Make Sure You Bring a Note

The Delaware Supreme Court Creates New Requirements for Foreclosing Mortgage Lenders

by
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The Delaware Supreme Court surprised the mortgage lending community in April with its opinion in *J.M. Shrewsbury v. Bank of New York Mellon*.[1] In Shrewsbury, the Court held that to foreclose on a mortgage the holder of the mortgage must also be the party entitled to enforce the underlying obligation secured by that mortgage. Stated differently, for a mortgage holder to have standing to bring a *scire facias sur* mortgage proceeding in Superior Court, that mortgage holder must show that it has the right to enforce the corresponding promissory note or other secured obligation.

The holding in *Shrewsbury* has given rise to many questions related to the specific requirements for a mortgage lender to bring a statutory foreclosure in Delaware. Yet one takeaway is abundantly clear. Without further clarification, the holding in *Shrewsbury* will impose more transactional and litigation costs on mortgage lenders.

The Foreclosure Proceedings and the Shrewsburys' Challenge

In 2007, the Shrewsburys signed a promissory note in favor of Countrywide Home Loans, Inc. The loan was secured by a mortgage on the borrower's home. The mortgagee was a nominee of Countrywide. In 2010, the Shrewsburys stopped making payments on the mortgage loan.

In 2015, the Bank of New York Mellon, the assignee of the original mortgagee, filed a statutory *scire facias* mortgage foreclosure action against the Shrewsburys in the Superior Court in New Castle County.[2] In the foreclosure proceeding, the Shrewsburys asserted a statutory defense called a "plea in avoidance." Delaware courts have held that a plea in avoidance essentially "admits the allegations of the complaint but asserts [a] matter which destroys the effect of the allegations and defeats the Plaintiffs' rights."[3] Prior to the *Shrewsbury* decision, Delaware law seemed to be clear that enforceable pleas in avoidance were limited to the subject matter of the transaction—the mortgage itself. Here, the Shrewsburys alleged that BNY Mellon's complaint was defective because the bank was not the proper assignee of the promissory note secured by the mortgage being foreclosed; rather, the bank was only the assignee of the mortgage. The Superior Court disagreed with the Shrewsburys' defense and granted summary judgment to BNY Mellon.[4] On appeal, the Supreme Court reversed the decision of the Superior Court and remanded the case to the Superior Court for further proceedings.

Citing cases from a variety of different jurisdictions, the Supreme Court held that a mortgage can only be enforced by the person who is entitled to enforce the underlying obligation (generally, a promissory note secured by the mortgage).[5] In so holding, the Court found that Delaware laws supported such an interpretation, as, in the Court's view, there is a history of Delaware courts requiring proof of "mortgage money" (e.g., the promissory note) in addition to the mortgage in a foreclosure action. As such, the plea in avoidance defense was properly raised by the defendant. BNY Mellon could not foreclose on the mortgage without proof that it was the assignee of the original promissory note.

The Major Shrewsbury Question: How Do You Prove Assignment Under *Shrewsbury*?

The Court in *Shrewsbury* made very clear that the rights under a promissory note must be assigned along with the mortgage in order for the lender to have standing to enforce the mortgage in a statutory foreclosure proceeding. *Shrewsbury* is thus a cautionary tale. Mortgage lenders should ensure that foreclosure complaints properly state that the underlying obligation is also held to the mortgage holder, whether as original holder or by assignment. Yet the Court gave little guidance on how such an assignment should be shown in the complaint. Mortgage lenders are therefore left with questions. Are mortgage lenders now required to state the specifics of the assignment in the complaint? Are they required to attach a copy of the note and assignment to the complaint?

The Court did not seem to share these concerns. Rather, it stated that the holding was not intended to "impose new pleading requirements which must be contained in the mortgage complaint."[6] Instead, the Court proposed alternative language in the Superior Court statutory foreclosure form. The form now reads that a foreclosing lender should include the sentence: "Defendant owes plaintiff the principal amount of the mortgage with interest from _____." The Court suggested that the Superior Court change the form to state that "the defendant owes the principle [sic] amount of the *mortgage money* with interest.…"[7] In other words, the complaint should make reference to the underlying obligation and make clear that such an obligation is owed to the foreclosing lender. Unfortunately, such a change to the form requires action by the Supreme Court, which has not yet occurred. Nor is the simple additional statement dispositive of the issue because the term "mortgage money" has no settled meaning, notwithstanding the statements in the Court's opinion.

Chief Justice Leo Strine, in his dissenting opinion, disagreed with the majority's assertion that *Shrewsbury* does not pose additional pleading requirements. In Delaware, he argued, a party bringing an action must show in the action that the party has standing to sue. The Delaware statute governing the *scire facias* foreclosure process seems clear: the holder of the mortgage has standing to bring the action. This clarity and simplicity have been among the benefits of Delaware's *scire facias* process. According to the majority's opinion, however, a mortgage holder only has standing if it is the holder, whether originally or by assignment, of the underlying obligation. Thus, in order for a mortgage lender to pass the new standing test imposed by the *Shrewsbury* decision, the mortgage lender *must* plead that it is the original holder or the assignee of the note. A prudent mortgage lender would therefore want to ensure that its attorneys are expanding any foreclosure complaint beyond the simple suggestion by the majority opinion in Shrewsbury, which, in any event, is not yet part of the Superior Court's form.

The heightened pleading standards described above are not the only questions arising from the *Shrewsbury* case. There are a number of other problems with its analysis. For example, Chief Justice Strine emphasized in his dissent that the majority decision ignored the interrelationship between the enforcement rights of the mortgagee under the mortgage and the obligation of a foreclosing mortgagee to satisfy the underlying debt.[8]

Practical Issues Resulting from *Shrewsbury*

Delaware practitioners will continue to analyze the implications of the *Shrewsbury* opinion. In the immediate short term, however, banks should be working with their attorneys to ensure that they are preserving their rights to the best of their ability. Issues can arise in both the litigation and transactional context.

Shrewsbury **Litigation Issues**

As noted above, *Shrewsbury* is, at best, murky in providing guidance as to how to properly plead the assignment of the promissory note in a statutory foreclosure proceeding. The majority held that new pleading standards have not been imposed, but, as noted by Chief Justice Strine in his dissent, to establish

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standing, the foreclosing bank would need to plead that it holds both the mortgage and the note because failure to do so would be met with a motion for dismissal on the basis of *Shrewsbury* and the absence of proof of its interest in the note.

Perhaps these concerns, as the majority suggested, can be remediated by a simple sentence in a pleading. Yet relying on one sentence could be a risky gamble. The facts in *Shrewsbury* make clear why the proper pleading is critical to the mortgage lender in foreclosure and how it avoids unnecessary delay and expense. Recall that in *Shrewsbury*, the borrowers stopped making loan payments on the mortgage in 2010. The foreclosure action was not filed until 2015, the Superior Court did not give its ruling until 2016, and the Supreme Court reversed in 2017. The matter is still ongoing. As such (and as emphasized by Chief Justice Strine in the dissent),[9] the Shrewsburys went a full seven years living in their home without making a single mortgage payment and without being foreclosed upon. BNY Mellon's failure to prove that it was assigned the original promissory note delayed the proceedings for two years. Any mortgage holder that does not adequately plead that it is the holder of the note runs the same risk of delay.

Thus, until there are further clarifications as to what is required for pleading under *Shrewsbury*, it would be wise for attorneys to clearly and unequivocally establish in their complaints that the foreclosing party has a right to the underlying obligation. It would be advisable to attach the note and any assignments as exhibits and to track any assignments clearly and specifically in the pleadings.

Such a requirement could add expense to the litigation process. Mortgage lenders and their attorneys will need to spend more time crafting complaints and ensuring they contain all the necessary information. Without clear guidance from the Court in *Shrewsbury*, the tendency of foreclosing lenders will be towards over-inclusive complaints. Thus, preparation of a foreclosure complaint in Delaware will be a more involved and expensive process for mortgage lenders. Additionally, as noted above, any insufficiency in the complaint could be exceedingly costly and time consuming, as mortgage lenders will be forced to litigate their starting to bring the foreclosure.

Shrewsbury Transactional Issues

Lenders should consider *Shrewsbury* prior to foreclosure as well. Recall that the opinion found that the mortgage holder had no right to bring the foreclosure action if it was not the assignee of the promissory note. As such, a mortgage lender should ensure that any time it is acquiring a mortgage loan by assignment, all of the underlying obligations are clearly included in the assignment. Any inadvertent break in the chain of assignments could prevent the statutory foreclosure of the loan. This can easily be accomplished, but it does require attention. And as the world of commercial finance has moved to electronic records or MERS assignments for mortgages, assignments can be accomplished rapidly and with little preparation, often without the note actually being assigned.

Still, guided by *Shrewsbury*, some additional precautionary measures should be taken. Lenders should ensure that when mortgage assignments are effectuated, the note has been indorsed by an allonge to the subsequent owner of the mortgage (unless prior owners of the obligation indorsed it in blank). The last endorsement should be that of the mortgage seller. For example, the endorsement could say:

> PAY TO THE ORDER OF
> WITHOUT RECOURSE
>
> [LENDER'S NAME]
>
> (Authorized Signature)
>
> [NAME OF AUTHORIZED SIGNER]
> [TITLE OF AUTHORIZED SIGNER]

When used correctly, an endorsement to an allonge would be helpful in the context of *Shrewsbury*, as a properly executed allonge results in an enforceable and properly transferred note. Remember, an allonge must be permanently affixed to the note and clearly identify the note by referencing, at least, the name of the maker, the date of the note, the amount of the note, and the address of the security property.

As illustrated above, the uncertainty of *Shrewsbury* makes the stakes a little higher for routine assignments and could raise transaction costs. If both the mortgage *and* the promissory note are not assigned, a lender could have trouble years later in foreclosure proceedings. Banks with Delaware mortgage loans might consider using outside counsel for even simple assignments to ensure that there are no procedural hold-ups during a later foreclosure. But retaining outside counsel adds costs to these relatively routine processes, which are often borne by the borrower.[10] The more expensive assignments get, the more lenders risk alienating repeat customers that may be trying to save on transaction costs.

Conclusion

In *Shrewsbury*, the Delaware Supreme Court stated that a mortgage lender cannot foreclose on a mortgage in Superior Court unless the lender is also the holder of the underlying obligation. Until Delaware courts give more guidance on this holding, a mortgage lender should proceed cautiously. In both litigation and transactions, a mortgage lender should work with its attorneys to ensure that the mortgage lender is the holder of both the mortgage and the note. Otherwise, the uncertainty of the path forward from the *Shrewsbury* decision could cause difficulty, expense and delay.

Perhaps as courts re-examine the questions raised by *Shrewsbury*, they should heed Chief Justice Strine's words from the dissent. "We should be careful," the Chief Justice wrote, "about mandating as judges, not legislators, an increase in the costs to lenders of enforcing their rights, when that is not necessary to protect the legitimate rights of borrowers." Until there is greater clarity, this warning resonates.

The views expressed in this article are those of the authors and not necessarily those of Richards, Layton & Finger or its clients.

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Notes

1- 2017 WL 137476 (April 17, 2017)
2- As a reminder, Delaware allows both statutory foreclosures (by a writ of *scire facias*) in the Superior Court and equitable foreclosures in the Chancery Court.
3- *Shrewsbury*, 2017 WL 137476 at *3.
4- *Bank of New York Mellon v. J.M. Shrewsbury*, 2016 WL 639372 (February 17, 2016).
5- *J.M. Shrewsbury v. Bank of New York Mellon*, 2017 WL 137476, at * 3-4 (April 17, 2017).
6- *Id*. at *5.
7- *Id.*
8- *Shrewsbury*, 2017 WL 1374746 at *8 (C.J. Strine, Dissenting).
9- *Shrewsbury*, 2017 WL 1374746 at *6 (C.J. Strine, Dissenting).
10- In his dissent, Chief Justice Strine also addressed the costs that could be imposed on borrowers. He warned, “Costs that are above what is truly necessary to protect borrowers from inequitable conduct by lenders will be ultimately borne by all borrowers and especially the vast bulk of those who prudently borrow and make their loan payments.” *Shrewsbury*, 2017 WL 1374746 at *6 (C.J. Strine, Dissenting).