Who's On First; The Mortgage Servicer's Standing to Bring Suit

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In today's complex world of mortgage backed securities it is less than clear who has standing to foreclose a mortgage or assert a claim based on a mortgage or other agreement. Is the proper party the trustee of the securitization trust, the owner and holder of the mortgage and mortgage note? Or, is the proper party, the trustee's delegate, the mortgage servicer or special servicer, who administers the trust pursuant to a pooling and servicing agreement?

In CWCapital Asset Management v. Chicago Properties, 2010 U.S. App LEXIS 13229, the issue was whether the plaintiff as a mortgage servicer had standing to bring a lawsuit in its own name based on a "Subordination, Non-Disturbance and Attornment Agreement" (SNDA) to which the securitization trust, the landlord/mortgagor and the former tenant, the Blockbuster Video Rental Company ("Blockbuster") were parties. The case also presented issues of contract interpretation under Illinois law. The underlying suit claims that the servicer, CWCapital, standing in the lender's shoes is contractually entitled to the money that Blockbuster paid to the mortgagor, Chicago Properties, in settlement of a suit by Blockbuster for unpaid rent.

The district court concluded that the servicer was not the real party in interest, and therefore dismissed the suit. The district court found that the servicer did not present a writing setting forth its authority by assignment or otherwise to initiate its

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action against the defendants. The district court also rejected attempts by the trustee to ratify the servicer's suit on behalf of the bank. The Court of Appeals reversed the dismissal with directions to enter judgment on the merits for the defendants. The Court held that the servicer was entitled to bring suit in its own name as the real party in interest. However, the servicer was not entitled to recovery on the merits of its claim.

The Court reviewed the documents and explained the servicer's role in administering a mortgage-backed security in concluding that the servicer had standing. In particular, the Court looked at the applicable pooling and servicing agreement.

The Court described the servicer's role in administering a mortgage backed security. It described a mortgage backed security as a giant bond that is secured by a large number of mortgages, including the mortgage against the mortgagee's building. The income from the mortgages is the income from the bond. The mortgages that secure the mortgage-backed security are placed in a securitization trust, and the trustee, or in this case the trustee's delegate (the plaintiff servicer) is responsible for servicing them.

The Court further explained that the trust holds legal title to the mortgages. The servicer is the trust's collection agent. The Court likened the servicer to an assignee for collection, who must render to the assignor the money collected by the assignee's suit on his behalf (minus the assignee's fee) but can sue in its own name.

The Court's analogy of a servicer to an assignee for collection was based on its reliance on the recent Supreme Court's holding in the case of Sprint Communications Co. v. APCC Services, Inc., 554 U.S. 269, 128 S.Ct. 2531 where that court held that an assignee for collection has standing to sue, within the meaning of Article III of the

Constitution. In Sprint, the Court held that an assignee who holds legal title to an injured party's claim has constitutional standing to pursue the claim even if the assignee has agreed to remit all proceeds from the litigation to the assignor. Sprint, 554 U.S. 128, S.Ct. at 2533. In so holding the Supreme Court relied on historical practice of federal courts that permitted assignees to bring suits in their own right when they were assigned title for the sole purpose of collection. The Court in CWCapital explained that although the servicer may not be an assignee; it has a personal stake in the outcome of the lawsuit because it receives a percentage of the proceeds of the defaulted loan that it services.

Although the pooling and servicing agreement between the trustee of the mortgages backing the mortgaged-backed security and the servicer was less than clear, it made the servicer, the real party in interest. The Court looked at the following provisions of the Agreement.

1. The servicer "shall …have full power and authority, acting alone, to do or cause to be done any and all things in connection with such servicing and administration which it may deem necessary or desirable;
2. The trustee shall at the servicer's "written request…promptly execute any limited powers of attorney and other documents furnished by the [Servicer]…that are necessary or appropriate to enable [the Servicer] to carry out [its] servicing and administrative duties hereunder,"; and
3. Without the Trustee's written consent, "except as relates to a Loan that the …Servicer…is servicing pursuant to its respective duties herein (in which case such servicer shall give notice to the Trustee of the initiation), [the

> Servicer shall not] initiate any action, suit or proceeding solely under the Trustee's name without indicating the…Servicer's representative capacity."

The Court concluded that based on its review of the law and the pooling and servicing agreement that the trust held legal title to the underlying mortgages and to the claim, but delegated equitable ownership to the servicer. Additionally, the applicable agreement required the trustee to confer with the servicer whatever authority the servicer needed to perform its servicing duties.

The Court stated

> "It is thus the servicer under the agreement who has the whip hand; he is the lawyer and the client, and the trustee's duty, when the servicer is carrying out his delegated duties, is to provide support. The securitization trust holds merely the bare legal title;" the Pooling and Servicing Agreement delegates what is effectively equitable ownership of the claim (albeit for eventual distribution of proceeds to the owners of the tranches of the mortgage – backed security in accordance with their priorities) to the servicer."

Accordingly, the servicer has standing to sue as the real party in interest. The Court also concluded that there existed an independent basis not to dismiss the suit, based on Fed. R. Civ. P. (17)(a). Rule 17(a)(3) provides that a case should not be dismissed because it has not been brought in the name of the real party of interest "until, after an objection, a reasonable time has been allowed for the real party in interest to ratify, join, or be substituted into the action," and "after ratification joinder, or

substitution, the action proceeds as if it had been originally commenced by the real party in interest." The Court found that the trustee submitted an affidavit in the district court, which was not contradicted, ratifying the suit on the trustee's behalf.

The Court then addressed the merits of the claim against Blockbuster. Blockbuster settled the breach of lease lawsuit for $161,000.00 although it owed the mortgagee $471,000. The SNDA defined the rights of the parties in the event of a default. A critical provision in the SNDA, which was the subject of the case, for the protection of the lender was that the lender is not bound by any rent that the tenant may have paid in advance, nor by any modification of the lease made without the lender's consent that reduces the term of the lease or the tenant's monetary obligation under it.

The Court found that there was no event of default which could trigger Blockbuster's liability under the SDNA. The mortgagor/landlord has continued to make its monthly mortgage payments in full. Furthermore, the servicer did not present evidence that Blockbuster's failure to direct rent impaired the value of its collateral.

The CWCapital case demonstrates that standing to assert a claim based on a mortgage or other agreement is not always clear. However, given the structure of the securitization trust, and the broad delegation to the servicer to sue on behalf of the trust, the standing of the mortgage servicer, standing in the lender's shoes to assert a claim makes sense.

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