What's Past Is Prologue

Applying lessons from the financial crisis to the future of eMortgage and eNote litigation

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In the fallout from the 2008 financial crisis, courts across the United States were inundated with litigation challenging the legitimacy of mortgages, notes and the records purporting the transfer or assign them. Such claims included asserting that endorsements of promissory notes were not enforceable, claiming assignments of mortgages were executed without authority, and allegations that the note, mortgage, or associated disclosure documents were neither presented to nor signed by the borrowers. In recent years, as the economy appears to have improved, much of this litigation has died down. However, it does not take much imagination to assume that if and when the next economic downturn hits, some borrowers may again find themselves in default on their mortgage obligations, and in turn may seek to challenge the enforceability of those agreements.

As eMortgages and eNotes continue to gain traction across the U.S. as an acceptable format for originating mortgage loans, lingering in the background is the issue of how these records might be treated by the courts in the event a borrower eventually attempts to challenge them in court. Given that challenging the enforceability of mortgage loan records was a common tactic in the years following 2008, it stands to reason that the increased use of eMortgages and eNotes will generate a fresh set of challenges to be employed by borrowers in default in order to attempt to avoid their obligations. As such, lenders, servicers, and investors seeking to originate, acquire or service eMortgages and eNotes should be mindful of how these records could be treated by the courts, and should implement systems, processes and procedures now to insure they will have the necessary evidentiary record in place should such litigation come in the future.

UETA, E-Sign, and establishing the validity of electronic signatures

The implementation of eMortgages and eNotes is made possible in part by a series of laws concerning the use of electronic signatures. The two primary sources of authority are the federal Electronic Signatures in Global and National Commerce Act, 15 U.S.C. ch. 96 ("E-SIGN"), along with various state adaptations and permutations of the Uniform Electronic Transactions Act (UETA). In very broad terms, these two statutory schemes provide, subject to certain exclusions, that records and signatures may not be denied legal effect, validity, or enforceability solely because they are in an electronic form or because an electronic signature or electronic record is used in their formation. Additionally, E-SIGN and UETA permit the electronic transfer of certain payment instruments, such as promissory notes, without traditional requirements such as an original paper copy continuing original signatures and endorsements. All states except for Illinois, New York and Washington have adopted UETA, but each of those three states has its own laws recognizing electronic signatures.

Those courts applying E-SIGN and UETA generally have interpreted the statutes broadly to hold that these statutes permit electronic signatures to be satisfactory in any scenario that traditionally required an original signature. For

example, Barwick v. Gov't Em. Ins. Co., 2011 Ark 128 (Ark. 2011) concerned the electronic rejection of medical coverage in an insurance context, which under Arkansas law needs to be specifically rejected in writing. The court, however, held that an electronic signature satisfied this requirement, noting "In our view, the meaning of [the UETA] could not be more straightforward when it states that '[i]f a law requires a record to be in writing, an electronic record satisfies the law."

The primary issue is determining what is required to establish that the e-signature itself is genuine. Put another way, one must consider what safeguards need to be in place at the time of the e-signing, in order to effectively defend against a future challenge by a borrower who might seek to avoid the agreements in litigation on the basis that he or she purportedly was not the person who e-signed the operative documents.

The answer, in simple terms, is "process." The lender must have a process and safeguards in place to establish that the electronic document is genuine and has not been altered. Some of the best processes ensure that the borrower consents to an electronic transaction, that the eNote signed at closing is digitally tamper sealed immediately post execution, and that a complete digital audit is saved related to the electronic transaction. A failure to illustrate adequate processes could result in an unenforceable agreement.

This concept is nicely illustrated by two UETA cases out of California concerning employee arbitration agreements. In Ruiz v. Moss Bros. Auto Grp., Inc., 181 Cal Rptr. 3d 781 (Cal. Ct. App. 2014), the court refused to enforce an electronically signed employee arbitration agreement because there was insufficient evidence that this particular person actually signed the agreement. There was evidence of a common practice (such that all employees had to e-sign such an agreement), and there were records showing that the electronic system was accessed and the electronic document was e-signed, but there was insufficient evidence to establish that the plaintiff was the person who did the e-signing. Missing, for example, was any evidence of security protocol, such as unique username and password combination, or evidence that only a person with the password could have e-signed the document. Conversely, in Espejo v. S. Cal. Permanente Med. Grp., 201 Cal. Rptr. 3d 318 (Cal Ct. App. 2016), the court enforced a similarly e-signed employee arbitration agreement. Unlike Ruiz, here there was ample evidence of process. The employee had received a link that could only be accessed by username and password combination. Once that was provided, the plaintiff had to change the password. This type of process evidence helped establish that the plaintiff was the individual who had actually electronically signed the arbitration agreement.

Enforcing the eNote

Whether the original e-signature itself is enforceable is not where the analysis ends, however, because the vast majority of mortgage loans do not remain with the originating lender. The issue then becomes how to authenticate and establish that the current owner of the eNote is entitled to enforce the document when the underlying records are electronic and there are no original ink signatures or paper endorsements to rely upon. The answer, once again, appears to be "process."

By way of background, proving the right to enforce a paper note turns on physical delivery, possession and endorsement. However, with an eNote, lenders and servicers (including subsequent holders) need to prove that they are in control of the authoritative copy of the transferable record and related business records.

For example, courts in UETA states have applied their respective state versions of UETA to permit subsequent holders to enforce electronically executed and delivered notes without normal UCC requirements such as physical delivery, possession, or endorsement. In Rivera v. Wells Fargo Bank, N.A., 189 So.3d 323 (Fla. Dist. Ct. App. 2016) an electronic signature on a promissory note was held to be enforceable under UETA in a real property foreclosure action.

Similarly, in N.Y. Comm'ty Bank v. McClendon, 29 N.Y.S.3d 507 (N.Y. App. Div. 2016), the court applied E-SIGN and held that an electronically signed promissory note was enforceable.

Specifically, in both the Rivera and McClendon cases, the borrowers challenged the electronic chain of title and custody of the eNotes. In McClendon, the court applied E-SIGN and found that "[d]elivery, possession, and endorsement are not required to obtain or exercise any of the rights" of a holder of an electronic note." Instead, the holder needed only to provide "reasonable proof that the person is in control of the transferable record," which "may include access to the authoritative copy of the transferable record and related business records sufficient to review the terms of the transferable record and to establish the identity of the person having control of the transferable record." The court found that the associated "eNote transfer history" was such a "transferrable record" and that the current holder had established ownership.

Similarly, in Rivera, the court held that Fannie Mae's system established that there was a single, authoritative copy of the note that was unalterable. Specifically, "[a]ccording to the bank's evidence, the bank's system stored the eNote in such a manner that a single authoritative copy of the eNote exists which is unique, identifiable, and unalterable. That authoritative copy, introduced into evidence by the bank as Fannie Mae's designated custodian, identified Fannie Mae as the entity to which the transferable record was most recently transferred." The court thus held that delivery, possession and endorsement of a physical note were not required.

Finally, in Wells Fargo Bank, NA v. Benitez, No. 15433, 2017 N.Y. Misc. LEXIS 5192, 2017 NY Slip Op 32747(U), ¶ 5, the court held that the plaintiff had sufficiently established standing to enforce an eNote, focusing on plaintiff's control over a single authoritative copy of the eNote. "Plaintiff has established its standing with the submission of the affidavits … establish[ing] plaintiff's standing as the controller of the eNote, since Wells Fargo maintains the single authoritative copy of the eNote and is entitled to enforce same."

A failure to establish a process demonstrating the ownership history and the existence of an authoritative copy can lead to evidentiary issues, and the potential that the court may deem the transfers unenforceable. For example, in Good v. Wells Fargo Bank N.A., 18 N.E.3d 618 (Ind. Ct. App. 2014), the court set aside an order granting summary judgment because it found that the lender had provided insufficient evidence to show it was the true owner of the note. The lender had provided an affidavit concerning the possession of certain records, but nothing illustrating that it had control of the interest in the note itself. As explained by the Court, "Wells Fargo did not provide any evidence documenting the transfer or assignment of the Note[.] Thus, Wells Fargo did not demonstrate it controlled the Note by showing that a system employed for evidencing the transfer of interests in the Note reliably established that the Note had been transferred to Wells Fargo."

The enforcement of eMortgages is a state-specific issue, and generally turns on whether the state permits remote electronic notarization and electronic signatures on recordable instruments. The use of eMortgages is further impacted by whether the specific local jurisdiction permits the electronic recording of documents.

Measures to avoid enforcement issues

While the specter of future litigation is never a pleasant consideration, those businesses seeking to utilize eMortgages and eNotes have to assume that somewhere down the line they will be faced with certain borrowers who seek to avoid their obligations by challenging the legitimacy of the e-signatures or the veracity and enforceable of electronic transfers of the ownership interest in the notes and mortgages. In order to avoid spending countless hours and incurring significant legal fees in future disputes on such evidentiary issues, companies looking to get into the eMortgage and eNote business should focus now on making certain they have the processes in place to create and retain the evidence they will need to quickly and efficiently resolve such issues if and when the next wave of litigation begins.

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