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COMMENT

In Defense of "Free Houses"

Eight years after the start of America's housing crisis, state courts are increasingly confronting an unanticipated consequence: what happens when a bank brings a foreclosure suit and loses? Well-established legal principles seem to provide a clear answer: the homeowner keeps her house, and res judicata bars any future suit to foreclose on the home. Yet state courts around the country resist this outcome.

Banks have lost many foreclosure cases for two reasons, both resulting from recent changes in the mortgage market. First, securitization has created widespread errors in mortgage notes' chains of assignment, making it difficult for banks to prove that they in fact own any particular mortgage. Second, securitization contracts incentivize banks to use "foreclosure mill" law firms to keep up with the flood of defaults, despite the fact that these firms are unable and sometimes unwilling to detect and rectify basic legal errors.

When addressing faulty foreclosures, courts are afraid to bar future attempts to foreclose—that is, afraid of giving borrowers "free houses." While courts rarely explain the reasoning behind this aversion, it seems to arise from a reflexive belief that such an outcome would be unjust.[1] Courts are therefore

1. *See, e.g.*, Washington v. Specialized Loan Servicing, LLC (*In re* Washington), No. 14-14573-TBA, 2014 WL 5714586, at *1 (Bankr. D.N.J. Nov. 5, 2014) ("'No one gets a free house.' This Court and others have uttered that admonition since the early days of the mortgage crisis, where homeowners have sought relief under a myriad of state and federal consumer protection statutes and the Bankruptcy Code. Yet, with a proper measure of disquiet and chagrin, the Court now must retreat from this position, as Gordon A. Washington ("the Debtor") has presented a convincing argument for entitlement to such relief. So, with figurative hand holding the nose, the Court, for the reasons set forth below, will grant Debtor's motion for summary judgment."), *rev'd*, No. 2:14-cv-8063-SDW, 2015 WL 4757924 (D.N.J. Aug. 12, 2015); Singleton v. Greymar Assocs., 882 So. 2d 1004, 1007-08 (Fla. 2004) ("If res judicata prevented a mortgagee from acting on a subsequent default even after an earlier claimed default could not be established, the mortgagor would have no incentive to make future timely payments on the note. The adjudication of the earlier default would essentially insulate her from future foreclosure

quick to sidestep well-established principles of res judicata in favor of ad hoc measures meant to protect banks against the specter of "free houses."

This Comment argues that this approach is misguided; courts should issue final judgments in favor of homeowners in cases where banks fail to prove the elements required for foreclosure. Furthermore, these judgments should have res judicata effect—thus giving homeowners "free houses." This approach has several benefits: it is consistent with longstanding res judicata principles in other forms of civil litigation, it provides a necessary market-correcting incentive to promote greater responsibility among foreclosure litigators, and it alleviates the tremendous costs of successive foreclosure proceedings.

This Comment proceeds as follows. Part I explains basic foreclosure and mortgage-acceleration law. Part II describes how systemic banking behaviors and market forces have resulted in banks increasingly losing foreclosure suits after the 2008 financial crisis. Part III then describes how state courts have struggled to develop their jurisprudence on "free houses," often ignoring these significant market problems. Finally, Part IV contends that the application of res judicata in foreclosure litigation is essential for two reasons: (1) it would uniformly apply civil rules of finality to foreclosure cases, and (2) it would have a much-needed positive behavioral effect on a mortgage-foreclosure market run amok.

I. THE FORECLOSURE LAW BACKDROP

Foreclosures begin with a mortgage note's "acceleration clause." Under a mortgage note, the homeowner is required to make a certain payment every month for a fixed period.[2] In judicial-foreclosure states, if the homeowner defaults on at least one payment for a specified amount of time,[3] the bank has a choice: it can bring suit to recover just the missed payments,[4] or it can exercise

actions on the note—merely because she prevailed in the first action. Clearly, justice would not be served if the mortgagee was barred from challenging the subsequent default payment solely because he failed to prove the earlier alleged default.").

2. The standard home mortgage is thirty years. *See* Annamaria Andriotis, *Picking the Right Mortgage*, WALL ST. J. (July 4, 2014), http://www.wsj.com/articles/picking-the-right-mortgage-1404487636 [http://perma.cc/T9B5-KCL4].

3. This time period may be specified in the note itself or it may be fixed by statute. *See, e.g.*, CAL. CIV. CODE § 2924c (West 2011) (requiring a minimum of ninety days between notice of default and sale date and providing for a right to cure until five days before the sale date); IOWA CODE § 654.2D (2015) (providing for a thirty-day right to cure); ME. REV. STAT. ANN. tit. 14, § 6111 (2015) (providing for a thirty-five-day right to cure); MASS. GEN. LAWS ch. 244, § 35A(b) (2015) (providing for a right to cure of at least ninety days).

4. This is the lender's only remedy in contracts without acceleration clauses. *See* RESTATEMENT (THIRD) OF PROP. (MORTGS.) § 8.1 cmt. a (AM. LAW. INST. 1997) ("[In t]he absence of an

the acceleration clause[5] in the note and bring the entire remaining loan balance due.[6] Under the mortgage contract, only acceleration allows the bank to foreclose on the mortgage.[7]

In a foreclosure suit, the bank must generally prove the following: (1) the homeowner has signed both the note (the underlying loan) and the mortgage assigning the house as collateral for that note; (2) the bank owns the note and mortgage; (3) the homeowner still owes a debt to the bank; (4) the homeowner is behind on that debt; and (5) the bank has accelerated that remaining debt in accordance with the terms of the note itself.[8] When a bank fails to prove these elements, a judge is legally required to rule in favor of the homeowner.

Recently, courts have been inundated with suits where homeowners question the bank's ability to prove the second element. Litigation over "proof-of-ownership" issues in foreclosures is a growing nationwide problem; sampling suggests a ten-fold increase between the periods immediately preceding and following the 2007 collapse of the housing market.[9] Cases

acceleration provision . . . the mortgagee must either foreclose for each installment as it comes due or wait until the amortization period expires to foreclose for the full accrued obligation.").

5. Acceleration clauses are routine in mortgage notes. *Id.* ("Virtually all mortgages today contain acceleration clauses.").

6. This option only exists where the acceleration clause is discretionary. In some rare cases, the note is automatically accelerated once the borrower defaults. *Id.* ("While [the] 'option' type [acceleration] provision is almost universally used, on rare occasion mortgage documents may contain language that makes acceleration automatic on mortgagor default or on the basis of a specific event . . . .").

7. Foreclosure can be either judicial or nonjudicial; judicial foreclosures require a successful suit prior to sale, whereas lenders may only go to court in a nonjudicial foreclosure to enforce an eviction after sale. *See id.* § 8.2 cmt. a.

8. *See, e.g.*, GMAC Mortg., LLC v. Ford, 73 A.3d 742, 751 (Conn. App. Ct. 2013) (setting out what Connecticut law requires in a prima facie case for foreclosure); Chase Home Fin. LLC v. Higgins, 2009 ME 136, ¶ 11, 985 A.2d 508, 510-11 (setting out what Maine law requires in a prima facie case for foreclosure).

9. A search on March 5, 2015 of the Lexis State & Federal Cases database for "(foreclosure w/s standing) AND (mortgage or 'deed of trust' or 'trust deed')" yielded 5,149 cases between January 1, 2007 and December 31, 2014. The corresponding number between January 1, 2000 and December 31, 2007 was 522. On Westlaw, the search produced 3,913 results for the 2007-2014 period, and 306 results for 2000-2007. For the results of an identical search performed in November 2013, see Adam J. Levitin, *The Paper Chase: Securitization, Foreclosure, and the Uncertainty of Mortgage Title*, 63 DUKE L.J. 637, 642 n.18 (2013). *See, e.g.*, *In re* Foreclosure Cases, No. 07-CV-2532, 2007 WL 3232430, at *2-3 (N.D. Ohio Oct. 31, 2007); Bank of Am., N.A. v. Greenleaf, 2014 ME 89, 96 A.3d 700; U.S. Bank Nat'l Ass'n v. Ibanez, 941 N.E.2d 40, 55 (Mass. 2011); Argent Mortg. Co. v. Maitland, 958 N.Y.S.2d 306 (Sup. Ct. 2010).

addressing this kind of "failed foreclosure" have reached state supreme and appellate courts, including—recently—the Maine Supreme Court.[10] In certain states, including Florida,[11] New Jersey,[12] and New York,[13] courts have also been confronted with cases where, after accelerating the note and initiating a foreclosure proceeding, the bank abandons the proceeding and the statute of limitations on the accelerated debt expires, calling the third element into question.[14]

This massive increase in cases where banks' prima facie case is challenged or outright fails is not the product of novel foreclosure law or changes in its application. Rather, we argue, it is due to fundamental changes in how banks handle mortgages—the same changes that facilitated the financial crisis of 2008—and banks' unwillingness to invest in sufficient legal services to adapt to these underlying structural changes when pursuing foreclosures.

II. WHY HOMEOWNERS WIN THEIR FORECLOSURE CASES: SECURITIZATION AND ITS MARKET FAILURES

To successfully bring a foreclosure suit a bank must produce very little evidence. Why has this proven so difficult? The answer lies with banks' own practices. In the last twenty years, banks have significantly altered how they profit from mortgages; however, they failed to adequately adapt their record keeping and customer-service practices.

In the 1990s, banks began to convert long-term mortgages, familiar to most Americans, into short-term financial commodities, a process called securitization. Rather than keep mortgages on the books, mortgagees (banks) sought to sell the mortgages immediately to financial entities that would

10. *See Bank of Am.*, 96 A.3d at 700; *see also, e.g.*, Lizio v. McCullom, 36 So. 3d 927, 928 (Fla. Dist. Ct. App. 2010).

11. U.S. Bank Nat'l Ass'n v. Bartram, 140 So. 3d 1007, 1008-09 (Fla. Dist. Ct. App.), *review granted*, 160 So. 3d 892 (Fla. 2014).

12. *See, e.g.*, Washington v. Specialized Loan Servicing, LLC (*In re* Washington), No. 14-14573-TBA, 2014 WL 5714586, at *1 (Bankr. D.N.J. Nov. 5, 2014), *rev'd*, No. 2:14-cv-8063 -SDW, 2015 WL 4757924 (D.N.J. Aug. 12, 2015).

13. *Argent Mortg. Co.*, 958 N.Y.S.2d 306.

14. *See, e.g.*, *Bartram*, 140 So. 3d at 1008; *In re Washington*, 2014 WL 5714586, at *1; *see also* Michael Corkery, *Foreclosure to Home Free, as 5-Year Clock Expires*, N.Y. TIMES (Mar. 29, 2015), http://www.nytimes.com/2015/03/30/business/foreclosure-to-home-free-as-5-year-clock-expires.html [http://perma.cc/LXD5-TM5J] ("[I]n a growing number of foreclosure cases filed when home prices collapsed during the financial crisis, lenders may never be able to seize the homes because the state statutes of limitations have been exceeded.").

transform thousands of individual mortgages into securities—financial instruments that entitled the bearer to homeowners' mortgage payments and that could be arbitrarily restructured or resold.[15] After securitization, although a homeowner would continue to make mortgage payments to the originating bank, that bank ceased to have a financial interest in receiving these payments. Instead, a variety of investors owned an interest in the pool of mortgage payments of which the homeowner's is a part.[16]

Securitization gave rise to widespread errors in the documentation of mortgage ownership. To allow a variety of investors to own portions of a mortgage pool, originating banks entered into pooling and servicing agreements, which authorized "servicers"—sometimes large commercial banks, but often companies who were primarily or exclusively engaged in servicing—to act as the diffuse investors' agents in receiving payments from and pursuing foreclosures against homeowners. Because actual ownership of the mortgage note became independent of servicing and the relationship with the mortgagor, a loan, or the right to receive part of the payments on that loan, might be sold several times while the homeowner still interacted with the same servicer. Conversely, the servicer might change while the loan remained part of the same investment pool. Throughout this reshuffling of title ownership and servicing, banks frequently made errors in how they documented and recorded their ownership of mortgages.[17]

Common mortgage fee structures set up in pooling and servicing agreements also disincentivized servicers and their attorneys from devoting adequate resources to foreclosures. Each servicing agreement paid servicers a flat annual fee of around 0.25% of the loan's total value (for example, $500 per year on a $200,000 loan), but the cost of pursuing a single foreclosure cost servicers around $2,500.[18] When foreclosures began climbing precipitously in 2007,[19] servicers were unprepared to handle the sudden increase in volume and

15. Eamonn K. Moran, *Wall Street Meets Main Street: Understanding the Financial Crisis*, 13 N.C. BANKING INST. 5, 32-33 (2009).

16. An excellent explanation of the process by which securitization took place, and of its role in the initial financial crisis of 2007, can be found in the podcast *This American Life: The Giant Pool of Money*, CHI. PUB. MEDIA (May 9, 2008), http://www.thisamericanlife.org/radio-archives/episode/355/the-giant-pool-of-money [http://perma.cc/H37H-YHN4].

17. *See, e.g.*, Molly Rose Goodman, *The Buck Stops Here: Toxic Titles and Title Insurance*, 42 REAL EST. L.J. 5, 30-32 (2013).

18. Eric Dash & Nelson D. Schwartz, *Bankers Ignored Signs of Trouble on Foreclosures*, N.Y. TIMES (Oct. 13, 2010), http://www.nytimes.com/2010/10/14/business/14mortgage.html [http://perma.cc/B4K4-BFE3].

19. FED. HOUS. FIN. AGENCY OFFICE OF INSPECTOR GEN., FHFA'S OVERSIGHT OF FANNIE MAE'S DEFAULT-RELATED LEGAL SERVICES 11 (2011), http://www.fhfaoig.gov/Content/Files/AUD-2011-004.pdf [http://perma.cc/776K-RWRE] ("Between 2007 and 2010, the volume of

had no incentives to devote additional resources to prove their banks' ownership over each mortgage.[20] To demonstrate ownership without expending more resources than pooling and servicing agreements allotted, bank employees signed hundreds of thousands of affidavits asserting that they had seen and could attest to the contents of original documents demonstrating ownership of the underlying mortgage. Although such affidavits were a legally acceptable means of demonstrating such ownership, a significant number of them were actually fraudulent.[21]

Similarly, servicers' attorneys also relied on sloppy paperwork—and, at times, on fraudulent and unethical practices in foreclosure proceedings. For example, one New Jersey foreclosure law firm operated without any method of contacting its mortgage-servicer clients. Instead, the firm received all work orders through a one-way computer system, along with a requested timeline and documents the servicer had determined were necessary.[22] This underresourcing and the resulting ethical transgressions have affected hundreds of thousands of foreclosures.[23]

Fannie Mae foreclosures increased to historic levels . . . . Fannie Mae foreclosed on 262,078 properties in 2010, an 80% increase from 2009 and a 433% increase from 2007.").

20. *See* Ariana Eunjung Cha & Brady Dennis, *Under Piles of Paperwork, A Foreclosure System in Chaos*, WASH. POST (Sept. 23, 2010), http://www.washingtonpost.com/wp-dyn/content/article/2010/09/22/AR2010092206146.html [http://perma.cc/QB59-PWHF] (noting that "as millions of Americans are being pushed out of the homes they can no longer afford, the foreclosure process is producing far more paperwork than anyone can read and making it vulnerable to fraud").

21. *See* Fed. Nat'l Mortg. Ass'n v. Bradbury, 2011 ME 120, ¶¶ 2-7, 32 A.3d 1014, 1015-16.

22. *In re* Taylor, 407 B.R. 618, 623 (Bankr. E.D. Pa. 2009), *aff'd*, 655 F.3d 274 (3d Cir. 2011).

23. For example, in 2012, New York Attorney General Eric Schneiderman announced a four-million-dollar settlement with the Steven J. Baum law firm and Pillar Processing, who had filed more than a hundred thousand foreclosure cases between 2007 and 2010. *See* Press Release, N.Y. State Office of the Att'y Gen., A.G. Schneiderman Announces $4 Million Settlement with New York Foreclosure Law Firm Steven J. Baum P.C. and Pillar Processing LLC (Mar. 22, 2012), http://www.ag.ny.gov/press-release/ag-schneiderman-announces-4-million-settlement-new-york-foreclosure-law-firm-steven-j [http://perma.cc/Q8ZA-QYSA]. Similarly, the Federal Housing Finance Agency (FHFA) issued a 2011 report that faulted Fannie Mae for its reliance on "foreclosure mills" and failure to intervene in the face of mounting evidence of attorney abuses, and described additional examples of firms perpetrating abuses in their efforts to do large volumes of foreclosures on the cheap. *See* FED. HOUS. FIN. AGENCY OFFICE OF INSPECTOR GEN., *supra* note 19, at 14. The FHFA report described cases where courts levied "significant financial sanctions against the abusive firms and—in some cases—their clients, which included Fannie Mae." *Id.* These included a 2006 New Jersey bankruptcy where the judge issued a $125,000 sanction against a mill that had "filed 250 motions seeking permission to seize homes using pre-signed certifications of default executed by an employee who had not worked at the firm for more than a year." *Id.* (citing Gretchen Morgenson & Jonathan D. Glater, *Foreclosure Machine Thrives on Woes*, N.Y. TIMES (Mar. 30, 2008), http://www.nytimes.com/2008/03

The result of securitization contracts' underresourcing of mortgage servicers and their attorneys has been a "factory-line approach to litigation," rife with abuses.[24] In many individual cases, these litigation strategies have been unsuccessful. Homeowners, their attorneys, and sometimes judges have successfully prevented foreclosure by demonstrating the falsity of an affidavit or simply by forcing the mortgagee to produce actual documentation that it owned the mortgage.[25] As an increasing number of foreclosure suits are lost on the merits for lack of documentation, or for failure to prosecute within the statute of limitations, courts face a new problem: what happens next?

III. THE COURTROOM SOLUTION: ANYTHING BUT "FREE HOUSES"

In many states, longstanding principles of res judicata, when taken with the state law's treatment of acceleration clauses, require courts to grant homeowners "free houses" when banks lose their foreclosure cases. But many courts have declined to give these cases preclusive effect.

Whether servicers lose because they fail to prove ownership or because their lawyers simply stop litigating, the first choice courts face is whether to dismiss the case with prejudice. Typically, once parties have a full and fair opportunity to present their cases, failure to prove one's case results in

/30/business/30mills.html [http://perma.cc/7N4G-QJ67]). In 2010, a judge sanctioned an Orlando law firm employed by Fannie Mae, imposing a fine of $33,500 for filing sixty-seven faulty motions to remove borrowers from their homes. *Id.* A Texas bankruptcy judge found problems in all eight of the foreclosure cases carried out by a mill it reviewed, including the use of "inaccurate information about defaults [and] fail[ure] to attach proper documentation when it moved to seize borrowers' homes." *Id.* The judge imposed seventy-five thousand dollars in sanctions. *Id.*

24. Morgenson & Glater, *supra* note 23.

25. *See, e.g.*, *In re* Foreclosure Cases, No. 07CV2532, 2007 WL 3232430, at *2-3 (N.D. Ohio Oct. 31, 2007) (finding mortgagee documentation inadequate and asserting the federal court's authority to rule in the case); U.S. Bank Nat'l Ass'n v. Ibanez, 941 N.E.2d 40, 55 (Mass. 2011) (holding that ownership of the note without title was an insufficient basis to foreclose, that this result was simply an application of the current law, and that "[a]ll that has changed is the plaintiffs' apparent failure to abide by those principles and requirements in the rush to sell mortgage-backed securities"). Judge Schack, a trial judge sitting in the New York Supreme Court for Kings County, has repeatedly sanctioned law firms for bringing improper foreclosure suits when he has independently discovered the inadequacy of the plaintiffs' evidence as to defendants' indebtedness or plaintiffs' ownership of the note. *See, e.g.*, Argent Mortg. Co. v. Maitland, 958 N.Y.S.2d 306 (Sup. Ct. 2010); Wells Fargo Bank v. Hunte, 910 N.Y.S.2d 409 (Sup. Ct. 2010); NetBank v. Vaughn, 841 N.Y.S.2d 827 (Sup. Ct. 2007).

dismissal with prejudice.[26] In addition, dismissal with prejudice can be used as a sanction. Judges in foreclosure cases have issued dismissals with prejudice due to a lender's failure to appear at case-management conferences[27] or mediation,[28] lack of prosecution,[29] or a lender's failure to meet court-imposed deadlines.[30] If banks attempt a subsequent foreclosure, courts must then determine whether that dismissal with prejudice bars only an attempt to collect on the particular missed payments that led to the initial foreclosure suit, or whether the dismissal bars a future attempt to collect on *any* default on the debt.

While the latter holding may seem extreme, it is in accordance with settled principles of lending law in many states. In these states, acceleration is irrevocable—exercising the acceleration clause in the mortgage note turns an obligation to make installment payments into an "indivisible" obligation.[31] Logically, after acceleration, there are no more monthly payments. A foreclosure is an action to recover the *entire* loan balance, and a loss bars any future attempt to collect on the note. In effect, the borrower gets to keep his

26. RESTATEMENT (SECOND) OF JUDGMENTS ch. 1, at 6 (AM. LAW. INST. 1982) ("The principle underlying the rule of claim preclusion is that a party who once has had a chance to litigate a claim before an appropriate tribunal usually ought not to have another chance to do so."). Res judicata attaches whenever the parties have had a "full and fair" opportunity to litigate, including the "freedom to present substantive contentions and full and fair access to evidence." *Id.* at 9. When these procedural predicates are satisfied, then "under that system of procedure there must be compelling reasons to sustain a plea for a second chance." *Id.*

27. *See, e.g.*, Singleton v. Greymar Assocs., 882 So. 2d 1004, 1005 (Fla. 2004) (noting the lower court's dismissal of a foreclosure with prejudice due to the mortgagee's failure to appear at a case-management conference); Deutsche Bank Tr. Co. Ams. v. Beauvais, No. 3D14-575, 2014 WL 7156961, at *1 (Fla. Dist. Ct. App. Dec. 17, 2014) (same).

28. *See, e.g.*, Bayview Loan Servicing, LLC v. Bartlett, 2014 ME 37, ¶ 4, 87 A.3d 741, 745 (noting the lower court's dismissal of a foreclosure with prejudice, in part because the plaintiff failed to attend mediation sessions).

29. *See, e.g.*, Washington v. Specialized Loan Servicing, LLC (*In re* Washington), No. 14-14573-TBA, 2014 WL 5714586, at *6 (Bankr. D.N.J. Nov. 5, 2014) (noting an earlier dismissal by the superior court for lack of prosecution), *rev'd*, No. 2:14-cv-8063-SDW, 2015 WL 4757924 (D.N.J. Aug. 12, 2015).

30. *See, e.g.*, Johnson v. Samson Constr. Corp., 1997 ME 220, ¶ 4, 704 A.2d 866, 868 (noting the lower court's dismissal of a foreclosure with prejudice because the plaintiff's attorney failed to file the report of conference of counsel within ten days).

31. *See id.* ¶ 8, 704 A.2d at 869; U.S. Bank Nat'l Ass'n v. Gullotta, 120 Ohio St. 3d 399, 2008-Ohio-6268, 899 N.E.2d 987, at ¶ 30; Snyder v. Exum, 315 S.E.2d 216, 218 (Va. 1984) (finding that acceleration of a mortgage was irrevocable); *see also* Tiedeman Mortg. & Fin. Co. v. Carlson, 152 S.E. 909, 909-10 (Ga. Ct. App. 1930) (applying this rule to an acceleration clause implied in an installment contract); Hamlin v. Peckler, No. 2005-SC-000166-MR, 2005 WL 3500784, at *2 (Ky. Dec. 22, 2005) (noting in dicta that acceleration would preclude a separate subsequent foreclosure action).

house without being subject to a continuing obligation on the mortgage—a "free house."[32] Courts in irrevocable acceleration states that considered the issue before the 2008 financial crisis applied res judicata to subsequent foreclosures in this way.[33]

Recently, however, judges have avoided applying res judicata to foreclosure cases and have bent the rules to favor banks. For example, in Maine, where longstanding precedent established that a failed foreclosure bars any future attempt to collect on the debt,[34] two trial courts recently refused to dismiss cases with prejudice, even after the cases were tried to completion and the banks had lost. The judges in those cases were explicit that they did so to allow any subsequent actions the banks might want to bring and to avoid giving the homeowners a windfall.[35]

On appeals from those cases, the Maine Supreme Court went even further than the trial courts in changing the law to favor foreclosing banks. The court held that the bank's ownership of the mortgage, which has long been recognized as an element of the bank's prima facie case for foreclosure,[36] is actually an element of standing.[37] Thus, whenever a bank fails to prove

32. Although we refer colloquially to these houses as "free," the homeowner may have paid the equivalent of a significant portion of the mortgage—or even close to the entirety—prior to falling behind on payments and incurring the foreclosure action, depending on when in the life of the mortgage the foreclosure claim is brought.

33. *See, e.g.*, Stadler v. Cherry Hill Developers, Inc., 150 So. 2d 468, 472 (Fla. Dist. Ct. App. 1963) ("[A]n election to accelerate puts all future installment payments in issue and forecloses successive suits."); *Johnson*, 1997 ME 220, ¶ 8, 704 A.2d at 869 ("Once Johnson triggered the acceleration clause of the note and the entire debt became due, the contract became indivisible. The obligations to pay each installment merged into one obligation to pay the entire balance on the note.").

34. *See Johnson*, 1997 ME 220, ¶ 8, 704 A.2d at 869.

35. *See* Order After Remand for Dismissal With Conditions, Bank of Am., N.A. v. Greenleaf, No. BRIDC-RE-11-109 (Me. Super. Ct. 2014) ("[T]he court is hard pressed to award the defendant the extraordinary benefit of a judgment or dismissal with prejudice that would preclude future enforcement of the mortgage security interest."); Homeward Residential, Inc. v. Gregor, No. RE11108, 2014 WL 7802864, at *3 (Me. Super. Ct. Aug. 15, 2014) ("[T]he court is entering judgment for Defendant, but the court is reserving the right for both parties to relitigate the issues discussed herein so that this action does not act as a bar to a future action."), *vacated*, 2015 ME 108, 122 A.3d 947.

36. Chase Home Fin. LLC v. Higgins, 2009 ME 136, ¶ 11, 985 A.2d 508, 510-11.

37. While this conclusion may appear reasonable on its face, consideration of other cases where elements of the plaintiff's prima facie case overlap with elements of standing reveals the court's error. For example, injury in fact is an element of standing while proof of damages is an element of many different causes of action. These two concepts are often closely related. *See, e.g.*, F. Andrew Hessick, *Standing, Injury in Fact, and Private Rights*, 93 CORNELL L. REV. 275, 307 (2008) ("Injury in fact asks whether the plaintiff suffered a factual injury, such as pain, the loss of money, or some other harm."). However, when a suit is tried to completion

ownership of the mortgage, even if that occurs after a full trial on the merits, the complaint must be dismissed without prejudice for lack of subject-matter jurisdiction.[38] In other words, the court's ruling granted banks potentially infinite bites at the apple in foreclosure proceedings.[39]

In Florida, where intermediate courts had similarly barred subsequent foreclosures on res judicata grounds,[40] the state supreme court in 2004 determined that irrevocable accelerations did not bar subsequent foreclosures. Instead, in *Singleton v. Greymar Associates*, the court held that the second action could go forward because it was based on a "subsequent default."[41] In other words, despite the acceleration of the mortgage, the court presumed a continuing obligation by the homeowner to make monthly payments.[42]

In *Singleton*, the Florida Supreme Court declared without analysis that barring subsequent foreclosures would produce inequitable results.[43] In the next Part, we argue that state courts like the *Singleton* court are wrong on this

and the fact finder determines that the plaintiff has failed to prove any injury, courts do not generally dismiss without prejudice for lack of subject-matter jurisdiction. Rather, they might award nominal damages. *See* Coastal Power Int'l, Ltd. v. Transcon. Capital Corp., 10 F. Supp. 2d 345, 364 (S.D.N.Y. 1998) *aff'd*, 182 F.3d 163 (2d Cir. 1999) ("Although any breach of contract entitles the injured party at least to nominal damages, he cannot recover more without establishing a basis for an inference of fact that he has been actually damaged." (quoting 11 SAMUEL WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 1345, at 231 (3d ed. 1968))). Similarly, when a plaintiff fails to prove causation, which is also an element of standing, courts rule against the plaintiff rather than dismissing the case. *See, e.g.*, Russo v. Baxter Healthcare Corp., 140 F.3d 6, 12 (1st Cir. 1998) (affirming entry of judgment as a matter of law for the defendant on the ground that the plaintiff failed to prove causation).

38. Homeward Residential, Inc. v. Gregor, 2015 ME 108, ¶¶ 25-26, 122 A.3d 947, 955; Bank of Am. v. Greenleaf, 2015 ME 127, ¶¶ 7-8, 124 A.3d 1122, 1124-25.

39. *See infra* Part IV.

40. *See* Stadler v. Cherry Hill Developers, Inc., 150 So. 2d 468, 472 (Fla. Dist. Ct. App. 1963) ("[A]n election to accelerate puts all future installment payments in issue and forecloses successive suits.").

41. 882 So. 2d 1004, 1008 (Fla. 2004). Some other courts have embraced the *Singleton* rule. *See* Fairbank's Capital Corp. v. Milligan, 234 F. App'x 21, 24 (3d Cir. 2007); Afolabi v. Atl. Mortg. & Inv. Corp., 849 N.E.2d 1170, 1174-75 (Ind. Ct. App. 2006). While no cases directly disavow *Singleton*, other states continue to apply res judicata to subsequent foreclosures. *See* U.S. Bank Nat'l Ass'n v. Gullotta, 120 Ohio St. 3d 399, 2008-Ohio-6268, 899 N.E.2d 987, at ¶ 29; Hamlin v. Peckler, No. 2005-SC-000166-MR, 2005 WL 3500784, at *1-2 (Ky. Dec. 22, 2005) (affirming the application of res judicata to subsequent foreclosures in theory while declining to reach the merits of the case because the trial court vacated its initial dismissal).

42. The *Singleton* court did not engage with the reasoning in *Stadler v. Cherry Hill Developers, Inc.* that acceleration places the entire balance at issue. *Singleton*, 882 So.2d 1004.

43. *Id.* at 1008 ("Clearly, justice would not be served if the mortgagee was barred from challenging the subsequent default payment solely because he failed to prove the earlier alleged default.").

score. By focusing on the immediate consequence of a ruling for homeowners, the courts ignore perverse incentives created by allowing banks to continue to externalize the costs of their mistakes.

iv. the case for "free houses" as market correction

So what should courts do when banks lose their foreclosure cases? As described above, one approach—that taken by the Florida and Maine Supreme Courts—is to bend the rules of res judicata to avoid a windfall for homeowners. This approach creates few benefits and significant economic problems. In this Part, we argue that further subsidizing banks' poor litigation practices results in deadweight loss by contributing to negative public-health outcomes and by disincentivizing banks from improving their servicing and litigation techniques. We also explain how granting winning homeowners "free houses" will not negatively affect the mortgage market.

First, giving systematic permission to mortgagees and their attorneys to engage in repeated attempts to foreclose upon properties results in a broader social subsidization of irresponsible behavior. And these subsidies are large. As economists recognize, prolonged foreclosure proceedings create negative social externalities, depressing surrounding homes' resale value, reducing local governments' tax revenues, and increasing criminal activity.[44] Foreclosures also appear to have significant effects on community members' physical and mental health, and correlate with increased rates of depression, anxiety, suicide, cardiovascular disease, and emergency-care treatment.[45] In fact, scholars who

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44. *See, e.g.*, GEOFFRY WALSH, NAT'L CONSUMER LAW CTR., STATE AND LOCAL FORECLOSURE MEDIATION PROGRAMS: CAN THEY SAVE HOMES? 3 (2009) (reporting that on every completed foreclosure in November of 2008, investors lost an average of fifty-seven percent of their initial investment); Dan Immergluck & Geoff Smith, *The External Costs of Foreclosure: The Impact of Single-Family Mortgage Foreclosures on Property Values*, 17 HOUSING POL'Y DEBATE 57, 58 (2006) (finding that "for the entire city of Chicago, the 3,750 foreclosures that occurred in 1997 and 1998 are estimated to have reduced nearby property values by more than $598 million, or an average of $159,000 per foreclosure"); Dan Immergluck & Geoff Smith, *The Impact of Single-Family Mortgage Foreclosures on Neighborhood Crime*, 21 HOUSING STUD. 851, 863 (2006) (suggesting that "[h]igher neighborhood foreclosure rates lead to higher levels of violent crime at appreciable levels"); *see also* Zhenguo Lin et al., *Spillover Effects of Foreclosures on Neighborhood Property Values*, 38 J. REAL EST. FIN. & ECON. 387 (2009) (finding significant spillover effects from foreclosed property within a ten-block radius that persisted for five years); Jenny Schuetz et al., *Neighborhood Effects of Concentrated Mortgage Foreclosures*, 17 J. HOUSING ECON. 306 (2008) (finding that home prices decreased with proximity to foreclosures on the basis of a 2000-2005 New York dataset).

45. *See* Mariana Arcaya et al., *Effects of Proximate Foreclosed Properties on Individuals' Systolic Blood Pressure in Massachusetts, 1987 to 2008*, 129 CIRCULATION 2262, 2267 (2014) ("[O]ur findings

track the health effects of the 2008 crisis found that foreclosures might have even greater negative health effects than unemployment.[46] Although these studies analyze the general phenomenon of foreclosures and do not specifically address how relitigation of foreclosures might impact homeowners or their neighbors, they make clear that prolonged foreclosures can have dire economic and social effects.

Second, the threat of a "free house" also provides leverage for homeowners to negotiate a voluntary settlement, whether through a modification or a "graceful exit" like a short sale.[47] In a world where mortgagees truly risk forfeiting their claim by bringing illegitimate or rushed suits, homeowners will have more time up front to regain their financial footing and negotiate a modification or repayment plan. Enforcing finality rules may dissuade mortgagees "from filing until they have their paperwork ready" and encourage potential plaintiffs "to look favorably on loan renegotiation."[48] Servicers of

suggest that real estate-owned foreclosed properties may put nearby neighbors at risk for increased systolic blood pressure."); Mariana Arcaya et al., *Effects of Proximate Foreclosed Properties on Individuals' Weight Gain in Massachusetts, 1987-2008*, 103 AM. J. PUB. HEALTH 50, 55 (2013) ("Exposure to proximate foreclosure activity significantly predicted higher subsequently measured BMI . . . ."); Kathleen A. Cagney et al., *The Onset of Depression During the Great Recession: Foreclosure and Older Adult Mental Health*, 104 AM. J. PUB. HEALTH 498, 504 (2014) ("Our results suggest that some portion of depression onset in older adults is yet another consequence of the Great Recession."); Janet Currie & Erdal Tekin, *Is There a Link Between Foreclosure and Health?*, 7 AM. ECON. J. 63, 87 (2015) ("[T]he estimates imply that 2.82 million foreclosures in 2009 resulted in an additional 2.21 million nonelective [hospital] visits."); Jason N. Houle, *Mental Health in the Foreclosure Crisis*, 118 SOC. SCI. & MED. 1 (2014) (examining the association between foreclosures and mental health); Jason N. Houle & Michael T. Light, *The Home Foreclosure Crisis and Rising Suicide Rates, 2005 to 2010*, 104 AM. J. PUB. HEALTH 1073, 1077 (2014) ("Our results suggest that the foreclosure crisis significantly contributed to the increase in suicides in the Great Recession."); K.A. McLaughlin et al., *Home Foreclosure and Risk of Psychiatric Morbidity During the Recent Financial Crisis*, 42 PSYCHOL. MED. 1441, 1447 (2012) ("These results . . . suggest that the foreclosure crisis could have adverse effects on the mental health of the US population."); Theresa L. Osypuk et al., *The Consequences of Foreclosure for Depressive Symptomatology*, 22 ANNAL EPIDEMIOLOGY 379, 385 (2012) ("We found that recent experience of foreclosure was associated with greater risk of severe depressive symptomatology.").

46. *See* Currie & Tekin, *supra* note 45, at 64 (finding "strong evidence" that increases in foreclosures are associated with increased hospital visits, noting that hospital visits increased from 2005 to 2007, a period during which foreclosure rates but not unemployment rates were increasing).

47. *See* Levitin, *supra* note 9, at 651 ("[E]nforcement of bargained-for procedural requirements such as standing gives homeowners leverage to achieve negotiated solutions to loan defaults, such as a loan modification . . . [or] can buy the homeowner time to relocate, enabling a softer landing with fewer social dislocations and externalities.").

48. Victoria V. Corder, *Homeowners and Bondholders as Unlikely Allies: Allocating the Costs of Securitization in Foreclosure*, 30 No. 5 BANKING & FIN. SERVICES POL'Y REP. 19, 24 (2011).

securitized loans typically believe mortgage foreclosures are faster and cheaper than loan renegotiation,[49] yet securitized-loan investors suffer greater financial losses in foreclosures than in renegotiation and repayment.[50] Courts' adhesion to traditional res judicata principles in the foreclosure process has the added benefit of making negotiated settlements with borrowers more appealing to banks. By realigning incentives through the increased risk of failure, courts can induce banks to act in their own long-term interest.

Finally, although judges have expressed concern about homeowner windfalls,[51] the alternative creates a windfall for *banks* that cut corners in managing and prosecuting foreclosures. The risk and costs of losing foreclosures should *already* be internalized in the price of current mortgages. Empirical studies suggest that greater protection for mortgagors historically corresponds to slightly higher mortgage rates among lenders.[52] These studies indicate that lenders adjust the price of mortgages based on what they anticipate the cost, and not just the likelihood, of foreclosures will be. In addition, lenders are more likely to extend subprime mortgages where there are fewer legal hurdles to foreclosure.[53] Because the requirements to bring a successful foreclosure suit and the legal rules concerning acceleration were well

49. *See* Sumit Agarwal et al., *The Role of Securitization in Mortgage Renegotiation*, 102 J. FIN. ECON. 559, 559 (2011) ("[B]ank-held loans are 26-36% more likely to be renegotiated than comparable securitized mortgages . . . [and] bank-held loans have 9% lower post-modification default rates . . . ."); Thomasz Piskorski et al., *Securitization and Distressed Loan Renegotiation: Evidence from the Subprime Mortgage Crisis*, 97 J. FIN. ECON. 369, 369 (2010) ("[T]he foreclosure rate of delinquent bank-held loans is 3% to 7% lower in absolute terms (13% to 32% in relative terms) [than that of securitized loans].").

50. *See, e.g.*, Eric A. Posner & Luigi Zingales, *A Loan Modification Approach to the Housing Crisis,* 17 AM. L. & ECON. REV. 1, 3-4 (2009).

51. *See supra* note 1 and accompanying text.

52. *See, e.g.*, Lawrence D. Jones, *Deficiency Judgments and the Exercise of the Default Option in Home Mortgage Loans*, 36 J.L. & ECON. 115, 126-27 (1993) (noting the lender response to default rates); Mark Meador, *The Effects of Mortgage Laws on Home Mortgage Rates*, 34 J. ECON. & BUS. 143, 146 (1982) (estimating a 13.87 basis-point increase in interest rates on new homes as a result of antideficiency laws); Karen M. Pence, *Foreclosing on Opportunity: State Laws and Mortgage Credit*, 88 REV. ECON. & STAT. 177, 180-82 (2006) (noting that the availability—and hence, the cost—of mortgages in states with judicial-foreclosure proceedings is greater than in states with nonjudicial foreclosures, but without inferring causality); Michael H. Schill, *An Economic Analysis of Mortgagor Protection Laws*, 77 VA. L. REV. 489, 491 (1991) (arguing that "the relatively modest costs associated with state mortgagor protection laws do suggest that mortgagor protections may indeed promote economic efficiency").

53. Quinn Curtis, *State Foreclosure Laws and Mortgage Origination in the Subprime*, 49 J. REAL EST. FIN. & ECON. 303, 321 (2013) ("The provisions that make foreclosure easier—non-judicial process and readily available deficiency judgments—lead to increased applications and accepted applications in the subprime market . . . .").

established at the time banks priced the mortgages currently in foreclosure, the mortgage agreements already had a chance to incorporate both the costs of pursuing foreclosure under irrevocable acceleration laws and the risks of homeowners prevailing—even though they often failed to do so.

Although a full discussion of the relationship between foreclosure procedure and mortgage costs is beyond the scope of this Comment, we reject the suggestion that lower mortgage costs and looser markets are ultimately beneficial, for at least two reasons. First, as described above, a growing body of empirical evidence suggests that the public-health and social costs of foreclosure are as widespread as the benefits of lower mortgage prices, suggesting that broader social allocation of the risk of foreclosure is appropriate. Second, the 2008 crisis that gave rise to the very problem this Comment addresses was caused in significant part by the loosening of underwriting standards and an increase in subprime lending.[54] In light of a crisis precipitated by precisely these lending practices, and given the link between the ease of foreclosures and lenders' proclivity for subprime loans, there is good reason to increase the price of socially harmful lending practices.

Therefore, a liberalization of rules governing foreclosure *after* the relevant loans have been issued would result in a broad windfall for lenders. When courts bypass res judicata and allow mortgagees a second shot at foreclosure, they are facilitating a shift of the risk associated with foreclosures—a risk that banks had, or should have, already priced into the cost of the mortgages themselves—onto homeowners.

Res judicata is generally justified as promoting respect for law because it tends to reduce social conflict and uncertainty.[55] These broader policy arguments for imposing claim preclusion are particularly strong in the foreclosure context, where banks have demonstrated a lack of respect for law through their reliance on "robo-signing" and where the economic, social, and public-health costs of legal uncertainty not only are especially dire for litigants but also extend well beyond the parties themselves.

54. *See generally* JENNIFER TAUB, OTHER PEOPLE'S HOUSES: HOW DECADES OF BAILOUTS, CAPTIVE REGULATORS, AND TOXIC BANKERS MADE HOME MORTGAGES A THRILLING BUSINESS 123-39 (2014) (describing the practices of subprime lender Washington Mutual).

55. *See* RESTATEMENT (SECOND) OF JUDGMENTS ch. 1, at 11 (AM. LAW. INST. 1982) ("Indefinite continuation of a dispute is a social burden. It consumes time and energy that may be put to other use, not only of the parties but of the community as a whole. It rewards the disputatious. It renders uncertain the working premises upon which the transactions of the day are to be conducted. The law of res judicata reduces these burdens even if it does not eliminate them, and is thus the quintessence of the law itself: A convention designed to compensate for man's incomplete knowledge and strong tendency to quarrel.").

conclusion

Mortgagees, their servicers, and their attorneys currently face a crisis of their own making. They failed to allocate the necessary resources to maintain accurate records of homeowners' indebtedness while pursuing the profits of securitization. Then they brought foreclosures in unprecedented numbers—on compressed timeframes and on the cheap—in an attempt to recover quickly their unanticipated losses. At trial, they received forgiveness for their mistakes and abuses, obtaining a highly unusual legal outcome: judgment or dismissal of a case, fully heard on its merits, without prejudice.

In asking courts to allow subsequent foreclosure attempts, banks ask states and homeowners to bear the psychological and economic costs of lenders' self-interested behavior. But if state courts refused to create an exception to the rule of res judicata—that is, dismissed these cases with prejudice and enforced res judicata—they would do more than enforce the rule of law. They would also create a counterweight to current perverse incentives, encourage alternative dispute resolution where possible, reduce negative public-health consequences from prolonged foreclosure litigation, and ultimately promote greater social outcomes in future foreclosure suits.

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