

7TH BORROWER LACKS STANDING TO RAISE ALLEGED VIOLATIONS OF POOLING AND SERVICING AGREEMENT

The U.S. Court of Appeals for the Seventh Circuit recently held that a mortgagor is not a third-party beneficiary under a pooling and servicing agreement under New York law, and therefore lacks standing to challenge purported violations of assignments under the agreement.

A copy of the opinion is available at: [Link to Opinion](#).

A borrower executed a note for a loan secured by a mortgage. The note was indorsed by the lender in blank and transferred to a residential mortgage-backed securities trust formed and governed by a pooling and servicing agreement (“PSA”). The trust’s trustee held the note and the lender later assigned the trustee the rights associated with the borrower’s mortgage.

The borrower defaulted and the trustee foreclosed on the mortgage. The borrower subsequently filed a petition for Chapter 7 bankruptcy. The trustee moved to modify the automatic stay to pursue the state court foreclosure action. The borrower filed an opposition to the motion to modify the stay and an adversary complaint.

In her adversary complaint, the borrower claimed that the trustee had no interest in her mortgage. The bankruptcy court granted the trustee’s motion and dismissed the borrower’s adversary complaint. The district court affirmed the bankruptcy court’s orders. The borrower appealed.

On appeal, the borrower argued that the trustee could not collect on the note because the assignment violated the PSA. Specifically, the borrower asserted that the transfers of the note and mortgage were missing intervening indorsements and that the note was transferred after the closing date of the trust.

However, the Seventh Circuit held that the borrower lacked standing to challenge the purported violations of the PSA.

As the PSA was governed by New York law, the Court noted that **only an intended beneficiary of a private trust may enforce its terms**. In addition, the Seventh Circuit explained that **New York courts have consistently held that a mortgagor whose loan is owned by a trust is not a beneficiary and does not have standing to challenge purported violations of a pooling and servicing agreement**.

Accordingly, the Seventh Circuit held that the borrower lacked standing to raise a challenge based on violations of the PSA because she was not a third-party beneficiary under the PSA.

The borrower conceded that a mortgagor may not challenge a mortgage that is voidable, as the intended beneficiaries may later ratify the assignment. Thus, a challenge to a voidable assignment would interfere with the beneficiaries' right of ratification.

However, the borrower attempted to distinguish the established authority by arguing that a mortgagor has prudential standing to challenge a void – and not merely voidable — assignment because a void assignment cannot be ratified by the beneficiaries. Therefore, such a challenge would not infringe on any of the beneficiaries' rights.

The Seventh Circuit rejected the borrowers' theory and explained that **New York courts have consistently held that assignments that fail to comply with the terms of a trust agreement are merely voidable, not void.**

In addition, the Seventh Circuit explained that **New York courts have nearly unanimously concluded that a beneficiary retains the authority to ratify a trustee's ultra vires act.** Thus, a mortgagor would still lack standing because the beneficiaries' ability to ratify any unauthorized mortgage assignment makes the assignment merely voidable.

The borrower also argued that section 10.01 of the PSA states “[t]he Trustee, the Depositor, the Master Servicer and the Sellers with the consent of the NIM Insurer may ... amend this Agreement, without the consent of the Certificateholders.” Thus, the borrower argued, the terms of the PSA prevented the certificateholders from amending the agreement, and therefore they supposedly could not ratify ultra vires assignments.

However, the Court again rejected the borrower's argument, and explained that the PSA requires the master servicer to speak and provide consent on behalf of the certificateholders. Thus, the Seventh Circuit held, **the provisions of the PSA contemplated the certificateholders having a voice in the amendment process and contesting unauthorized acts through a derivative action.** Therefore, the Court held, the PSA provided a way for the certificateholders to ratify or challenge unauthorized acts.

Last, the Seventh Circuit addressed the borrower's assertions that: (1) the note is void and not negotiable because the lender was a fictitious entity; and (2) the trustee is an unlicensed debt collector under Illinois law.

The Court found that neither the bankruptcy court nor the district court addressed these claims because they found that the borrower lacked standing. However, because these claims did not arise out of the PSA, the Seventh Circuit remanded to the bankruptcy court to determine whether it should abstain from hearing the adversary proceeding and allow the Illinois courts to consider the claims in the foreclosure.

Accordingly, the Seventh Circuit affirmed in part and remanded in part.