62A.3-204(a). "For the purpose of determining whether a signature is made on an instrument, a paper affixed to the instrument [an 'allonge'] is part of the instrument." RCW 62A.3-204(a) (emphasis added). "Affixed," while not defined by statute, requires that the indorsement must be so "firmly attached thereto as to become a part thereof." ***In re Weisband***, 427 B.R. 13, 19 (Bankr. D.Ariz. 2010).

A "special indorsement" identifies a specific person to whom a holder makes the instrument payable. RCW 62A.3-205(a). When specially indorsed, an instrument may be negotiated only by the indorsee. RCW 62A.3-205(a). Only an instrument with a blank indorsement may be negotiated by anyone in physical possession of the instrument. RCW 62A.3-205(b).

A party's failure to establish that an allonge is physically attached to the note defeats that party's "status as legal owner" and holder of the note. ***Booker v. Sarasota, Inc.***, 707 So.2d 886, 889 (Fla. App. 1998). In ***Weisband***, for instance, the bankruptcy court rejected GMAC's attempt to establish its ownership of a note and deed of trust where GMAC offered different versions of a promissory note, some without an indorsement affixed to the note: "[T]here was no evidence that it was stapled or otherwise attached to the rest of the Note. Furthermore, when GMAC filed its proof of claim, the Endorsement was not included, which is a further indication that the allonge containing the Endorsement was not affixed to the Note." ***Weisband***, 427 B.R at 15, 19. *Accord*, ***U.S. Bank Nat'l Ass'n v. Kimball***, 2011 Vt. 81, __ A.3d __, 2011 WL 2937311 (2011); ***Bryen v. Krassner***, 208 N.J.Super. 639, 506 A.D.2d 803, *cert. denied*, 523 A.2d 210 (1986). Similarly here, the trial court found that U.S. Bank did not have possession of the Note indorsed in blank because it failed to prove that the allonge containing such an indorsement was authentic, that it was affixed to the Note, or the date upon which it was made. (FF 8, 16; CP 2152, 2154) Those findings are supported by substantial evidence.

The version of the Note relied upon by U.S. Bank at trial (Ex. 151) is not the same version of the Note U.S. Bank authenticated under oath in support of its motion to intervene. (Ex. 72; CP 148-154, 176) It is not the version of the Note relied upon by U.S. Bank in its affidavit in support of summary judgment (Ex. 82), nor was it authenticated by its representative Duclos in his deposition. (9/16 RP 91-94) U.S. Bank never authenticated GreenPoint Mortgage Funding Inc.'s ostensible indorsement in blank by an unidentified and unknown individual named "Mitchell," and there was no competent evidence of *when* this indorsement in blank became affixed to the Note: for example, *after* the Collings filed suit. In 2009, U.S. Bank submitted a copy of the Note under oath to the court, but without the indorsement in blank and without an allonge attached to the Note. Instead, U.S. Bank submitted the Note and allonge as two separate exhibits. (Ex. 72) Later in 2009, U.S. Bank again filed a copy of the Note under oath with the court with allonge, but the allonge did not include the "indorsement in blank" and other purported addendums to the Note were missing. (CP 2191-96)

The Collings expressly denied the authenticity of the indorsement in blank (CP 204-06, 199-201, 1993-95), placing on U.S. Bank the burden of establishing the authenticity of the Mitchell signature; that it was placed

on the allonge with authority; and the timing of that placement. *See* RCW 62A.3-308(a) ("In an action with respect to an instrument, the authenticity of, and authority to make, *each signature on the instrument* is admitted unless specifically denied in the pleadings. If the validity of the signature is denied in the pleadings, the burden of establishing *the validity is on the person claiming validity* . . .") (emphasis added). Substantial evidence supports the trial court's finding that "U.S. Bank failed to establish the date on which the alleged endorsement in blank was placed on the allonge or that the endorsement of blank was placed on the allonge with the authority and knowledge of Greepoint Mortgage Funding Inc., to whom the Note was specially endorsed." (FF 8, CP 2152)

U.S. Bank could not establish that it was either in possession of an instrument made payable to bearer or indorsed in blank. RCW 62A.1-201(5), (20). Without such an indorsement, the trial court properly found that U.S. Bank is not a "holder," let alone a "holder in due course."

3. U.S. Bank Is Not A Holder By Virtue Of The Mortgage Securitization Agreements.

Faced with substantial evidence that supports the trial court's findings that U.S. Bank cannot be a "holder" of the Loveless loan because the allonge and indorsement upon which it relies was not physically attached to the Note, U.S. Bank argues that it established its right to

enforce the Loveless loan because it obtained both the Note and Deed of Trust by virtue of the mortgage securitization agreements in favor of the GreenPoint Mortgage Funding Trust, for which U.S. Bank serves as Trustee. (U.S. Bank Br. at 23-25) The trial court rejected U.S. Bank's argument that the mortgage securitization agreements conclusively establish its ownership of the loan as of February 2007, finding that the securitization agreements failed to establish the "chain of ownership of the Loveless loan (the Note) and the MERS deed of trust." (FF 16, CP 2154) This finding also is supported by substantial evidence.

U.S. Bank asserts that because "GreenPoint signed certain securitization documents," it established that that U.S. Bank obtained the Loveless loan as "Trustee for the GreenPoint Mortgage Funding Trust." (U.S. Bank Br. at 23, *citing* Exs. 157-59) But those documents raise more questions than they answer regarding chain of ownership of the Loveless loan.

First, under the Trust Agreement (Ex. 156), the Structured Asset Securities Corporation ("SASC") as Depositor "acquired the mortgage loans from Lehman Brothers Holdings, Inc.," under a "Mortgage Loan Sale Agreement" and agreed to transfer them into the trust. (Ex. 156 at 815, 894) Under the Mortgage Loan Sale Agreement (Ex. 155) between

Lehman Brothers Holdings Inc. and SASC (dated the same day as the Trust Agreement), the Seller (Lehman) transferred its interest in the loans to SASC but "exclusive of any Retained Interest on such Mortgage loans" as identified on Schedule A-1 and Schedule A-2." (Ex. 155 at 0237) Schedules A-1 and A-2 are not part of the exhibit, and U.S. Bank offered no evidence or testimony that SASC or Lehman ever "owned" the Loveless loan. There was no evidence establishing how Lehman acquired its rights, if any, from GreenPoint Mortgage Funding, Inc., as the Lehman purchase agreements are also not of record. (*See* Ex. 158, at 534, 555, 557) (reciting existence of "Flow Mortgage Loan Purchase and Warranties Agreement," but intentionally omitting it as an exhibit).

Second, the Trust Agreement recites that the Depositor (SASC) was obliged to deliver to the Custodian (U.S. Bank) the "original" "security agreement or pledge agreement executed in connection with the Mortgage Note, assigned to the Trustee," along with "the original recorded mortgage with evidence of recording indicated thereon." (Ex. 156 at 894) But MERS remained in possession of the Deed of Trust until 2009, and did not prepare a notarized assignment of it to U.S. Bank until after this suit was filed. (Ex. 154) The trial court was justified in finding that U.S.

Bank and its predecessors failed to prove the chain of title through the mortgage securitization agreements.

Citing Duclos' testimony about what U.S. Bank "would" do before certifying the validity of the underlying loans (9/16 RP 73), U.S. Bank argues that because an "Exception Report" (Ex. 163), does not mention the Loveless loan, the indorsement in blank must have been initially affixed to the Note. But *none* of the loans listed on the Exception Report are included on the Mortgage Loan Schedule, and there was no evidence that the Schedule was actually part of the Trust Agreement that was executed. (Ex. 157) The trial court was free to reject Duclos' testimony, particularly after he admitted his lack of personal involvement in the loan certification process on cross examination. (9/16 RP 118) The trial court properly held that U.S. Bank "has further failed to prove the chain of ownership of the Loveless loan and the MERS deed of trust." (FF 16, CP 2154)

4. U.S. Bank Is Not A Holder In Due Course Because The Loveless Loan Was Not Transferred For Value.

The trial court also found that U.S. Bank could not be a holder in due course and was subject to the Collings' defense that the loan was void for fraud because if it obtained the Loveless loan, it did not take it "for any value." (FF 16, CP 2154) It was undisputed that U.S. Bank did not pay

cash for the Note or Deed of Trust. (9/16 RP 108-111) Instead, U.S. Bank argues that it issued "certificates" for loan "tranches," which certificates were then sold to investors who in turn shared the money paid by mortgagors on that tranche of loans. (U.S. Bank Br. at 9, *citing* 9/16 RP 65-66) The trial court, however, was free to discredit U.S. Bank's witness's testimony given his lack of personal involvement not only with the Loveless loan, but with the sale of these trust certifications. (9/16 RP 67) Just as U.S. Bank's securitization evidence failed to establish chain of title, the documents did not establish that U.S. Bank paid any value for the Note.

The bankruptcy court in ***Weisband*** similarly rejected the contention that mortgage securitization agreements could substitute for evidence that the party seeking to enforce a loan against a borrower received transfer of the underlying loan documents, including the note, for value: "GMAC's documents regarding the securitization of the Note and DOT provide no evidence of actual transfers of the Note and DOT to either the FISA or the Trust. Because such transfers must be 'true sales,' they must be properly documented to be effective. Thus, to use an overused term, GMAC has failed 'to connect the dots' to demonstrate that the Note and DOT were securitized." ***Weisband***, 427 B.R. at 21.

Substantial evidence supports the trial court finding that U.S. Bank also failed to "connect the dots" here, and that its securitization documents did not give it any rights to the Loveless loan.

5. U.S. Bank Took Possession Of The Note With Knowledge Of The Collings' Claims.

Finally, U.S. Bank cannot be a holder in due course unless it became a "holder" of the Note in good faith and without notice of any claims. RCW 62A.3-302.[10] The trial court correctly held that U.S. Bank acquired the Note with (a) knowledge of the Collings' claims, (b) unreasonably failed to take any steps to verify whether the Note was indorsed, and (c) with knowledge that the Loveless loan violated the terms of the Collings' lease. (FF 11-14, CP 2153-54) Any of these findings support the trial court's judgment that U.S. Bank was not a holder in due course.

The trial court found that U.S. Bank received its assignment of both the Note and Deed of Trust in July 2009, well after U.S. Bank had notice of the Collings' suit. (FF 8, 12, CP 2152-53) Because U.S. Bank failed to establish that the allonge was placed on the Note before the Collings provided notice of their claims, the court's finding that U.S. Bank

[10] Only a holder in due course is immune from a defense that that could be asserted in an action on a simple contract. RCW 62A.3-305(2)(b), Comment 2.

knew of the Collings' claims when it acquired possession of the Note are supported by substantial evidence.

The trial court also found that U.S. Bank did not take the Note in good faith because it unreasonably relied on warranties in the securitization documents and therefore knew or should have known about the deficiencies in the Note, particularly the lack of indorsement. (FF 15, CP 2154) Even if the loan was included in the Trust "pool," U.S. Bank knew that it was not reasonably possible for either Lehman Brothers, which purported to sell the Loveless loan to the SASC, or for SASC, which purported to deposit the Note into the Trust, to competently review the Note, as both agreements are dated February 1, 2007. (Exs. 155, 156; 9/16 RP 60, 67, 77-78, 87)

Under the UCC, good faith means "honesty in fact and the observance of reasonable commercial standards of fair dealing." RCW 62A.1-201(43). The trial court's finding that U.S. Bank failed to make *any* inquiry into the validity of the Loveless loan supports its conclusion that U.S. Bank was not a holder in due course.

U.S. Bank devotes much of its argument to challenging the trial court's finding that U.S. Bank had notice that the Collings' lease prohibited the Loveless loan. Don and Beth Collings both testified that

they signed Exhibit 5, which prohibited further encumbrancing the Collings' home, and sent it to City First. (9/14 RP 32, 64; 9/15 RP 39) That lease would have been reviewed as part of the underwriting process for Loveless' loan for investment property. (9/15 RP 76, 193; 9/16 RP 10-11; CP 768-69) City First destroyed the December 2006 loan file. (9/15 RP 66-67) U.S. Bank then failed to produce the December 2006 loan file (Ex. 81 at 6) even though its witnesses at trial admitted the file was scanned to a computer file. (9/16 RP 36) The trial court was justified in finding that the City First loan file included the Collings' lease, and that had U.S. Bank reviewed the loan origination file during the securitization's 180 day certification process, it would have discovered the prohibition against encumbering the property. (FF 2-3, 13, CP 2151, 2153) U.S. Bank could not, therefore, be a holder in due course. (CL 22, CP 2155)

D. U.S. Bank Is Not A Bona Fide Purchaser For Value Of The Loan.

To qualify as a bona fide purchaser, U.S. Bank must have (1) acquired "legal title" to the Deed of Trust; (2) "must have paid value therefore"; and (3) have been innocent of knowledge of the equity against the property when acquiring title." ***Huber v. Coast Inv. Co., Inc.***, 30 Wn. App. 804, 810, 638 P.2d 609 (1981).

Actual knowledge of another person's claim to the property is not required. Constructive notice is sufficient. ***Miebach v. Colasurdo,*** 102 Wn.2d 170, 175-76, 685 P.2d 1074 (1984). Constructive notice is knowledge or information of facts sufficient to put an ordinarily prudent person upon inquiry, and the inquiry, if followed with reasonable diligence, would lead to the discovery of defects in the title or of equitable rights of others affecting the property in question. In other words, constructive notice is knowledge of facts sufficient to elicit inquiry.

Possession of real property by someone other than the legal owner is constructive notice of whatever rights a prudent and reasonable inquiry would reveal. ***Peoples Nat'l Bank of Washington v. Birney's Enterprises, Inc.***, 54 Wn. App. 668, 673, 775 P.2d 466 (1989) ("Birney's had the burden of proving that the Bank had notice. Plainly, however, that burden has been met . . . Birney's, a legal entity separate from the property owner, was quite visibly in possession of the property when the Bank acquired its interest."). Here, the Lease was not the only constructive notice of the Collings' claims, the Collings' residence and use of the Property alone is a form of constructive notice:

> The classic case has been a leasehold tenant or contract purchaser who is in possession. Obviously, if the reason for that person's possession is not explained, inquiry should be made. Even if a tenant has a recorded lease or our

> subsequent party sees a copy of his lease, a majority of American courts that have faced the question still hold inquiry must be made, to discover other possible claims, such as purchase option or possession as owner under an unrecorded deed, the tenant may have beyond those contained in the lease. A grantee who fails to inquire of the apparent tenant in possession would be charged with notice of those other interests.

Stoebuck, 18 *Wash. Practice* § 14.10 at 151-52 (2d ed. 2004).

U.S. Bank could not avoid constructive notice by refusing to pursue inquiry. ***Peoples Nat'l Bank***, 54 Wn. App. at 673. The Collings' constructive trust, which predates any lien U.S. Bank could have had, is superior to the Deed of Trust that U.S. Bank seeks to enforce.

V. ATTORNEYS FEES

The Deed of Trust on which U.S. Bank bases its claim and its appeal contains an attorney fee clause. (Ex. 12, ¶ 26) Pursuant to RAP 18.1, U.S. Bank should pay the Collings' attorneys fees and costs on appeal.

VI. CONCLUSION

U.S. Bank was neither a holder of the Collings' loan nor a bona fide purchaser for value. U.S. Bank has challenged neither the legitimacy of the Collings' title, nor the trial court's judgment on the jury's verdict establishing that the Loveless loan that it sought to equitably enforce in this action was the result of an illegal equity skim. "Where a contract

grows immediately out of and is connected with a prior illegal contract, the illegality of such prior contract will enter into the new contract and render it illegal." ***Tompkins v. Seattle Construction & Dry Dock Co.***, 96 Wash. 511, 513, 65 P. 384 (1917) (U.S. Bank Br. at 38) (quotation omitted). The trial court determined that the Collings have not been unjustly enriched, have not experienced a windfall "and that the balances of the equities do not support imposition of an equitable lien in favor of U.S. Bank." (CL 27, CP 2156) U.S. Bank has not challenged that conclusion. The trial court did not abuse its equitable discretion in refusing to enforce the Loveless loan because it was the product of an illegal equity skim. The trial court's judgment quieting title to the Collings is supported by substantial evidence. This court should affirm and award the Collings fees on appeal.

Dated this 3rd day of October, 2011.

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DECLARATION OF SERVICE

The undersigned declares under penalty of perjury, under the laws of the State of Washington, that the following is true and correct:

That on October 3, 2011, I arranged for service of the foregoing Brief of Respondents Collings in Response to Brief of U.S. Bank National Association as Trustee for the Greenpoint Mortgage Funding Trust Mortgage Pass-Through Certificates, Series 2007-Ar1, to the court and to the parties to this action as follows:

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DATED at Seattle, Washington this 3rd day of October, 2011.

Amanda C. King

THE HONORABLE JOHN C. COUGHENOUR

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

KRISTIN BAIN, Plaintiff, v. METROPOLITAN MORTGAGE GROUP INC. et al., Defendants.	CASE NO. C09-0149-JCC ORDER CERTIFYING QUESTION TO THE WASHINGTON SUPREME COURT

KEVIN SELKOWITZ, Plaintiff, v. LITTON LOAN SERVICING LP et al., Defendants.	CASE NO. 10-5523-JCC

I. BACKGROUND

This Court previously ordered the parties in *Bain v. Metropolitan Mortgage Group Inc.*, No. C09-0149-JCC (W.D. Wash. removed Feb. 3, 2009), to show cause why this Court should

not decline to exercise supplemental jurisdiction over Plaintiff's state-law claims. In its order, the Court asked the parties to identify whether Washington law addresses Mortgage Electronic Registration Systems' (MERS)—and similar organizations'—ability to serve as the beneficiary and nominee of the lender under Washington's Deed of Trust Act when it does not hold the promissory note secured by the deed of trust. (Dkt. No. 130.) The Court also ordered the parties to identify whether Washington law addresses the legal effect in a nonjudicial foreclosure of an unauthorized beneficiary's appointment of a successor trustee. (*Id.*) The parties' responses demonstrated that Washington law does not specifically address these issues.

This Court later learned that a Washington Superior Court certified to the Washington Supreme Court similar (if not identical) questions involving MERS's role in the foreclosure process, namely, whether MERS was a lawful beneficiary under Washington's Deed of Trust Act and, if not, the resulting legal effect of the unlawful beneficiary. This Court stayed its cases involving MERS pending resolution by the Washington Supreme Court. *Bain v. Metropolitan Mortgage Group Inc.*, No. C09-0149-JCC (W.D. Wash. removed Feb. 3, 2009) (Dkt. No. 155); *Selkowitz v. Litton Loan Servicing LP*, No. C10-5523-JCC (W.D. Wash. removed July 27, 2010) (Dkt. No. 39).

On April 25, 2011, the Commissioner of the Washington Supreme Court, Steven Goff, entered a ruling denying discretionary review of the Superior Court's certified question. Under Washington Rule of Appellate Procedure 2.3(a), "a party may seek discretionary review of any act of the superior court not appealable as a matter of right." The Commissioner concluded that because the Superior Court had not yet ruled on the merits of the MERS issue, there was no "act" of the Superior Court on which to seek discretionary review.

Although the Superior Court's certification was not the proper vehicle for review by the Washington Supreme Court, the Commissioner described both the importance of the legal questions posed by the Superior Court as well as the probability that the Washington Supreme Court would eventually address the issue:

> I agree with Mr. Vinluan that whether MERS can be a deed of trust beneficiary under Washington law is an important issue that deserves resolution, probably by this court. It appears that there is considerable ongoing foreclosure litigation on the point in both state and federal courts, with no authority from this court [or] the Court of Appeals to guide those decisions.

Vinluan v. Fidelity Nat'l Title & Escrow Co., No. 85637-1, at *4 (Wash. Apr. 25, 2011) (ruling denying review).[1]

II. CERTIFICATION

Pursuant to Washington Revised Code section 2.60.020,

> When in the opinion of any federal court before whom a proceeding is pending, it is necessary to ascertain the local law of this state in order to dispose of such proceeding and the local law has not been clearly determined, such federal court may certify to the supreme court for answer the question of local law involved and the supreme court shall render its opinion in answer thereto.

The certification process serves the important judicial interests of efficiency and comity. As noted by the United States Supreme Court, certification saves "time, energy, and resources and helps build a cooperative judicial federalism." *Lehman Bros. v. Schein,* 416 U.S. 386, 391 (1974). Because this matter involves important and far-reaching issues of first impression regarding MERS's ability to serve as the beneficiary and nominee of the lender under Washington's Deed of Trust Act, this matter should be presented for expedited review to the Washington Supreme Court. The following questions are hereby certified to the Washington Supreme Court:

1. Is Mortgage Electronic Registration Systems, Inc., a lawful "beneficiary" within the terms of Washington's Deed of Trust Act, Revised Code of Washington section 61.24.005(2), if it never held the promissory note secured by the deed of trust?

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[1] The Commissioner also noted that this Court had stayed its cases pending the Washington Supreme Court's decision whether to accept certification from the Superior Court.

2. If so, what is the legal effect of Mortgage Electronic Registration Systems, Inc., acting as an unlawful beneficiary under the terms of Washington's Deed of Trust Act?

3. Does a homeowner possess a cause of action under Washington's Consumer Protection Act against Mortgage Electronic Registration Systems, Inc., if MERS acts as an unlawful beneficiary under the terms of Washington's Deed of Trust Act?

This Court does not intend its framing of the questions to restrict the Washington Supreme Court's consideration of any issues that it determines are relevant. If the Washington Supreme Court decides to consider the certified questions, it may in its discretion reformulate the questions. *See Affiliated FM Ins. Co. v. LTK Consulting Servs. Inc.*, 556 F.3d 920, 922 (9th Cir. 2009). Further, this Court leaves to the sound discretion of the Washington Supreme Court the choice of which of the two (or both) of the above-captioned cases it believes serves as the preferable vehicle through which to resolve the questions posed.

The Clerk of Court is directed to submit to the Washington Supreme Court certified copies of this Order; a copy of the docket in the above-captioned matters; Docket Numbers 1, 10, 21, 22, 24, 30, 31, 39, 41, 42, 44, 48, 57, 62, 65–69, 77, 79, 80, 82, 86–88, 90, 91, 94, 96, 98, 99, 102, 104, 107–109, 111, 112, 116–118, 120, 122, 123, 128, 130, 131, 132, 138–146, 148, 149, 153, 155, and 156 in Case No. 09-0149-JCC; and Docket Numbers 7–9, 12–17, 20–31, 33, and 38 in Case No. C10-5523-JCC. The record so compiled contains all matters in the pending causes deemed material for consideration of the local-law questions certified for answer.

This Court STAYS these actions until the Washington Supreme Court answers the certified questions.

DATED this 24th day of June 2011.

John C. Coughenour
UNITED STATES DISTRICT JUDGE