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Fannie Mae/Freddie Mac Home Mortgage Documents Interpreted as Nonrecourse Debt (with poetic comments lifted from Carl Sandburg)

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I. LAWYERS (BUT NOT HOME MORTGAGE BORROWERS) KNOW THE DIFFERENCE BETWEEN RECOURSE AND NONRECOURSE DEBT

The Lawyers, Bob, know too much.
They are chums of the books of old John Marshall.
They know it all, what a dead hand wrote,
A stiff dead hand and its knuckles crumbling,
The bones of the fingers a thin white ash.

The lawyers know
a dead man's thought too well.¹

Lawyers know there are two types of mortgage obligations: recourse and nonrecourse.² Recourse promissory notes impose

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¹ CARL SANDBURG, The Lawyers Know Too Much, in SMOKE AND STEEL 85, 85 (1920).

² Out of context, I am not sure what the author meant by nonrecourse debt.
personal liability on borrowers for the total amount borrowed. The mortgage pledges the land (for present purposes, a personal residence) as security. If the borrower defaults, the lender can foreclose, have the land sold, and apply the proceeds to reduce the debt. But the note obliges the borrower to repay the borrowed amount in full and he or she is personally liable for deficiency if foreclosure sale proceeds do not satisfy the debt. The deficiency can be reduced to judgment and recorded in county records, where it hovers over the debtor for ten or more years. The judgment has the practical effect of disabling the debtor from participating in the normal credit market, authorizing seizure and sale of all non-exempt assets, and, where allowed, subjecting wages to garnishment.

Nonrecourse obligations also pledge the land, which can be sold at foreclosure and its proceeds applied to the debt, but, in contrast, impose no personal liability for deficiency after foreclosure except claims for waste and foreclosure costs. Nonrecourse obligations (and


3. NELSON & WHITMAN, supra note 2, § 8.1.

5. NELSON & WHITMAN, supra note 2, § 8.1.
7. See, e.g., CAL. CIV. PROC. CODE § 337.5 (West 2006) (setting a ten year limitation on judgments).

10. See NELSON & WHITMAN, supra note 2, §§ 8.1, 2.1. Nonrecourse does not necessarily mean that the borrower is totally free from liability for some costs of
limited recourse obligations) are common in commercial transactions, but not in home purchase mortgage transactions.¹¹

Virtually all home purchase mortgage lenders use standard documents that are commonly thought to impose recourse liability on home purchase mortgagors¹² except where limited or excluded by state law.¹³

A. Recourse Mortgage Notes Assign the Formal Risk of Market Decline to Borrowers

When the lawyers are through
What is there left, Bob?
Can a mouse nibble at it
And find enough to fasten a tooth in?¹⁴

foreclosure, such as court costs, attorney fees, and property devaluation from waste. See Stein, supra note 2, at 1207 (describing obligations that may be imposed on nonrecourse obligors for waste, cost of foreclosure, and so on).


12. This article focuses on home purchase mortgages, but parts of it can apply as well to equity mortgages, particularly on personal residences.

13. For example, Houston real estate developers during the 1970s and 1980s sometimes undertook personal liability for a percentage of the debt, but not for the entire obligation, e.g., $5,000,000 personal recourse on a $50,000,000 note. Marvin Nathan, a Houston real estate lawyer for more than thirty years, stated: “Many deeds of trust used in commercial transactions involving much more knowledgeable borrowers contain . . . express exculpatory clauses excusing the borrowers from personal liability except for . . . fraud, misapplication of rents, condemnation awards, insurance proceeds, etc.” E-mail from Marvin D. Nathan, Shareholder & Attorney, Nathan, Sommers, Jacobs, Corp., to John Mixon (Jan. 24, 2008, 12:17 CST) (on file with author).

14. SANDBURG, supra note 1, at 85.
The matter of deficiencies after foreclosure is important. A congressional report estimates that subprime mortgages alone will generate two million foreclosures.\footnote{Senator Charles E. Schumer & Rep. Carolyn B. Maloney, Joint Econ. Comm., 110th Cong., The Subprime Lending Crisis: The Economic Impact on Wealth, Property Values and Tax Revenues, and How We Got Here, Report and Recommendations by the Majority Staff of the Joint Economic Committee I (Oct. 2007), http://jec.senate.gov/index.cfm?FuseAction=Reports.Reports&ContentRecordid=C6627BB2-7E9C-9AF9-7AC7-32B94D398D27 (follow the “The Subprime Lending Crisis” hyperlink) (“For the period beginning in the first quarter of 2007 and extending through the final quarter of 2009, if housing prices continue to decline, we estimate that subprime foreclosures alone will total approximately 2 million.”).} House values in some parts of the United States have dropped dramatically, and many distressed owners find it virtually impossible to sell at prices anywhere near their mortgage debt.\footnote{See, e.g., Michael M. Grynbaum, Home Prices Sank in 2007, and Buyers Hid, N.Y. Times, Jan. 25, 2008, at CS; Les Christie, Double-Digit Home Price Drops Coming, CNNMoney.com, Sept. 19, 2007, http://money.cnn.com/2007/09/19/real_estate/steep_home_price_drops_coming/index.htm (warning of a twenty-five percent drop in Stockton, California).} If two million foreclosures produce an average of twenty thousand dollars deficiency each, the lingering liability could total forty billion dollars. Even if actual judgments or collection efforts reach only one-tenth of that amount,\footnote{Not all foreclosures will produce deficiencies. Some will be subject to state limitations on deficiency. Some lenders will not pursue deficiencies for economic reasons.} four billion dollars is still a big hit on that part of society that has just been through financial disaster and is least able to pay. Moreover, the liability is formal, but not real. The borrowers will not pay because they have few, if any, assets to attach in satisfaction of the judgment. The only recovery in most cases will be the pittance professional bill collectors extract.

The subprime meltdown has illustrated an indisputable fact: home mortgage lenders and secondary market purchasers, not borrowers, bear the unassignable cost of a market crash in real estate. It is appropriate that they do. As allies and enablers of the professional housing industry, lenders advertise their services, promote the values of home ownership, and create an image that they know what they are doing and that they are worthy of trust.\footnote{See Louise Story, No Lull in Mortgage Pitches, N.Y. Times, Feb. 18, 2008, at Cl. For example, “Bank of America says ‘Homeownership is the best medicine.’} Their profit comes from

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  \item[15.] Senator Charles E. Schumer & Rep. Carolyn B. Maloney, Joint Econ. Comm., 110th Cong., The Subprime Lending Crisis: The Economic Impact on Wealth, Property Values and Tax Revenues, and How We Got Here, Report and Recommendations by the Majority Staff of the Joint Economic Committee I (Oct. 2007), http://jec.senate.gov/index.cfm?FuseAction=Reports.Reports&ContentRecordid=C6627BB2-7E9C-9AF9-7AC7-32B94D398D27 (follow the “The Subprime Lending Crisis” hyperlink) (“For the period beginning in the first quarter of 2007 and extending through the final quarter of 2009, if housing prices continue to decline, we estimate that subprime foreclosures alone will total approximately 2 million.”).
  \item[17.] Not all foreclosures will produce deficiencies. Some will be subject to state limitations on deficiency. Some lenders will not pursue deficiencies for economic reasons.
  \item[18.] See Louise Story, No Lull in Mortgage Pitches, N.Y. Times, Feb. 18, 2008, at Cl. For example, “Bank of America says ‘Homeownership is the best medicine.’
lending to borrowers who know little about the details of land finance. Lenders, not borrowers, make the biggest investment when they provide up to 100% of the home purchase price. When the housing market goes up, lenders and housing providers profit by lending more money and selling more houses. When the market goes down, mortgages go into default, foreclosures occur, and lenders and housing providers lose.

Lenders cannot really shift foreclosure losses to borrowers because borrowers, as a class, do not have the financial capability to bear them. In a general economic decline, borrowers lose their down payments, good credit histories, and the security of the places they live. Deficiency judgments and aggressive debt collection after foreclosure do not transfer that loss; they make the loss greater. Deficiency exposure after home mortgage foreclosure is haphazard. Some mortgage lenders forgo pursuit of deficiency because judgments are not worth the hassle.

Also, the National Association of Realtors is running national television ads saying there has never been a better time to buy a home.” Id.

19. See James Grant, Op-Ed., Paying the Price for the Fed’s Success, N.Y. TIMES, Jan. 27, 2008, at 16 (commenting on the tendency of “profit-seeking people to take on more financial risk” and to lend and borrow more when the economy is stable). Until recently, the U.S. economy has enjoyed a relatively peaceful and stable period. Id. But, this stability led to risky behavior, which has proven to be dangerous in today’s market. Id. Housing providers and lenders may also suffer from consumer reluctance to enter the housing market that carries a downside of lingering liability after foreclosure. An Associated Press-AOL poll shows that a majority of potential buyers are reluctant to enter the market for fear that prices will continue to fall. See Majority Not Buying Homes, Poll Shows, CNNMONEY.COM, Apr. 14, 2008, http://money.cnn.com/2008/04/14/realestate/housing-crisis.ap/index.htm?postversion=2008041411.

20. U.S. DEP’T OF HOUS. & URBAN DEV., PROVIDING ALTERNATIVES TO MORTGAGE FORECLOSURE: A REPORT TO CONGRESS 126-27 (1996) (mentioning deficiency judgments, but rarely touching the downside of them). The benign report focuses on protective legislation to prevent deficiency abuses, then shifts to an allocation of risk of market decline. The report implies that deficiencies are used against investors, repeat defaulters, and non-hardship cases, and states that deficiencies are rarely pursued in practice. Id.

21. Texas lenders almost always employ deeds of trust that employ nonjudicial foreclosure without redemption after sale. Local foreclosure specialists agreed that few lenders today are pursuing claims to the point of deficiency judgments after foreclosure. One law firm specializes in foreclosures and charges high volume clients $500 to $750 to obtain (probably uncontested) deficiency judgments after
(FHA)\textsuperscript{22} and U.S. Department of Veterans Affairs (VA)\textsuperscript{23} have policies of substantial forbearance and waiver of deficiencies. Freddie Mac currently does not pursue collection on hardship homeowner foreclosures, but it does pursue investors.\textsuperscript{24} Various private lenders and private mortgage insurance companies pursue deficiencies aggressively where not limited by state law.\textsuperscript{25} While some states

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A principal in that firm reports that, contrary to practices in the 1980s when lenders automatically pursued deficiency liability, many lenders now bid the full debt plus attorneys' fees as a matter of course, eliminating deficiency entirely. The reason given was that deficiencies create more hassle than they are worth, taking into account the additional legal fees, potential bankruptcy filings, and contested hearings on market value to determine the amount of deficiency. Telephone Interview with Michael C. Barrett (Member) and Tommy Bastian (Attorney), Barrett, Dafin, Frappier, Turner & Engel, LLP (Feb. 4, 2008) (Texas attorneys specializing in foreclosures statewide).

\end{quote}

22. FHA employs deficiency power against borrowers who commit fraud or display excess assets. The Assistant General Counsel for the Single Family Mortgage Division of FHA observed that if someone walked away from an FHA insured house after winning the lottery, deficiency would likely be pursued. In a case such as that posed in the survey of my class, there would likely be no action to recover deficiency. Veterans Affairs, on the other hand, at least in the local area, does not have organized collection procedures and seems to treat home purchase obligations as functionally nonrecourse. Those who were simply caught in an economic bind and have no excess assets are treated compassionately. Interview with Assistant General Counsel, Single Family Mortgage Division of the FHA, in Houston, Tex. (Feb. 6, 2008) (author promised confidentiality to interviewee).

23. Compassion may be involved in the U.S. Department of Veterans Affairs' policy of general forbearance from pursuing deficiencies on VA guaranteed loans. One regional office does not even maintain a record of deficiencies as collectible debt. The office must set up a debt account if a borrower wants to clear the default and qualify for another loan. Interview with Veterans Affairs Representative, in Houston, Tex. (Feb. 7, 2008) (author promised confidentiality to interviewee).

24. E-mail from Dean S. Cooper, Managing Associate General Counsel, Freddie Mac, to John Mixon (Feb. 4, 2008, 16:09 CST) (on file with author). Mortgage insurance companies have their own policies concerning deficiency collection for Freddie Mac mortgages. \textit{Id.}

25. A private mortgage insurance company lawyer indicated that his company pursues deficiency judgments in about thirty-five states where borrowers are not protected by local law. Telephone Interview with a Deficiency Collection Attorney, in Houston, Tex. (Feb. 11, 2008) (author promised confidentiality to interviewee). According to a Texas foreclosure specialist, an undetermined number of foreclosing lenders bid seventy-five to eighty percent of the debt, but do not take the next step of obtaining a deficiency judgment. Instead, they sell the unsatisfied claim at a deep discount to a “vulture fund,” a group that buys judgments at a deep discount and
disable mortgage insurers from suing homeowners for deficiency, other states prohibit home mortgage deficiencies entirely or use market value instead of foreclosure bid to calculate loss. Furthermore, some states provide time-consuming statutory redemption after foreclosure that encourages lenders to forgo or bargain away deficiency liability in exchange for speedy liquidation.

There seems to be no nationwide organizing principle to explain industry practices that are applied haphazardly from jurisdiction to jurisdiction, arbitrarily capturing one borrower in the deficiency net while letting others go. That may be about to change. Subprime

then uses pressure tactics to collect whatever it can from the debtors. Automatic pursuit of judgment would be more likely in states where judicial foreclosure is the norm and the cost for entering a deficiency judgment is minimal. The prospect of collecting is greater in states that protect few assets from levy and allow garnishment of wages. Some judgments are automatically satisfied if the debtor engages in a later real estate transaction in the county where the judgment is recorded. Title insurance companies and mortgage lenders will require satisfaction of outstanding judgments by debtors seeking to buy or sell real estate. Telephone Interview with Michael C. Barrett, Bastian Law Firm, in Houston, Tex. (Feb. 13, 2008).

26. See, e.g., N.Y. INS. LAW § 6503(g) (Consol. 2006); TEX. INS. CODE ANN. § 3502.106 (2007). New York law provides that “a mortgage insurer may not obtain a deficiency judgment against a borrower in the event of foreclosure.” N.Y. INS. LAW § 6503(g) (Consol. 2006). Texas law prohibits provisions that allow “subrogation rights or any other claim by the insurer against the borrower for a deficiency arising from a foreclosure sale of a single-family dwelling that is occupied by the borrower as the borrower’s principal residence.” TEX. INS. CODE ANN. § 3502.106 (2007).

27. See, e.g., CAL. CIV. PROC. CODE § 580(b) (2006) (shielding purchase money borrowers from deficiency after foreclosure).

28. See, e.g., TEX. PROP. CODE ANN. § 51.003 (2007). Adopted after the real estate crash of the 1980s, Texas Property Code section 51.003 enables foreclosed borrowers to prove fair market value of land sold at foreclosure instead of the sale price as a credit against debt. Id. The statute was likely drafted for the benefit of land developers and investors, not home mortgagors. They primarily benefit those borrowers who are knowledgeable and have the financial resources to pursue judicial action.

29. NELSON & WHITMAN, supra note 2, § 8.3 (listing California, Idaho, Nevada, New York, North Carolina, Oklahoma, South Carolina, South Dakota, Washington, Utah, and Georgia as providing significant homeowner protection).

30. One of the specialists interviewed said that when state law provides statutory redemption after foreclosure, the lender may bargain with the borrower for a voluntary release of redemption in exchange for immunity from deficiency. See Deficiency Collection Attorney, supra note 25.
failures may soon override lenders' current tendency to forbear in particular markets. When banks and mortgage insurance companies begin to fail, receivers and trustees will pursue all assets available to the failed institution, including deficiencies after foreclosure of home mortgage notes.\textsuperscript{31}

There is a reasonable way to eliminate the haphazard application and magnification of inevitable deficiency loss: insulate home mortgage borrowers from deficiencies after foreclosure by reading mortgage documents anew and interpreting them as nonrecourse. This interpretation is based on a fundamental contract principle: contract obligation is based on consent.\textsuperscript{32} If borrowers have not consented to lingering liability after foreclosure, then it should not be imposed.

\textbf{B. Home Mortgage Borrowers Do Not Understand Recourse Liability and Deficiency After Foreclosure}

\begin{quote}
In the heels of the higling lawyers, Bob,

Too many slippery ifs and buts and howevers,

Too much hereinbefore provided whereas

Too many doors to go in and out of\textsuperscript{33}
\end{quote}

I begin with an outright declaration that virtually no home mortgage borrower who has not had (1) extensive professional training, or (2) prior experience as a foreclosed borrower, understands that home mortgages include the potential of a hovering judgment lien after foreclosure. This lack of understanding makes any pretense of consent pure rationalization. Law acts in complicity with lenders to

\textsuperscript{31} New pressure to collect on any available asset may come from nontraditional real estate entities, such as a "credit swaps market" involved in insuring credit obligations. \textit{See} Gretchen Morgenson, \textit{Arcane Market Is Next to Face Big Credit Test}, \textit{N.Y. TIMES}, Feb. 17, 2008, at A1.

\textsuperscript{32} The word "consent" is used here in a non-technical sense to distinguish contract obligation from obligation based on status. The technical term for consent for the purpose of contract liability is "manifestation of assent." \textit{Restatement (Second) of Contracts} § 3 (1981) ("An agreement is a manifestation of mutual assent on the part of two or more persons.").

\textsuperscript{33} \textit{Sandburg, supra} note 1, at 85.
commit virtual fraud when it imposes this consequence on home buyers without full disclosure and real, intelligent consent.\textsuperscript{34}

Most people understand that if they do not repay money borrowed to buy a refrigerator, car, house, or any other consumer good, the creditor will "repossess" the property and their credit will suffer. But a limited survey of friends and acquaintances, all college and professional school graduates, revealed that only the lawyers among them understood the potential for deficiency judgments after foreclosure, even though all were home owners.\textsuperscript{35} This discovery prompted me to do a more formal survey of an evening section of third-semester law students to see whether my hypothesis was correct.\textsuperscript{36}

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\textsuperscript{34} For a description of the role of intent in a related area, the extension of negotiable instrument law and liability to persons other than merchants, see Kurt Eggert, \textit{Held Up in Due Course: Codification and the Victory of Form Over Intent in Negotiable Instrument Law}, 35 CREIGHTON L. REV. 363, 381 (2002). "[I]nitially, bills of exchange were considered a part of a merchant's business, a specialized art for the businessperson, and alien to the life of the non-merchant. The binding legal effect of negotiability was limited, at least theoretically, to those few likely to understand the effects of negotiability." Id.

\textsuperscript{35} The informal and formal surveys included additional information that income tax law treats cancelled debt, whether by voluntary act or running of the statute of limitations, as ordinary income. For example, if the bid at foreclosure is $30,000 less than the debt, the borrower must either pay the deficiency or report the $30,000 as income if and when it is voluntarily released or becomes uncollectible by the statute of limitations. I.R.C. §§ 61(a)(12), 108 (West 2008). The potential income tax liability following home mortgage foreclosure came as a complete surprise to virtually all of the lay people surveyed and interviewed. If the debt is nonrecourse, income from debt cancellation would not apply. See John Mixon and Ira B. Shepard, \textit{Antideficiency Relief for Foreclosed Homeowners: ULSIA Section 511(b)}, 27 WAKE FOREST L. REV. 455, 467-69 (1992). For most home mortgage foreclosures, this income tax treatment was suspended by the Mortgage Forgiveness Debt Relief Act of 2007, Pub. L. No. 110-142, 121 Stat. 1803 (codified in scattered sections of 26 U.S.C.). The suspension was extended to January 1, 2013 by the Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, § 303(a), 122 Stat. 3765 (2008).

\textsuperscript{36} After students responded to the questionnaires, I polled the class to see what their backgrounds were. Thirty-two members of the class were homeowners, with an average age of thirty years old. Six students had jobs that included banking or some related professional field. Two class members learned about deficiency liability from friends or family whose work or personal experience had taught them about deficiencies. One student learned about deficiency judgments from research
\end{quote}
An open-ended questionnaire asked students to describe what they thought would likely happen in three successive time periods if they borrowed $200,000 to buy a house, but became disabled after one year and could not make monthly payments. The primary purpose of the question was to see whether answers indicated any general awareness of lingering liability after foreclosure.

Only four of the forty-seven respondents clearly identified continuing liability for deficiency as something they would connect with foreclosure. Later inquiry revealed that six additional students understood the prospect of deficiency liability, but did not think to record it on the open-ended questionnaire. The remainder of the class indicated they regarded the debt as satisfied by foreclosure, which forty out of forty-seven identified as a likely event. Eighteen specified that their credit would be harmed. What was surprising was that twenty-seven students, more than half, identified personal bankruptcy as an acceptable strategy to satisfy the debt. It is not clear what necessity they thought would drive them to bankruptcy, but they were clearly ready to take the cleansing bath.

A specific question asked whether the FHA or private mortgage insurance would have any effect on their answers. Of twenty-eight respondents, fifteen believed that mortgage insurance would protect them from loss, while thirteen understood that mortgage insurance policies protect lenders, not borrowers. A second round of multiple-choice questions reinforced that deficiency liability did not come into their contemplation.

on the Internet. These nine respondents claimed to understand recourse debt and probably accounted for all of the unambiguously correct answers.

37. Students may, however, have intuited the operation of the Texas statute prohibiting mortgage insurance companies from pursuing homeowners for deficiencies. See TEX. INS. CODE ANN. § 3502.106 (2007).

38. The second set posed true/false statements based on the same set of facts. Only one alternative was clearly true: that the borrower would be exposed to ten years of liability to seizure and sale of non-exempt assets. Only ten respondents correctly selected the one correct deficiency judgment alternative. I infer, though without proof, that this group included the six who had professional experience and understood the lawspeak analysis and the four who had information from family or friends with such knowledge. Twenty-four of the forty-seven multiple choice questions contained an additional fact statement, namely that the borrower had bought a policy of mortgage insurance as required by the lender, and a sixth true/false statement that the mortgage insurer would make the mortgage payments so
I concluded that my hypothesis was true: layspeakers, even those who have bought houses and endured two semesters of law study, do not understand the nature of recourse home mortgage debt and they do not associate foreclosure with lingering liability. Lawspeakers, by contrast, do. Lawyers understand that contract law treats parties categorically either as competent or not competent. Unless underage or mentally deficient, these supposedly autonomous, rational borrowers are responsible for knowing or learning the content and legal effect of even the most complex agreements they sign. Apart from relieving defrauded parties from their contracts and providing timid supervision of unconscionable contracts, law takes little account for the fact that lenders are advised by professionals with perfect information and perfect understanding of the content and legal consequences of recourse mortgage debt. Furthermore, lenders package nonnegotiable mortgage terms in complex, lengthy, and intimidating documents that only a professional can understand.

How can the law hold borrowers to obligations they did not understand, and that are not understood in the borrower’s general community? Do judges really think people consent to such liability by signing mortgage documents, or is deficiency liability simply imposed long as the borrower was disabled. Fifteen of the twenty-four respondents erroneously thought mortgage insurance protected the homeowner.

39. But the students’ views of reality are close to truth. In Texas, at least, deficiency judgments following foreclosure are currently so rare as to be virtually irrelevant. See supra notes 21, 25, and 26.


41. Restatement (Second) of Contracts § 15 (1981); 5 Richard A. Lord, Williston on Contracts § 10:8 (4th ed. 1990). There is no claim that the home mortgage borrowers under discussion in this paper are not fully competent in law. The claim is that otherwise fully competent parties do not understand and do not consent to lingering liability after foreclosure.

42. See Restatement (Second) of Contracts § 154(b) (1981) (assigning the risk of mistake to a party who “is aware, at the time of contract, that he has only limited knowledge with respect to the facts to which the mistake relates but treats his limited knowledge as sufficient”); James B. Hughes, Jr., Taking Personal Responsibility: A Different View of Mortgage Antideficiency and Redemption Statutes, 39 Ariz. L. Rev. 117, 141 (1997) (advancing this view as a moral imperative: “The relevant question is whether we have the moral backbone to hold each competent adult responsible for the choices she makes”).
through raw and arbitrary power that instinctively, but unconsciously, favors lenders?

C. Home Mortgage Borrowers Neither Consent Nor Manifest Consent to Recourse Liability for Deficiency After Foreclosure

Why is there always a secret singing
When a lawyer cashes in?
Why does a hearse horse snicker
Hauling a lawyer away?43

As defined by common usage (and by the dictionary), assent implies personal agreement after thoughtful consideration.44 But this lay notion of subjective consent does not determine legal obligation. Contract doctrine long ago adopted a rule that holds people to what reasonable third parties would infer from their actions.45 This policy protects the reliance interest of both contracting parties, who obviously cannot see inside the heads of others and must therefore respond to appearances of, or apparent, consent.

The "objective" theory of contract imposes obligation on parties who manifest assent to a contract.46 The manifested assent rule tells us that signing a mortgage and note implies consent to lingering deficiency liability if an observer would infer that understanding from the words in the documentation and the transaction itself.47 Here is

43. SANDBURG, supra note 1, at 85.
44. WEBSTER’S II NEW COLLEGE DICTIONARY 69, 245 (3d ed. 2005) (defining assent as derived from Latin roots “assentari: ad-, toward + sentire, to feel. To express agreement: CONCUR. –n. 1. Agreement, as to a plan or proposal. 2. Acquiescence: consent); Id. (defining consent as derived from Latin roots “consentire, to agree: com-, together + sentire, to feel. 1. To give assent: AGREE. 2. Archaic. To be of the same mind or opinion.–n. 1. Voluntary allowance of what is planned or done by another: PERMISSION. 2. Agreement and acceptance as to opinion or a course of action”).
45. See 1 ARTHUR LINTON CORBIN, CORBIN ON CONTRACTS § 4.12 (Joseph M. Perillo ed., rev. ed. 1993) (“[T]hey are bound in accordance with the meaning that reasonable third parties would give to their expressions without regard to the meaning given by either of the parties themselves.”).
47. See CORBIN, supra note 45.
where law fudges. Law does not admit it, but the meaning (this time a meaning constructed by the observer) is still subjective. A truly “objective” observer would infer assent only if parties used language that transcends (is common to) both the lay and legal community. This is a language set of allspeak that contains both layspeak and lawspeak. But if there is no allspeak, and lay observers and law observers speak different languages; there is no single “objective” interpretation or “meaning” that can be assigned to the manifestations.

The necessary conclusion is that, when we look for a hypothetical observer, we find two types: lay observers and law observers. We must choose one over the other to determine whether signing the note and mortgage manifested assent to recourse obligation.

1. Lay Observers Interpret Home Mortgage Loans as Nonrecourse

The lay interpretation of the mortgage transaction would mirror the lay community’s understanding that home mortgagors assent to “repossession” and credit score reduction if they cannot make their payments, but not more. A lay observer therefore infers neither consent nor manifested assent by a borrower to the hovering judgment for deficiency after foreclosure. However, the issue cannot be so simply dismissed because the legal system unquestionably holds recourse debt mortgagors liable for deficiency, absent state law restriction.

2. Law Imposes Recourse Obligation on Home Mortgage Borrowers

If the community interpretation of obligation is not authoritative, does law impose deficiency liability by simple authoritarian will? Not necessarily. An alternative assent analysis would hold that the lay mortgagor blindly agreed to whatever law imposes if he or she submits voluntarily to the transaction itself. But this analysis circles back to whether the borrower assented to recourse debt, on the one hand, or nonrecourse debt on the other. The legal consequences are different for the two transactions. Thus, even by lawspeak, the inquiry is led back to the different interpretations by lay and law observers.

Traditionally, lawspeak interprets the transaction and its documentation as manifesting the borrower’s assent to both
foreclosure and deficiency, with the result that borrowers are bound legally and, by some observers, even morally.\footnote{48} This is fair enough if the mortgagor is a member of the lawspeak community; for example, a professional land developer who certainly knows the difference between recourse and nonrecourse financing. But it is not at all clear that the lawspeak interpretation should bind a lay mortgagor who is not a member of that community.\footnote{49}

3. Trade Usage Analogy Implies that Layspeak, not Lawspeak, Should Govern Liability

To a lay mortgagor, liability imposed by lawspeak is as obscure and unknowable as if it were a foreign language. In analogous situations, the Uniform Commercial Code (UCC)\footnote{50} and contract law\footnote{51} acknowledge that words can have special trade meanings that bind members of the trade, but not people outside the trade.\footnote{52} This implies that the meaning to be applied to the mortgage transaction should be that of the community at large, and not the trade usage (lawspeak),


\footnote{49. See, e.g., RESTATEMENT (SECOND) OF CONTRACTS § 211 (1981) (providing special rules for standardized agreements, such as the mortgage documents: section two favors interpreting such agreements as “treating alike all those similarly situated, without regard to their knowledge or understanding of the standard terms of the writing,” and section three implies that if the lender has reason to believe the borrower would not assent if he knew that the writing contained a particular term (i.e., recourse liability), the term is not part of the agreement). Home mortgage borrowers and lenders are not similarly situated, and the lender should know that the borrower does not understand recourse liability. Whether the borrower would nevertheless enter into the agreement is unknown for particular cases.}

\footnote{50. U.C.C. §§ 1-206, 2-208 (2004). The U.C.C. does not apply to real estate transactions and real estate mortgages, only to the sale of goods. U.C.C. §§ 2-102, 2-105 (2004).}

\footnote{51. RESTATEMENT (SECOND) OF CONTRACTS § 220(1) (1981) (favoring interpretation in accordance with a relevant usage if each party knew or had reason to know of the usage and neither party knew or had reason to know that the meaning attached by the other was inconsistent with the usage).}

\footnote{52. See, e.g., Flower City Painting Contractors, Inc. v. Gumina Constr. Co., 591 F.2d 162, 164-65 (2d Cir. 1979) (holding that a newcomer to the painting business is not bound by a trade usage definition of “units”).}
unless the borrower is a member of the lawspeak community. By contrast, an investor who used home mortgage financing to buy property to "flip" or rent has entered the lawspeak arena and can reasonably be held to its interpretations.

4. Law Holds Lay Parties Responsible for Learning the Lawspeak Meaning of Contract Terms

Lenders and lawyers have an answer to the trade usage analogy: if the mortgagor does not totally understand all of the terms of the deal, then he or she is responsible for seeking professional help to explain them. This assignment of responsibility assumes the mortgagor is an autonomous, free will agent with reasoning power to comprehend not only what he or she does not understand, but also that he or she does not understand.

In reality, if a mortgagor asked a lawyer for representation in a home mortgage transaction, the lawyer would check the closing figures, check the interest rate, and look at the documents to see whether they fit the standard practice forms. But not many real estate lawyers would advise the client about the very basic fact of deficiency liability in event of default.

53. Restatement (Second) of Contracts § 154(b) (1981) (stating that a party bears the risk of a mistake when he is aware, at the time the contract is made, that he has only limited knowledge with respect to the facts to which the mistake relates but treats his limited knowledge as sufficient). This is a catch-22 if it is applied to a party who does not realize that he or she does not understand.

The notion that mortgagors should understand the transaction well enough to know when to seek expert advice assumes that both borrowers and lenders function in an objectivist world of stable categories of fact that can be comprehended by any observer. If such a world does not exist, and if all human understanding is personal and subjective, limited to what goes on inside individual brains, then the underlying logic of that proposition crumbles. This article adopts the latter assumptions, supported by current linguistic and brain science, and rejects the objectivist position that knowledge of a stable, coherent reality is accessible to everybody who looks. Even if the standard for personal responsibility is expanded to include what is known within the borrower’s community, recourse liability on home mortgage loans is still not known or consented to for the reason that the borrower’s own community does not so understand it.

6. Recourse Liability Is Imposed by Fiat, Not Consent

An admission that deficiency liability is based on raw, authoritarian power would suggest that law and lenders have simply ganged up on unsuspecting borrowers. Accordingly, lawspeakers will retreat to their consent model and read the promissory note and mortgage as a logical and grammatically correct statement that the mortgagor absolutely undertook to repay the entire debt or submit to deficiency. Lawspeakers will say the borrower’s consent to the transaction itself invoked the full traditional legal obligation of recourse liability.

This exercise produces a satisfactory justification in lawspeak. But if layspeak, the language of the community, reads the documents

56. See id.; James B. Hughes, supra note 48, at 148 (Hughes appears to believe in such a world, but even he would require disclosure of the fundamental terms of the deal); Stanley Fish, Almost Pragmatism: Richard Posner’s Jurisprudence, 57 U. Chi. L. Rev. 1447, 1448-49 (1990) (reviewing Richard A. Posner, The Problems of Jurisprudence 7, 31-32 (Harvard 1990) and analyzing Posner’s discussion of objectivity).
differently, the document is ambiguous. 57 Special rules then apply that justify, if not compel, application of the lay meaning—nonrecourse debt. 58

II. A Fresh Look at Mortgage Documentation Justifies Interpreting Home Mortgage Debt as Nonrecourse.

As a prediction, any judge would dismiss a borrower’s defense to deficiency based on lack of consent. But what would happen, even in lawspeak, if the transaction and the documents were looked at anew? The answers may be surprising.

A. Standard Mortgage Documents Are Confusing and Ambiguous

The language problem is not lack of formalistic disclosure of the terms of the home loan itself. 59 Virtually all home mortgage transactions provide borrowers with disclosure statements that spell

57. See Taylor v. State Farm Mutual Auto. Ins. Co., 854 P.2d 1134, 1144 (Ariz. 1993). “The judge . . . must avoid the often irresistible temptation to automatically interpret contract language as he or she would understand the words. This natural tendency is sometimes disguised in the judge’s ruling that contract language is ‘unambiguous.’” Id. at 1139; see also CORBIN, supra note 45, § 543A. “Words, however, are seldom so clear that they ‘apply themselves to the subject matter.’ Thus, ambiguity determined by the judge’s view of ‘clear meaning’ is a troublesome concept that often obstructs the court’s proper and primary function in this area—to enforce the meaning intended by the contracting parties.” Id. In determining the “intention of the parties” the court must look at the issues referenced infra note 58.

58. RESTATEMENT (SECOND) OF CONTRACTS § 20(2) (1981) (making the understanding of the borrower operative if (a) the borrower did not know of any different meaning attached by the lender, or (b) the lender has reason to know the borrower’s meaning does not contemplate deficiency liability, and the lender has reason to know of the borrower’s meaning).

59. The Real Estate Settlement Procedures Act (RESPA) does not, however, mention deficiency liability. Instead, it presents an optimistic picture that the borrower in default may work out a settlement that can include a deed in lieu of foreclosure. It does not clearly explain that failure to work out the arrangement will result in deficiency. See U.S. Dep’t of Hous. and Urban Dev., RESPA—Real Estate Settlement Procedures Act, http://www.hud.gov/offices/hsg/sfh/res/respa_hm.cfm (last visited Feb. 20, 2008).
out the full terms of their loans in layspeak. But the consequence of lingering liability after foreclosure, which can be far worse than a misstated interest rate, is not disclosed (and perhaps cannot be disclosed meaningfully). Even the standard documents prescribed by secondary market purchasers with close affiliation with the federal government are misleading and subject to interpretation as nonrecourse obligation, as judged by both lawspeak and layspeak. These documents dominate the field, and their uniform covenants apply throughout the United States’ mortgage market.

60. Disclosures are even clearly written, for the most part, in layspeak, and a super-competent lay observer could figure out the actual interest rate, terms of payment, and so on, but they do not ordinarily disclose the lingering liability of deficiency after foreclosure. An article that is sympathetic to the interests of subprime borrowers calls for full disclosure, but does not mention disclosure of the prospect of deficiency liability. See Cassandra Jones Havard, *Democratizing Credit: Examining the Structural Inequities of Subprime Lending*, 56 Syracuse L. Rev. 233, 266-67 (2006).


62. The Note and Security Instrument examined for the article were specialized to Texas. Fannie Mae/Freddie Mac, Form 3044: Texas Deed of Trust (n.d.) [hereinafter Form 3044], available at http://www.freddiemac.com/uniform/unifsecurity.html#highlights (follow “Form 3044: Texas Deed of Trust” hyperlink). To validate the claim that the provisions apply generally, I looked at posted forms for Alabama, California, District of Columbia, Florida, Illinois, Louisiana, Massachusetts, Michigan, Missouri, New Jersey, New York, Ohio, Pennsylvania, Washington, and Wisconsin. All forms contained the Uniform Covenants referred to in the article, such as the “in addition to” language in the promissory note, the “secures . . . repayment” clause, and the “excess, if any” provision in the security instrument. See Freddie Mac, Security Instruments, http://www.freddiemac.com/uniform/unifsecurity.html#highlights (last visited Feb. 20, 2008) (providing security instruments from different states). New York documents could be said to give more notice of lingering liability, but they stop short of spelling out the deficiency judgment consequence of failure to pay. The New York Security Instrument declares that after conveyance, “I will still be fully obligated under the Note and under this Security Instrument unless Lender agrees to release me, in writing, from my obligations,” along with a more specific indication of personal liability in paragraph thirteen. Fannie Mae/Freddie Mac, Form 3033: New York Mortgage 13 (n.d.) [hereinafter Form 3033], available at http://www.freddiemac.com/uniform/unifsecurity.html#highlights (follow “Form 3033: New York Mortgage” hyperlink). At best, though, the New York provisions leave the documents as ambiguous as interpreted by a lay observer.
B. Fannie Mae/Freddie Mac Documents Can Be Interpreted as Recourse or Nonrecourse

Fannie Mae’s standard real estate security forms consist of two documents: a promissory note and a security instrument, discussed herein in its form as a Deed of Trust. These mortgage forms are drafted to fit requirements of secondary market purchasers with close ties to federal monetary and housing policy and carry uniform covenants that apply virtually throughout the United States. One must therefore assume the forms carry some credibility. What the forms do not contain is information about recourse debt sufficient to inform a lay observer (or even a law observer outside the specialty) of the full consequence of default.

1. In Lawspeak, Fannie Mae/Freddie Mac Home Mortgage Debt Is Recourse, with Deficiency Liability

In paragraph one, the Promissory Note (FM Note) contains an unconditional promise that the borrower will repay the principal amount borrowed, plus interest. It also states that if, at maturity, amounts are still owed, the borrower will pay those amounts. The FM Note is made to the order of the lender, it is in writing, and it is signed by the maker. Accepting (for the moment) lawspeak’s assessment that the promise to repay the debt is unconditional, the FM Note appears to satisfy the formal requirements of recourse obligation and negotiability. Accordingly, a secondary market purchaser who takes

63. See Ronald J. Mann, Searching for Negotiability in Payment and Credit Systems, 44 UCLA L. REV. 951, 971 (1997) (“Fannie Mae and Freddie Mac have promulgated a number of standard forms for use in those transactions. Transactions that do not use those forms are not eligible for repurchase by Fannie Mae or Freddie Mac. Accordingly, although a significant number of home-mortgage notes are not securitized for various reasons, the Fannie Mae/Freddie Mac forms dominate the market, even for transactions in which the lender does not contemplate an immediate sale to Fannie Mae or Freddie Mac.”).


65. See U.C.C. § 3-104 (2000); Ronald J. Mann, supra note 63 at 971-72 (suggesting that the borrower’s right to prepay in the FNMA/FHLMC single family
delivery of the note before maturity, for value, without notice, and by endorsement expects to qualify as a holder in due course who is entitled to enforce the obligation fully without regard to personal defenses to payment. If that were the entire transaction, there would be no question but that the maker of the note was obligated to repay the entire amount, at least by lawspeak. But that is not all the FM Note says. Paragraph ten states:

In addition to the protections given to the Note Holder under this Note, a Mortgage, Deed of Trust, or Security Deed (the ‘Security Instrument’), dated the same date as this Note, protects the Note Holder from possible losses which might result if I do not keep the promises which I make in this Note.

As interpreted by lawspeakers, the security instrument simply adds a pledge of the land to the obligation imposed in the note ("in addition to"), and does not diminish, replace, or require the lender to forego the absolute obligation stated in the note. To a lawspeaker, the words "in addition to" would refer to the mortgage document without incorporating it by reference, which would impair negotiability.

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67. FORM 3200, supra note 64, at 2.
68. See generally Baker v. Gardner, 770 P.2d 766, 775 (Ariz. 1988) (explaining that a creditor can elect to forego foreclosure and sue on the note in all cases except those involving the mortgages and deeds of trust to which the anti-deficiency statutes apply).
69. See Sturgis Nat. Bank v. Harris Trust & Savings Bank, 184 N.E. 589, 592 (Ill. 1933) ("The reference to another writing which will destroy the negotiability of an instrument, otherwise negotiable, must be of a kind which in some respect qualifies or makes uncertain or conditional the promise."); McGee v. First Nat. Bank of Ellsworth, 232 N.W. 336, 337 (Minn. 1933) ("The appellant contends that the recital that the note is secured by a mortgage destroys its negotiability. This recital in no way incorporates into the note the provisions of the mortgage, or any part thereof. Nothing is thereby added to the contract. We therefore hold that the instrument is negotiable.").
2. In LaySpeak, Fannie Mae/Freddie Mac Home Mortgage Debt Is Nonrecourse, With No Liability for Deficiency

Now consider the same language from the standpoint of a layspeaker, with the ultimate question "to what did the borrower manifest assent?"

The words "in addition to" appear to combine the promissory note and the mortgage and make them one. Just as one plus one produces a single referent "two," the note "in addition to" the mortgage combines the two documents into a single agreement. This lay reading would impair negotiability and negate the privileged holder in due course status. As developed below, reading the two documents together implies nonrecourse debt.

Apart from the favored position the law gives to negotiable instruments, the words would probably incorporate the mortgage by reference, even in lawspeak. The reference is sufficient to make the two documents contemporaneous agreements for Statute of Frauds and parol evidence rule purposes, and to some extent they must be read as one. The mortgage file that contains both documents is likely to be in the physical custody or legal control of the secondary market purchaser who is therefore on notice of the existence and terms of both.


73. See Restatement (Second) of Contracts § 132 (1981); Crabtree v. Elizabeth Arden Sales Corp., 110 N.E.2d 551, 553 (N.Y. 1953).

74. See Luck v. Wood, 132 S.E. 178, 178 (Va. 1926) ("Where two papers are executed at the same time, or contemporaneously between the same parties, in reference to the same subject matter, they must be regarded as parts of one transaction and receive the same construction as if their several provisions were in one and the same instrument.") (quoting Portsmouth Refining Co. v. Oliver Refining Co., 64 S.E. 178, 178 (Va. 1909)).

75. See Nelson & Whitman, supra note 2, § 5.28. "[I]f a negotiable note is involved[,] the note must be physically transferred into the hands of the person who is gaining the right to enforce it. The use of a separate document of assignment is not necessarily objectionable, but it cannot substitute for delivery of the note." Id.
To the lay reader, "in addition to" implies that the note and the deed of trust are of equal dignity, and the pledge of land acts as the performance equivalent of enforcing the promise. The FM Note states "the Deed of Trust . . . protects the Note Holder from possible losses which might result if I do not keep the promises which I make in this Note." This provision specifically anticipates the potential of nonpayment and implies that foreclosure sale perfectly "protects the Note Holder from losses which might result if the borrower does not keep the promises which I make in this Note." Even if a lawspeaker quibbled about this interpretation, it is hard not to accept it as a possible and reasonable one. Consider a contract whereby:

I promise to deliver a cow named Rose to a buyer, and in addition, if I do not deliver that cow, then to protect the buyer from possible losses which might result if I do not keep that promise, the buyer can pick out and take any cow in my pasture.

It would appear to a layspeaker and, even to most lawspeakers, that the two performances are alternative, not cumulative. If I default, the promissee can pick a cow from my pasture. That is an alternative performance, and I do not owe another cow. The obligation has been satisfied.

If we can read the promissory note to say the borrower will pay as provided in the note, or, in the alternative, the lender can do what the deed of trust provides, we must read the deed of trust closely to see what it says to a lay reader.

3. The Note and Security Instrument Read as Contemporaneous Documents, Reinforce Layspeak Interpretation as Nonrecourse

In paragraph one, the Deed of Trust refers to the Note and restates the borrower’s obligations. It does not negate the lay reader’s alternative performance interpretation. Instead, it states:

76. FORM 3200, supra note 64, at 2.
77. Id.
78. FORM 3044, supra note 62.
79. Id. at 3.
This Security Instrument secures to Lender: (i) the repayment of the Loan, and all renewals, extensions and modifications of the Note; and (ii) the performance of Borrower’s covenants and agreements under this Security Instrument and the Note. For this purpose, Borrower [conveys the land to the Trustee] . . .

To lawspeakers, the word “secures” is associated with an entire activity of pledging property as collateral that can be sold on default, with proceeds applied to the debt without discharging the debt beyond the proceeds realized.81

To layspeakers, the word “secures” can have an entirely different meaning. Webster’s II College Dictionary82 defines “secure” in verb transitive form as:

1. To guard from danger, harm, or risk of loss. 2. To make tight or firm : FASTEN. 3. To make certain : GUARANTEE. 4. To make a pledge on (e.g., a loan). 5. To gain possession of : ACQUIRE. 6. To bring about : EFFECT.

As an objective observer, the layspeaker must acknowledge that the deed of trust secures protection to the lender (not the borrower). But what does the security instrument “secure” to the lender?

80. Id. There are variations in the language of documents specialized to individual states. For example, Form 3018, the Kentucky Mortgage, states: “This Security Instrument secures 150% of the principal amount of the Note, but any amount secured in excess of the amount stated in the second sentence of this paragraph must be a ‘Protective Advance’ as defined by Section 26 hereof (or, if the rate of interest is adjustable, may be interest added to principal, commonly called ‘negative amortization’).” FANNIE MAE/FREDDIE MAC, FORM 3018: KENTUCKY DEED OF TRUST 1 (n.d.) [hereinafter FORM 3018], available at http://www.freddiemac.com/uniform/unifsecurity.html#highlights (follow “Form 3018: Kentucky Deed of Trust” hyperlink).

81. This characterization adopts Wittgenstein’s insight that words do not refer to reality, and language is learned as a game from infancy, and meaning comes from community members’ associating words with activities, not things. LUDWIG WITTGENSTEIN, PHILOSOPHICAL INVESTIGATIONS 2, 3 (G.E.M. Anscombe, trans., 3d ed. 2001).

82. WEBSTER’S II NEW COLLEGE DICTIONARY, supra note 44, at 1022.
a. Guards the Lender From Risk of Loss

By definition one in Webster's II College Dictionary, the instrument itself (and the rights created) guards the lender from danger, harm, or risk of loss. By definition three, the instrument makes the lender certain of protection by guaranteeing repayment of the loan. These interpretations imply that the pledge itself guards the lender from risk of loss, guarantees repayment, and makes performance certain. If the Deed of Trust guarantees performance, the lender has no need for deficiency, the pledge operates as an alternative performance of the note's obligation, and the borrower is released if the lender takes the property. The dictionary definition of the word "guarantee" nowhere suggests that a guarantor will seek recovery against the borrower.

b. Pledge

The word "pledge" in meaning four is defined by Webster's as "pawn." In layspeak, as in lawspeak, the word "pawn" commonly negates both the obligation to repay and the existence of a debt. This reasonable interpretation reinforces the lay understanding that home mortgage debt is nonrecourse. Moreover, the fact that the mortgage document may be, and often is, called a "deed" (of trust) can imply in layspeak that the house has been conveyed, but will be returned if the debt is paid. The release provision of paragraph twenty-three is consistent with this layspeak interpretation. The dictionary definition does not even hint at a recourse outcome.

83. The Deed of Trust contains a Uniform Covenants paragraph by which in paragraph one, the borrower promises again to pay principal and interest when due. In paragraph three, the borrower promises to pay to the lender until the Note is paid in full, along with escrow and other items. Restating the promise adds nothing to what has already been discussed. See FORM 3044, supra note 62, at 3-5.

84. WEBSTER'S II NEW COLLEGE DICTIONARY, supra note 44, at 504.

85. WEBSTER'S II NEW COLLEGE DICTIONARY, supra note 44, at 867 (defining the verb transitive form of pledge "3. To deposit as security: PAWN"); see also 10 N.Y. JUR. 2d Banks § 976 ("Pawn tickets do not come within the categories of 'securities and printed evidence of indebtedness, for they are evidence not of debt, but of a right of redemption, or a bailment subject to a debt.").

86. FORM 3044, supra note 62, at 15.
c. But Not By Lawspeak

Real estate lawyers and lenders will blanche and fume at the lay reading. Yet, it is as reasonable as the lawspeak reading, and it undoubtedly reflects the intent and understanding of borrowers. If law imposes a different outcome by applying lawspeak to an ambiguous document, it does so by fiat,87 not by consent.

4. Failure to Disclose That Mortgage Insurance Does Not Protect Borrowers Amounts to Concealment

Paragraph ten of the Kentucky Deed of Trust refers at length to mortgage insurance, and states: “Mortgage Insurance reimburses Lender (or any entity that purchases the Note) for certain losses it may incur if Borrower does not repay the Loan as agreed. Borrower is not a party to the Mortgage Insurance.”88

Lawyers and lenders know that mortgage insurance is paid for by the borrower, but its purpose is to entice the lender to lend to this borrower with little money down.89 Mortgage insurance policies ordinarily claim a right of subrogation to pursue the borrower for deficiency for payments made to the lender under the policy.90 This is likely to be stated clearly in the policy itself. But our focus is not on what the mortgage insurance policy says. Instead, we focus on what the security instrument says.

87. WEBSTER’S II NEW COLLEGE DICTIONARY, supra note 44, at 423 (defining fiat as “Latin, Let it be done. 1. An arbitrary decree. 2. Authorization or sanction”).
88. FORM 3018, supra note 80, at 9.
90. Johnstone, supra note 89, at 801 n.69.
Everything is understood in context. The word "insurance" comes wrapped in context. The lender knows mortgage insurance ordinarily protects only the lender, but this may not be what the context says to a borrower. To a lay borrower, the word "insurance" means protection, which is also its dictionary definition. Merriam Webster's online dictionary defines "insurance" as "coverage by contract whereby one party undertakes to indemnify or guarantee another against loss by a specified contingency or peril;" and also "a means of guaranteeing protection or safety."

The contextual understanding for an ordinary layspeaker is that insurance protects the person who pays the policy premium. That is the case with fire insurance, auto insurance, liability insurance, life

91. It is elementary that words acquire meaning from and within the context in which they are used. The word "hot," for example, may imply something about temperature, stolen goods, sexiness, popularity, or a multitude of other references. See Martha Minow & Elizabeth V. Spelman, In Context, 63 S. CAL. L. REV. 1597, 1652 (1990) ("The reminder that we are all in context might lead to different understandings of who and what we are all about.").

92. See Rodman v. State Farm Mutual Ins. Co., 208 N.W.2d 903, 905-08 (Iowa 1973). Rodman adopted a "reasonable expectations" doctrine, stating "[t]he objectively reasonable expectations of applicants and intended beneficiaries regarding the terms of insurance contracts will be honored even though painstaking study of the policy provisions would have negated those expectations." Id. at 906 (quoting KEETON, INSURANCE LAW-BASIC TEXT § 6.3(a), at 351 (1971)); see also C. & J. Fertilizer, Inc. v. Allied Mutual Ins. Co., 227 N.W.2d 169, 176 (Iowa 1975) (quoting Rodman and applying the "reasonable expectations" doctrine).

93. See Kilmer v. Citicorp Mortgage, Inc., 860 P.2d 1165, 1168-69 (Wyo. 1993) ("Mortgage insurance protects a mortgagee when it loans money to what would normally be considered a higher risk mortgagor. . . . [F]ederal mortgage insurance is not an alternate mechanism for the repayment of defaulted loans which extinguishes a mortgagor's obligation thereon or its liability for a deficiency judgment. . . . Accordingly, the mortgagor was the insured party under the federal mortgage insurance policy.") (quoting Platte Valley Sav. by Resolution Trust Corp. v. Crall, 821 P.2d 305, 307 (Colo. App. 1991)). Statutes in New York and Texas specifically disable mortgage insurers from pursing deficiencies. See supra note 26.

94. For example, fifteen out of twenty-three of my students thought the words "as required by the lender, you bought a Mortgage Insurance Policy issued by a private insurance company" meant the borrower was protected from foreclosure when default was due to disability.

insurance connected with a loan, and the like. In this context, the mere term “mortgage insurance” is bound to generate unjustified expectations that the borrower who pays the premium is somehow protected by the policy. What is the policy for, if not to pay the mortgage if the borrower is disabled or loses a job?

A closer look at the mortgage insurance provision reinforces the borrower’s notion that the lender will not seek deficiency when it states, “Mortgage Insurance reimburses Lender . . . for . . . losses it may incur if Borrower does not repay the Loan as agreed.” This clear and simple statement implies there is nothing left of the obligation if the lender is reimbursed for losses it may incur if the borrower does not pay. Likewise, there is no hint that the mortgage insurer will turn on the borrower and demand payment of deficiency by way of subrogation.

What about the statement: “Borrower is not a party to the Mortgage Insurance”? First, it may not be true. If “party” means “in privity,” then the borrower is a party by the English definition as providing consideration for the insurer’s promise. The lender may be the one that is not privy if mortgage insurance is considered as a standalone contract. The lender can collect on the policy, but as a third party beneficiary, and not as one who provided consideration for the promises contained in the insurance contract. Saying the borrower

96. NAA Life offers such insurance, advertising, “What is Mortgage Life Insurance? Mortgage life insurance is life insurance that pays off your mortgage in the event of your death . . . . You can rest easy knowing that your family will never lose its home, even if the unthinkable should occur.” NAA Life, Homepage, http://www.naalife.com (last visited Feb. 20, 2008).
97. See supra notes 94-96 and accompanying text.
98. FORM 3044, supra note 62, at 9.
100. FORM 3044, supra note 62, at 9.
101. See CORBIN, supra note 45, § 779.
102. This is not the only analysis that could be made. The lender does provide consideration by making the loan that indirectly supports the insurer’s promise by requiring the borrower to buy the policy. See, e.g., Vogan v. Hayes Appraisal Assoc., Inc., 588 N.W.2d 420 (Iowa 1999) (holding that the lender had privity as promisee of a contract with an appraiser, and the borrower was third party beneficiary of the appraiser’s promise to monitor construction of a new house).
is not a party to the contract does not imply, even in lawspeak, that the borrower cannot benefit as third-party beneficiary. 103

What is inexcusable is that the documentation conceals its denial of benefits to the borrower behind lawspeak. The drafter of the mortgage undoubtedly intended that the borrower get no benefit from mortgage insurance. But stating the exclusion in lawspeak is a poor excuse for a simple statement that the borrower pays the premium but gets no benefit other than satisfying the lender’s condition for making the loan. Second, and even more crucial, why would the document not state clearly that, in event of default, the mortgage insurer may turn on the borrower and sue for deficiency, even though the borrower paid his or her premium? 104 If the documents were drafted by an entity with less affiliation with the U.S. Government, one might think a common crook had undertaken to defraud, mislead, or conceal the truth from the borrower.

5. Failure to Disclose the Prospect of Deficiency Liability After Foreclosure Amounts to Concealment 105

Given the difference between recourse and nonrecourse consequences, one would expect that a recourse mortgage document would at least use the term deficiency somewhere in the text or spell out the activity that creates it. The fact that the paradigm Security Instrument never uses the terms “recourse,” “deficiency,” or “liability after foreclosure” is not just misleading, it is outright deceptive. For

104. Johnstone, supra note 89, at 801 n.69.
105. See RESTATEMENT (SECOND) OF CONTRACTS § 161 (1981). The Restatement treats nondisclosure as misrepresentation, (b) where [a party] knows that disclosure of the fact would correct a mistake of the other party as to a basic assumption on which that party is making the contract and if non-disclosure of the fact amounts to a failure to act in good faith and in accordance with reasonable standards of fair dealing, or (c) where [a party] knows that disclosure of the fact would correct a mistake of the other party as to the contents or effect of a writing, evidencing or embodying an agreement in whole or in part, or (d) where the other person is entitled to know the fact because of a relation of trust and confidence between them. Id.
example, paragraph eleven\textsuperscript{106} allows the lender to apply funds from a total taking or insured loss against the debt. But it does not state in clear terms that the borrower remains liable for the debt if the proceeds are inadequate to satisfy it. Instead, the paragraph states that the excess, if any, will be paid to borrower.\textsuperscript{107} Failure to state what happens if the proceeds of sale are not sufficient to pay the debt or produce a surplus comes close to active concealment.

Paragraph twenty-two describes the lender’s right to have the property sold at foreclosure by the trustee. Nowhere does it state that the borrower remains liable for deficiency if the proceeds of sale are not sufficient to satisfy the debt. Instead, it optimistically states, “[t]rustee shall apply the proceeds of the sale in the following order: (a) to all expenses of the sale . . . ; (b) to all sums secured by this Security Instrument; and (c) any excess to the person or persons legally entitled to it.”\textsuperscript{108}

This is a crucial paragraph. It is the logical place for the document to state clearly that if the proceeds of sale are not sufficient to satisfy the debt, the borrower remains liable and subject to judgment for deficiency. But it does not say that. A lawyer or lender reading the paragraph with a contextual understanding of mortgage law does not even pause to note the absence of the critical warning, but a layspacker or even a lawyer whose practice does not include real estate would not infer liability for deficiency. Without that inference there is no consent. An observer would not infer recourse liability. Deficiency liability is therefore imposed by fiat, not by consent given after full disclosure.

California\textsuperscript{109} and Arizona\textsuperscript{110} prohibit or limit deficiency judgments against homeowners. The critical paragraphs of the California Security Instrument are identical to those examined herein, so virtually the same words create a nonrecourse loan in California

\textsuperscript{106} FORM 3044, supra note 62, at 9-11.

\textsuperscript{107} Id.

\textsuperscript{108} Id. at 15 (emphasis added).


\textsuperscript{110} ARIZ. REV. STAT. ANN. § 33-729(A) (Lexis Nexis 2007).
and a recourse loan in Texas. Of course, the California statute makes the difference, but a layspeak interpretation of identical documentation as nonrecourse is reasonable.

It is an overstatement to say that lenders commit intentional fraud by not revealing the full consequences of default. But the documents are intentionally chosen by the lender, they are misleading in that they conceal a critical fact, and the borrower presumably relies on what they say.

I do not suggest that lay mortgagors read the loan documents with a high degree of care, nor that, even if they did, they would comprehend the full lay meaning of the words. Even more to the point, it would do the borrower no good to read the documents because loan terms and documents are offered on a “take-it-or-leave-it” basis. But the “take-it-or-leave-it” lender should be held to the same terms it imposing on borrowers.\textsuperscript{111} A reasonable lay reader and a reasonable law reader could easily interpret the documents as providing (1) that the borrower promises to pay the debt, and (2) if the borrower defaults, then (3) the lender can foreclose and have the property sold to the highest bidder, with any excess going to the mortgagor. And that is the end of it. There is no continuing liability, no deficiency, no lingering judgment, and no need for bankruptcy.\textsuperscript{112}

The documents, standing alone, are not at all instructive as to the consequences of default. But surely, one might think, that with access to the Internet, all of those dangers can be discovered with the click of a mouse. However, one should not count on it. A net searcher who knows to search “deficiency” can find some references. But just searching websites that are maintained by lenders,\textsuperscript{113} loan guarantors and insurers, Mortgage Insurance Companies of America (MICA),\textsuperscript{114}

\begin{itemize}
  \item \textsuperscript{111} The Restatement (Second) of Contracts states that, “[i]n choosing among the reasonable meanings of a promise or agreement or a term thereof, that meaning is generally preferred which operates against the party who supplies the words or from whom a writing otherwise proceeds.” \textit{Restatement (Second) of Contracts} § 206 (1981).
  \item \textsuperscript{112} There is, however, possible liability for costs of foreclosure and for waste, even if the obligation itself is nonrecourse. \textit{See} Stein, \textit{supra} note 2.
  \item \textsuperscript{113} Countrywide Financial, Homepage, http://my.countrywide.com (last visited Feb. 20, 2008).
  \item \textsuperscript{114} MICA, \textit{supra} note 89. MICA’s website does state that the insurance does not provide a benefit to the borrower. It says nothing about deficiencies. \textit{Id.}
\end{itemize}
VA, HUD and FHA, secondary market purchasers, Fannie Mae, Freddie Mac, and Ginnie Mae, does not give quick access to the downside of foreclosure. Instead, these sites offer helpful hints about avoiding foreclosure, debt counseling, and similar trivia. They tout home ownership as a good thing. But where is the bad news? If it is there, I could not find it by a reasonable search.

6. Full Disclosure Could Shield Lenders from Legal Responsibility for Concealing Recourse Obligation

Words that make sense only in lawspeak do not and cannot enable lay brains to stumble toward rational decisions that take into account all of the downside of recourse liability. Disclosures, even if made, are ineffective to educate borrowers as to the consequences of recourse debt.

Nevertheless, disclosures (particularly those written in

119. Freddie Mac, Dos and Don’ts of Foreclosure, http://www.freddie mac.com/corporate/buyown/english/avoiding_foreclosure/dos_and_donts.html (last visited Feb. 20, 2008). Freddie Mac does mention the possibility that “[e]ven if the lender sells your property, you may still be responsible for the difference in the sale price and what you owe.” But it takes a while to navigate through the site to that statement. Id.
121. See U.S. GEN. ACCOUNTING OFFICE, supra note 61, at 88-98. The author of an article about disclosures in a medical setting states

[p]hysician-investigators face the daunting task of enrolling desperate patients into Phase I cancer trials that are not meant to be therapeutic. Patients doggedly regard the trials as therapeutic, and researchers tend to collaborate in their confusion by glossing the trial’s true purposes and noting the occasional benefit that subjects accidentally receive.

Matthew Miller, Phase I Cancer Trials: A Collusion of Misunderstanding, 30 HASTING CTR. REP. 4 (July-Aug. 2000). Home mortgage borrowers are equally blind to information about the deficiency downside of mortgage foreclosure, and equally
lawspeak) have an obvious strategic function of protecting lenders from claims of fraud. That function might prompt a rational lender to disclose the consequences of recourse liability; but there is not even a lawspeak disclosure in the standard mortgage documentation. At best, disclosure is partial and the most important part of all may be left out.

C. Fannie Mae/Freddie Mac Promissory Note and Security Instrument Are Ambiguous

1. How Should Ambiguity Be Addressed?

a. The Drafter May or May Not Have Intended to Impose Recourse Liability

Lenders may or may not\textsuperscript{122} intend to impose liability for deficiency after foreclosure, but absent statutory limitations, the standard mortgage transaction is widely assumed to impose recourse obligation with liability for deficiency after foreclosure. Accordingly, if we live in an objectivist, modern world in which reality is apparent and available to all of us, and if the content of the documents is tested by the “intent of the author,” the documents may impose liability for deficiency after foreclosure. But the world of human understanding is not objectivist, and the intent of the author is not controlling when a reader interprets a text.

b. Read Textually, the Documents do Not Impose Recourse Liability

Postmodern literary theory\textsuperscript{123} may not be worth much in ordinary legal discourse,\textsuperscript{124} but it undeniably has something to say about a

\textsuperscript{122} See supra notes 20-29 and accompanying text.


\textsuperscript{124} See, e.g., J. M. Balkin, Tradition, Betrayal, and the Politics of Deconstruction, 11 CARDOZO L. REV. 1613, 1625-30 (1990) (pointing out that deconstruction is a political practice, not a tool of legal analysis).
mortgagor's understanding of the deficiency question, and it is consistent with today's cognitive science.

We know only what our individual brains can understand by way of interpretation.\textsuperscript{125} The brain has some inherent capabilities, but everything we assume to understand has to be interpreted in the light of past private experience that has been recorded in our neural memory.\textsuperscript{126} All thought is physical and occurs within the body's neural system, mostly inside the skull.\textsuperscript{127} We can never know reality as truth; all we think we know is belief.\textsuperscript{128} Unless the potential of lingering liability is somehow lodged inside the borrower's brain, it simply has not been taken into account.

There is no mental "I" separate and apart from the physical brain, that acts as Descartes' thinker.\textsuperscript{129} Likewise, there is no transcendental reason that enables us to expand our knowledge of reality by reasoning from one abstract or foundational proposition to another.\textsuperscript{130} The lay mind may contain two schemas for loans—a payday loan and a pledge at the pawnshop. Reason does not say the obligation to pay a mortgage debt is like a promise to repay a payday loan, and not like a pledge of a guitar at the pawnshop. Failure to repay the payday loan may result in legal action, physical injury, or midnight phone calls; failure to redeem the pledged guitar means the pawnshop owner will keep it and sell it to somebody else. There is no necessary logic that says the mortgage promise is more like one of these familiar transactions than the other.

\begin{footnotes}
\footnote{125}{See ANTONIO DAMASIO, DESCARTES’ ERROR 96-113 (Penguin Books 1994). "Dispositional representations constitute our full repository of knowledge, encompassing both innate knowledge and knowledge acquired by experience." \textit{Id.} at 104.}
\footnote{126}{\textit{Id.} at 97. "These various images—perceptual, recalled from real past, and recalled from plans of the future—are constructions of your organism's brain. All that you can know for certain is that they are real to your self, and that other beings make comparable images." \textit{Id.}}
\footnote{127}{\textit{Id.} at 98-100. Damasio describes the physical process by which neural activity forms perceptual images. \textit{Id.}}
\footnote{128}{Schank, \textit{supra} note 123, at 2508.}
\footnote{129}{See DAMASIO, \textit{supra} note 125, at 247-52.}
\footnote{130}{See DAMASIO, \textit{supra} note 125, at 170-73; Schanck, \textit{supra} note 123, at 2508.}
\end{footnotes}
When a reader (a mortgagor) is presented with a mortgage and note to sign, the text is all there is. The author of the text, if not "dead" as popularly referenced in postmodern literary theory, is at least not accessible to the reader. The author's intent therefore does not produce the reader's interpretation. The text is all law ordinarily takes into account, for example, applying a parol evidence rule to limit consideration to the written document, but admitting extraneous evidence to resolve meaning when an instrument is ambiguous. The text of the mortgage documents nowhere commands deficiency liability after foreclosure.

Meaning attaches, not just to texts, but also to context. The home mortgage transaction itself is an event with far greater meaning than the words in the documents, the written texts. Probably few, if any, people in the lender's own office have read the documents all the way through, and even fewer understand the lawspeak consequences of the words. It is the activity of borrowing, lending, signing documents, making payments, defaulting, and foreclosing that lenders and lawyers understand. As judged by their behavior, many, perhaps most lenders do not expect the loans to be treated as recourse debt. To the extent borrowers know about this practice, their expectations that foreclosure is the end of their obligations are reinforced.

Decisions are not a product of pure reason. Decisions are, instead, the result of fairly messy neural competition within the brain to find a fit between incoming data and an appropriate cognitive

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133. See RESTATEMENT (SECOND) OF CONTRACTS §§ 209-217 (1981); e.g., id. § 214(c) (allowing admission of parol evidence to establish the meaning of the agreement).
134. See Minow and Spelman, supra note 91.
135. See Kurt Eggert, Lashed to the Mast and Crying for Help: How Self-Limitation of Autonomy Can Protect Elders From Predatory Lending, 36 LOY. L.A. L. REV. 693, 726 (2003) ("When a person is buffeted by influences, threats, pleas, and promises from all sides, from parents, churches, friends, governments, and businesses, it is difficult to determine whether that person's decisions were made autonomously or were merely the product of one or more outside influences.")
model, schema, or meme to classify them for possible action.\textsuperscript{136} Imbedded schemas, such as "home ownership is a good investment with tax benefits," may engage other parts of the brain and prompt motor neurons to fire, thereby producing a call to a real estate agent. The entire homebuilding industry combines with the mortgage lending industry to build those neural patterns within the minds of their customers. Their joint prosperity depends more on implanting mental images than on customers making rational choices based on economic balancing of alternatives.

This is why home mortgage borrowers neither understand, expect, nor consent to lingering liability for deficiencies after foreclosure. For that matter, neither does the lender's loan closer who did not go to law school and understands only the origination and not the foreclosure process. Neither the language used in the mortgage documents nor the nature of the transaction itself carries lawspeak's recourse consequences into the minds of borrowers or creates the mental association in the language of the ordinary borrower. That consequence is inferred only by lawspeakers.

The difference between a robber and a lender armed with a deficiency judgment is the rule of law, which defines both. Is there not a reservoir of justice in legal rules that can be called upon to prevent law from being used as a total fraud?

2. Traditional Legal Doctrine Justifies Nonrecourse Interpretation

There is one unambiguous provision that is understood in both layspeak and lawspeak; if the borrower defaults, the lender can foreclose and have the property sold. Ambiguity exists as to whether

\textsuperscript{136} See Marvin Minsky, The Society of Mind 17 (1986).

[Y]ou can build a mind from many little parts, each mindless by itself. I'll call "Society of Mind" this scheme in which each mind is made of many smaller processes. These we'll call agents. Each mental agent by itself can only do some simple thing that needs no mind or thought at all. Yet when we join these agents in societies—in certain very special ways—this leads to true intelligence.

Id.; see also Lakoff, supra note 55, at 13 ("Cognitive models are directly embodied with respect to their content, or else they are systematically linked to directly embodied models. Cognitive models structure thought and are used in forming categories and in reasoning. Concepts characterized by cognitive models are understood via the embodiment of the models.").
foreclosure and loss of the house extinguishes the debt. If the obligation is nonrecourse, the debt is paid; if it is recourse, it remains owing. There is no common language or common understanding that determines the issue.

a. Extrinsic Evidence Can Be Admitted to Explain Ambiguous Documents

A standard way of resolving contract ambiguity is to ask whether one party understood that the other had a different meaning for the terms. If so, then the knowledge is treated as a fault basis for choosing the meaning of the mistaken party. The borrower did not even know about the alternative meaning and is free from sin. The lender, however, is a member of both the lawspeak community and the layspeak community. At the office, the lender speaks lawspeak. At the corner grocery, the lender speaks layspeak. When the lender writes a letter to his or her mother, he or she uses Webster’s Dictionary, not Black’s Law Dictionary. As a layspeaker as well as lawspeaker, the lender either knew or should have known that the borrower did not understand the lingering liability consequences of the transaction enough to have consented to them.

137. See generally Ferdinand S. Tinio, Annotation, The Parol Evidence Rule and Admissibility of Extrinsic Evidence to Establish and Clarify Ambiguity in Written Contract, 40 A.L.R. 3d 1384 (1971) (citing hundreds of cases for this proposition).

138. See Restatement (Second) of Contracts § 20(2)(b) (1981) (indicating the borrower’s meaning attaches if the borrower does not know of any different meaning attached by the other, and the other lender knows the meaning attached by the borrower). There is also a robust inclination to construe ambiguous documents against the drafter. See Klapp v. United Ins. Group Agency, Inc., 663 N.W.2d 447, 455 (Mich. 2003) (“In interpreting a contract whose language is ambiguous, the jury should also consider that ambiguities are to be construed against the drafter of the document.”).

139. See Restatement (Second) of Contracts § 211 (1981). The Restatement has special rules for standardized agreements, such as the mortgage documents. Subsection two favors interpreting such agreements as treating alike all those similarly situated, without regard to their knowledge or understanding of the standard terms of the writing. Subsection three implies that if the lender has reason to believe the borrower would not agree if he knew that the writing contained a particular term (recourse liability), the term is not part of the agreement. Id. Home mortgage borrowers and lenders are not similarly situated, and the lender should
If the document is ambiguous, a question of fact is raised, namely "what was the intent of the parties?" However, the answer is not clear. If in fact lenders do not pursue deficiencies in the vast majority of transactions, it is reasonable to say that lenders as well as borrowers did not intend such consequences, at least as judged by their behavior. At a minimum, the lender knew or should have known of the borrower's understanding—or lack of understanding. That being the case, courts should adopt the borrower's meaning and declare the debt nonrecourse as a matter of law unless the lender can prove otherwise.

*b. Recourse Obligation Is Unconscionable, Absent Disclosure and Negotiation*

The seventeen pages of Fannie Mae's Security Instrument are procedurally unconscionable in that they are written in lawspeak that is confusing, misleading, and unintelligible to the borrower. Mortgage documents are unquestionably contracts of adhesion. The lender possesses overpowering financial power and legal knowledge. The borrower has no choice other than to accept the deal or be left out of the home market entirely.

The lender's failure to reveal the full consequences of default and to refuse to negotiate on that point is substantively unconscionable. Recourse liability is an unexpected and harsh penalty for default know that the borrower does not understand recourse liability. Whether informed borrowers would nevertheless enter into the agreement is unknown as applied in particular cases.

140. Taken literally, the question itself is nonsense. Intent as a describable function is purely personal. There may or may not be two intents as to deficiency, or it may never have been contemplated by either party. The issue is really one of inference, and the issues previously discussed, whether a lay or law observer is postulated, continue unresolved.

141. See supra notes 20-29 and accompanying text.


143. See Higgins v. Superior Court, 45 Cal. Rptr. 3d 293, 301 (Ct. App. 2006) ("Unconscionability has both a procedural and a substantive element, the former focusing on 'oppression' or 'surprise' due to unequal bargaining power, the latter on 'overly harsh' or 'one-sided' results.") (quoting Armendariz v. Found. Health Psychcare Serv., Inc., 6 P.3d 669, 690 (Cal. 2000)).
unless it is revealed and negotiated. The burden of recourse liability on the borrower far outweighs the benefit to the lender. Given their behavior, most lenders do not intend to enforce their contract right to deficiency. They expect, instead, to acquire power they can exercise over the borrower if they choose. This grant of arbitrary power is itself unconscionable unless connected with some real economic interest.

Lenders bear the unavoidable risk of market decline, and any attempt to pass it off to the average home mortgage borrower is simply unconscionable, unless the assignment of risk is clearly negotiated, bargained for, and understood by the borrower.

3. Nonrecourse Status Does Not Impair Negotiability

Recourse liability and negotiability are separate, but related, concepts. Purchasers of negotiable home mortgage notes can claim holder in due course protection from personal defense advanced by the borrower that lessens the apparent obligation on the note, whether the note is recourse or nonrecourse. Nonrecourse status simply limits the payment to a particular source (the land).

The Fannie Mae Note may be nonnegotiable as well as nonrecourse. Uniform Commercial Code section 3-104(a)(3)(ii)

See id.

See id. ("'The prevailing view is that [procedural and substantive unconscionability] must both be present in order for a court to exercise its discretion to refuse to enforce a contract or clause under the doctrine of unconscionability.' But they need not be present in the same degree. 'Essentially a sliding scale is invoked which disregards the regularity of the procedural process of the contract formation, that creates the terms, in proportion to the greater harshness or unreasonableness of the substantive terms themselves.' In other words, the more substantively oppressive the contract term, the less evidence of procedural unconscionability is required to come to the conclusion that the term is unenforceable, and vice versa.'") (quoting Armendariz, 6 P.3d at 690 (Cal. 2000)); Siddhartha Venkatesan, Note, Abrogating the Holder in Due Course Doctrine in Subprime Mortgage Transactions to More Effectively Police Predatory Lending, 7 N.Y.U. J. LEGIS. & PUB. POL'Y 177, 206-09 (2003) (arguing that the doctrine is detrimental and operates inefficiently between homeowners and assignees).

See Johnstone, supra note 89, at 801 n.69.
preserves negotiability even though the note contains “an authorization or power to the holder to . . . realize on or dispose of collateral . . . .” The traditional analysis of real estate mortgage notes is that the mortgage acts simply as collateral.150 But if the Fannie Mae Note’s “in addition to” reference to the security instrument requires the two documents to be read together,151 the multiple additional provisions in the security instrument render the note nonnegotiable.

A secondary market purchaser may claim that the appearance of the note as recourse obligation may make it such in the hands of a holder in due course. But to be a holder in due course the purchaser must, in addition to the technical requirements, buy in good faith and without notice that the maker (borrower) had a defense.152 Secondary market purchasers undoubtedly acquire possession or control of the entire file associated with the home mortgage loans they buy.153 Therefore, they have access to the security instrument and note that, as interpreted in layspeak, are misleading, ambiguous, and nonrecourse. Consequently, secondary market purchasers have notice that the obligation itself is nonrecourse, or at least ambiguous as to personal liability.

154. Holder in due course protection in predatory lending cases is giving way to assignee liability in light of recent abuses. See Julie R. Caggiano et al., Predatory Lending Law Developments and Assignee Liability Under HOEPA and State Law, 62 BUS. LAW. 617, 620-21 (Feb. 2007) (“An individual borrower under HOEPA may assert a defensive claim against an assignee who is trying to enforce the loan following a borrower's default . . . . Should the law go beyond that displacement of the Uniform Commercial Code (“UCC”) holder in due course doctrine, e.g., to permit affirmative claims to be brought against an innocent assignee, often as a class action, independent of the borrower’s default and enforcement of the loan by the assignee? A literal reading of the HOEPA language might include affirmative claims, but the legislative history makes clear that the purpose of the provision on affirmative claims was to displace the effect of the ‘holder in due course’ doctrine under the UCC, which applies only to defensive claims and which should be the standard.”); Kathleen C. Engel & Patricia A. McCoy, Turning a Blind Eye: Wall Street Finance of Predatory Lending, 75 FORDHAM L. REV. 2039, 2042 (2007)
Uniform Commercial Code section 3-305(a)(1)(iii) preserves a
defense of fraud (fraud in the factum) as against a holder in due course
if the obligor was induced to sign the instrument with neither
knowledge nor reasonable opportunity to learn of its character or its
essential terms. The case made herein does not fit the classic
definition of fraud in the factum as, for example, having a blind
person sign a check represented to be a laundry ticket. But it does fall
in the same category from the standpoint of an objective observer.
Fraud in the factum involves such deceit when the maker does not
know or have an opportunity to know its essential terms. The maker of
a home mortgage note may know that he or she is signing a note and
may understand the remedy of foreclosure. But a note can still be
recourse or nonrecourse, and the essential fact of recourse liability is
not revealed in the documentation, but is concealed by the lender’s
own documentation. Concealment deprives the maker of the
opportunity to know this essential character of the note, providing the
borrower a real defense as to the recourse aspect of the note, though
not to the lien on the property.

III. REALITY, POLICY, AND JUSTICE SUPPORT
NONRECOURSE TREATMENT

It would be unrealistic to think that the truths revealed herein will
cause courts to declare that a much-used set of mortgage documents

(proposing the imposition of assignee liability on securitized secondary market
purchasers). Also, “[t]he Truth in Lending Act (TILA) allows borrowers to recover
against assignees for originators’ violations if the violations are ‘apparent on the
face of’ federal disclosure statements.” Id. at 2052 (quoting 15 U.S.C. §§ 1641(a),
(e)(2) (2000)).

155. Milton Roberts, Annotation, Fraud in the Inducement and Fraud in the
Factum as Defenses Under UCC § 3-305 Against Holder in Due Course, 78 A.L.R.
3d 1020, 1033 (1977) (“[T]he misrepresentation of a water softener equipment
company’s salesman as to the nature and effect of a cognovit note and security
agreement warranted assertion by the maker of the defense of fraud in the factum
under Code § 3-305(2)(c), as against a holder in due course . . . .”) (quoting
American Plan Corp. v. Woods, 240 N.E.2d 886 (Ohio App. 1968)). But see Savoy
notes from asserting a personal defense against the National Credit Union
Administration, which held holder in due course status by taking over the assets of a
defunct credit union).
does not impose recourse liability on homeowners. If courts did decide that this particular Security Instrument is nonrecourse, then it would have far-reaching consequences, considering the similarity of home purchase mortgage documents.

A. Basic Mortgage Law Would Be Unaffected by Holding the Fannie Mae/Freddie Mac Documents Nonrecourse

The cash value of declaring the Fannie Mae Security Instrument nonrecourse may be substantial if losses on subprime mortgages generate serious efforts to impose liability after foreclosure on home purchasers. Recasting, in particular, subprime home mortgage documents as nonrecourse provides a rough measure of justice by imposing the market loss on the bad guys.\textsuperscript{156} The loss from this financial debacle has already been taken at the investment end, with banks and Wall Street firms writing off billions of dollars in losses.\textsuperscript{157} Recasting specific mortgage documents affects the obligations created by these culpable market participants, but, since background mortgage law stays unchanged, borrowers and lenders remain free to create recourse liability.\textsuperscript{158} Not all lenders are guilty of the excesses and frauds committed by some subprime lenders. Holding home mortgage notes nonrecourse would undoubtedly hurt some innocent lenders and benefit some crooked borrowers. But law needs to be right in more cases than it is wrong. On balance, nonrecourse treatment is justified because in the ordinary, honest borrower's case, he or she did not bargain for recourse liability, and the lender did not reveal the consequence. When borrower fraud is a serious issue, the lender is likely to have a tort action to litigate liability and damages.

\textsuperscript{156} For an example of a particularly egregious case of subprime lending see Venkatesan, \textit{supra} note 145, at 180.

\textsuperscript{157} \textsc{Majority Staff of Joint Econ. Comm., 110th Cong., supra} note 15, at 1.

\textsuperscript{158} \textit{See} Venkatesan, \textit{supra} note 145, at 206-08 (arguing that the doctrine is inefficient as applied in the subprime secondary market); \textit{see also} Mann, \textit{supra} note 63, at 971 (calling negotiability in home-mortgage transactions irrelevant).
B. Deficiency Liability After Home Mortgage Foreclosure Is Inefficient

1. As Measured by Traditional Economic Theory

Economists undertake to apply scientific method to analyze market activity in terms of efficiency—a net increase in individual satisfactions, which is implicitly assumed to be a good thing or, per Richard Posner, an increase in overall wealth. Economists construct hypothetical models of behavior that postulate both borrowers and lenders as rational maximizers of their own utility in an amoral market. Rationality implies the borrower is competent and has enough information to commit to the obligation.

Fraud is inefficient in that it misleads market participants into making irrational choices. Documentary concealment of the consequences of default and foreclosure has the same effect as fraud.


160. Richard A. Posner, Utilitarianism, Economics, and Legal Theory, 8 J. LEGAL STUD. 103, 103 (1979) ("[T]he economic norm I shall call 'wealth maximization' provides a firmer basis for a normative theory of law than does utilitarianism.").

161. See, e.g., Karen M. Pence, Foreclosing on Opportunity: State Laws and Mortgage Credit, 88 THE REVIEW OF ECON. AND STAT. 177, 177-78, 181-82 (2006) (identifying state laws that require judicial foreclosure and periods of redemption as discouraging lenders from making very low equity loans). Pence does not single out antideficiency laws as a factor, although she does include them in her equation. Id.

162. RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 51, 51 (1973). Posner states: "If . . . the product is complex and any defects latent, and if it is purchased infrequently, the cost of obtaining relevant information may be much higher to the consumer than to the seller and the seller should be liable for nondisclosure of information important to a sensible choice by the consumer." Id. It is clear that the borrower is the consumer, the home mortgage transaction is complex, and the seller does not disclose the important information a consumer needs.

163. For an unsympathetic discussion of this aspect of fraud see POSNER, supra note 162, at 156-57. See also Siddhartha Venkatesan, Note, Abrogating the Holder in Due Course Doctrine in Subprime Mortgage Transactions to More Effectively Police Predatory Lending, 7 N.Y.U. J. LEGIS. & PUB. POL'Y 177, 206-09 (2003) (arguing that holder in due course doctrine operates inefficiently between homeowners and assignees). Advocates of the holder in due course doctrine argue that it will shield assignees from claims of fraud in subprime transactions. Id.

http://scholarlycommons.law.cwsl.edu/cwlr/vol45/iss1/3
in that borrowers cannot accurately measure the exchange value of the
loan and therefore, cannot make a rational decision.\textsuperscript{164} If lenders get
the advantage of recourse liability without full disclosure, there is not
only a lack of incentive to disclose, there is incentive to avoid calling
borrowers' attention to the downside of default. Lenders' advertisements and websites bear this out.

Judged as wealth maximization\textsuperscript{165}, there is a net wealth loss if the
gain to the lender from deficiency collections is smaller than the loss
to the borrower, or if the borrower chooses bankruptcy to wipe out the
debt. The loss to individual borrowers probably exceeds gains to the
lender when collection costs, market exclusion, lawyers' fees, and
demoralization are taken into account. Thus, deficiency liability
flunks the wealth maximization test.

If the market offered a choice, risk averse borrowers who were
willing to pay additional interest or settle for a lower loan-to-value
ratio would logically bargain for nonrecourse debt.\textsuperscript{166} Willing lenders

\textsuperscript{164}. Even advocates of "personal responsibility" on the part of borrowers
acknowledge the necessity of full disclosure and the possibility that some borrowers
cannot comprehend the fundamental facts of a complex transaction. See Hughes, \textit{supra} note 42, at 143-44. Hughes emphasizes disclosure of foreclosure as a
consequence of breach, not deficiency liability. \textit{Id.} at 144. "It should be the
mortgagee's responsibility to insure that all required disclosures are made to the
mortgagor . . . ." \textit{Id.}

\textsuperscript{165}. \textit{See} Anthony T. Kronman, \textit{Wealth Maximization as a Normative

According to Richard Posner, legal rules (at least those promulgated by
common law courts) can best be understood as efforts, usually
unconscious, to maximize wealth. In Posner's view, wealth maximization
is an ethically attractive goal. His recent article on the subject seeks to
show that wealth maximization has properties that make it preferable, from
a moral point of view, to other normative principles, particularly
utilitarianism (with which, Posner claims, wealth maximization is often
confused).

\textit{Id.}

\textsuperscript{166}. A rational borrower who uses nonrecourse financing has an option to pay
and keep the property or to default and lose the property along with a period of bad
credit. A recourse borrower, on the other hand, runs the risk of a ruinous deficiency
judgment that, if not paid, will linger for ten years or longer, ready to grab any non-
exempt asset the debtor acquires during that time. All professional developers are
aware of the distinction and those who are financially able to do so bargain for
nonrecourse or limited recourse financing.
would assess the nonrecourse borrower’s credit and property value more carefully because the lender, not the borrower, would clearly bear the risk of market downturn. This is what happens in the commercial real estate market, where all participants understand the difference between recourse and nonrecourse obligations and are in a position to bargain to efficient outcomes.\footnote{Stein, supra note 2, at 1210 ("Real estate lenders readily agree to nonrecourse loans in spite of their greater risk . . . . The slightly greater risk may translate into a modest increase in the interest rate.").} But this is not the case in the home loan market,\footnote{Home equity mortgages may be treated differently. See, e.g., Tex. Const. art. 16, § 50 (a)(6)(B-C) (authorizing home equity loans only if they include nonrecourse obligations).} where loans that are expressly nonrecourse are virtually unknown.

In a purely rational home mortgage market, lenders would offer two rates: lower rates to home buyers who agree to recourse financing, and higher rates to those who bargain for nonrecourse financing. The home mortgage finance market does not do this, perhaps because having two types of loans would increase the complexity of transactions without producing much gain. Contrary to rational economic assumption, mortgage rates in California, where purchase mortgages are nonrecourse by statute, do not appear to be dramatically different from rates in states that permit deficiencies after foreclosure.\footnote{A visit to the website, Realtors.com, showed California (antideficiency) rates at or below the average on a 30-year fixed rate home mortgage for $300,000 with 5% down. On February 15, 2008, the lowest posted rate for Sacramento and Stockton was 5.753%, the same as Albany, N.Y., Denver, Colorado, Bellevue, Washington, Fort Myers, Florida, and Indianapolis, Indiana. Austin and Houston, Texas were slightly lower at 5.704%, and Bennington, Vermont was higher at 6.25%. Move, Inc., Home Finance: Compare Rates, http://finance.move.com/homefinance/findlender/findlender.asp?poe=&gate=\&Inksrc=MINGFALSRPBC01 (last visited Feb. 15, 2008) (displaying a search engine for the current rates).}

The influence of Fannie Mae and Freddie Mac in secondary mortgage finance may have discouraged development of alternative mortgage types, particularly with respect to recourse and nonrecourse liability.\footnote{Richard Posner states without approval, "[s]ome economists believe that monopoly reduces the incentive of the firm to innovate and to use its inputs efficiently." POSNER, supra note 162, at 108. To the extent that FNMA and GNMA}
nonnegotiable set of documents is efficient, in that it eliminates wasteful bargaining over terms. It does this, however, at the cost of depriving borrowers of true, intelligent choice.

Lenders may argue that nonrecourse home loans pose a moral hazard that borrowers would walk away from home mortgage obligations whenever house values drop below mortgage debt. Despite some evidence to support the proposition, borrowers have other reasons for not walking away from their homes, notably that they would probably pay the same amount in rent if they lost the mortgaged house. In addition, if lenders do not ordinarily pursue deficiencies, or if borrowers do not know about deficiency liability, there is no reason to think that fear of deficiency will prompt borrowers to stretch their budgets to perform. Economic theory would hold that, if nonrecourse loans resulted in higher defaults, lenders would either raise rates or restrict funds in the area. Neither seems to have happened in California where home purchase loans are nonrecourse.

have monopolized mortgage documentation, innovation does seem to have been reduced.

171. Id. at 37.

172. See Move, Inc. supra note 169. California eliminated purchase mortgage deficiencies and nonrecourse mortgage investment. Stockton, California is one of the most overbuilt housing areas in the country, partly as a result of excessive subprime lending. See Press Release, U.S. Dep't of Treasury, Secretary Paulson's Prepared Remarks Before Stockton Housing Town Hall Meeting (Dec. 18, 2007), http://www.treas.gov/press/releases/hp743.htm (last visited Feb. 20, 2008). Texas law authorizes home equity loans only if nonrecourse. TEX. CONST. art. 16 § 50(a)(6)(C). VA loans are for all practical purposes nonrecourse, apparently without an increase in defaults. See supra notes 22-23. Lenders would argue that recourse liability and holder in due course protection are efficient in that they reduce the risk to secondary market purchasers and therefore reduce the price of borrowed money to borrowers. To some extent this may be true. It would not be troubling to allow some aspects of negotiability for nonrecourse notes, for example, protection from purely personal misrepresentations that are not revealed in the documents and related papers. But negotiability does not necessarily impart efficiency. Ronald Mann argues that negotiability is not an important aspect of today's payment systems. Mann, supra note 63, at 953. Secondary market purchasers are just as likely to rely on originating lenders to make sensible loans as they may rely on negotiability as a significant aspect of value.

173. CAL. CIV. PROC. CODE § 580(b) (West 2006).
A rational lender who forecloses recourse mortgage debt by judicial procedure would obtain a deficiency judgment if the additional cost in time and fees is minimal and if the judgment has some value. But this gain is nullified if the time value of money makes alternative arrangements such as negotiated settlement more profitable. Particularly where foreclosure produces a right to statutory redemption, lenders may forego deficiency and bargain for a voluntary conveyance to speed up liquidation. Unfortunately, securitization makes such individual bargaining problematic and removes this theoretically efficient outcome.\textsuperscript{174}

A rational lender who forecloses nonjudicially would assess whether the value of likely collections outweighs the cost of the judicial procedure required to obtain a judgment lien against the borrower and the costs of continuing pursuit. For some lenders, public perceptions of overreaching may be viewed as a cost. A rational lender might, in lieu of judicial action, sell the claim to a debt collection entity at a substantial discount or use collection agents who will threaten legal action, but file suit only if the prospect of collection outweighs the cost of suit. Recourse liability may be worth a few pennies to such lenders and to private mortgage insurers, but there is little social advantage in encouraging collection tactics that impose external costs of abuse that are not taken into account by the industry.

Bankruptcy offers a way out for borrowers when deficiency liability becomes unbearable. This unattractive, expensive, inefficient option destroys any benefit lenders derive from recourse liability.\textsuperscript{175}

\textsuperscript{174} Securitization of mortgage loans makes any individualized negotiation difficult, if not impossible. "One of the principal characteristics of securitization is that it tends to erect many barriers that prevent consumers from complaining effectively about unethical, unfair, or illegal treatment by loan brokers, originators, or servicers." \textit{Subprime Mortgage Market Turmoil: Examining the Role of Securitization: Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs,} 110th Cong. 11 (2007) (statement of Christopher L. Peterson, Associate Professor of Law, University of Florida), available at http://banking.senate.gov/public/_files/ACFE4F.pdf.

\textsuperscript{175} Only Chapter 7 liquidation bankruptcy is available for home mortgage debt, inasmuch as Chapter 13 prohibits modification of mortgages secured by a first lien on the debtor's primary residence. \textit{See} 7 William Norton Jr., Norton \textit{Bankruptcy Law and Practice} § 149:8 (3d ed. 2008) ("[Section] 1322(b)(2) permits a Chapter 13 debtor to modify the rights of the holders of secured claims or
Unless lawyers’ fees are counted as generating positive utility instead of wasted transaction costs, the overall loss from recourse liability appears to outweigh any efficiency gains when bankruptcy is considered a viable option.

Continuing liability after foreclosure shifts the risk of market decline from lender to borrower. An efficiency analysis justifies this shift only if borrowers consented to it at the time of contract, something they simply did not do.

2. As Measured by Behavioral Economics

Behavioral economics is less rigidly formulaic, and probably more realistic in its assessment of human economic behavior.\(^\text{176}\) Applying what is called “bounded rationality,” behavioral economists acknowledge the limited cognitive abilities that constrain human problem solving.\(^\text{177}\) “Bounded willpower” implies people sometimes make decisions against their long-term interest.\(^\text{178}\) These acknowledgments considerably weaken the notion that borrowers are so rational that they obtain information they do not know they need, weigh all consequences of their decisions, and reach a conclusion based on rational self-interest. The behavioral concept of “bounded self-interest” implies humans are often willing to sacrifice their own interests to help others.\(^\text{179}\) At the risk of humanizing government institutions, FHA’s and particularly VA’s forbearance policies seem to be based on bounded self-interest.\(^\text{180}\)


\(^{177}\) Id. at 3-4.

\(^{178}\) Id. at 4-5.

\(^{179}\) See Mullainathan & Thaler, supra note 176.

\(^{180}\) See supra notes 22-23.
C. Uniform Law Proposals Would Eliminate Deficiency Liability Following Home Mortgage Foreclosure

The idea of eliminating deficiency judgments following home mortgage foreclosures is not a radical dream hatched by a single law professor. Several states now prohibit or restrict deficiency collection on home mortgages. Section 511(b) of a proposed Uniform Land Security Interest Act would eliminate liability for deficiency after foreclosure of a mortgage on property bought for individual use as a personal residence. The new Uniform Nonjudicial Foreclosure Act shelters home mortgage debtors except in cases of fraud. These Acts, though not currently adopted, imply that when home mortgage recourse liability is considered anew, it is found wanting. The attractive thing about holding the predominant mortgage form nonrecourse is it could provide a large-scale test of the concept without radically changing mortgage law itself. If it works, then the idea can spread. If it does not work, basic mortgage law is unaffected and recourse documents can be drafted (more artfully than the current Fannie Mae form).


182. See supra note 29 and accompanying text.

183. Uniform Land Transactions Act § 1-203(a)(1) (1975). This Act assigns protected party status to individuals who give security interests on their residential property. Section 3-510(b) states: "If the debtor is a protected party and the obligation secured is a purchase money security interest, there is no liability for a deficiency, notwithstanding any agreement of the protected party." Id.


D. Trust as a Public Good Is Reinforced by Holding Home Mortgages Nonrecourse

Many demoralized borrowers facing foreclosure do not understand that legal representation might be useful if they could afford it, and they would not know to ask about recourse debt consequences. Except for personal injury claims with substantial medical or earnings loss, most ordinary citizens are better off taking what an economics-driven market offers than undertaking a legal contest. This reality leaves powerful market participants as judges of their own case. Life is full of examples of abuse; for example, insurance companies that delay and deny legitimate casualty payments or, deny health coverage and let insureds die, and Internet sales that unilaterally impose unconscionable terms on downloads.

Trust is a serious casualty when concentrated market power is placed in the hands of such private interests, especially when it is exercised unfairly.

E. Trust is a Public Good

Francis Fukuyama makes a convincing case that trust is a public good.\textsuperscript{186} A nation with high trust in its institutions supports industrial and financial development that is impossible where trust is lacking.\textsuperscript{187} For example, people trust Swiss banks, not Kenyan banks; and capital accumulation is possible in Europe, but not Africa. Continued betrayal of trust by lenders, insurance companies, and the legal system will eventually damage any nation's fundamental economy, respect for law, and community morality itself.\textsuperscript{188}

\textsuperscript{186} FRANCIS FUKUYAMA, TRUST: THE SOCIAL VIRTUES AND THE CREATION OF PROSPERITY 151 (The Free Press, 1995) ("[T]he presence of a high degree of trust as an additional condition of economic relations can increase economic efficiency by reducing what economists call transaction costs, incurred by activities like... negotiating a contract... Each of these transactions is made easier if the parties believe in each other's basic honesty: there is less need to spell things out in lengthy contracts; less need to hedge against unexpected contingencies; fewer disputes, and less need to litigate if disputes arise.").

\textsuperscript{187} Id. at 30.

\textsuperscript{188} Id.
Mortgage lenders present themselves to the consuming public as business entities worthy of trust, and borrowers tend to trust them. Lenders ordinarily trust borrowers to repay. Citizens trust the legal system to be fair. Trust must be mutual to maintain the public good.

When mortgage documents hide the downside of a home mortgage transaction in a foreign language and impose the burden of recourse liability on borrowers that vastly outweighs benefit to the lender, trust is sacrificed along with fairness. The subprime mess came from violation of trust. Many subprime borrowers trusted lenders to provide loans that were fairly priced and not designed for default. A fair number of lenders broke trust with borrowers by predatory practices and they broke trust with financial markets through outright fraud as they offered their defective mortgage-backed securities around the world. Some borrowers were party to the fraud, and the entire securitization debacle reduced trust in financial institutions at an international level.

Who is to police the trust obligation? Legislators are captives of the interests that are causing the problem. Courts are too conservative to act boldly, claiming that legislatures are the proper body to make corrective rules. Lenders have been so schooled in neoclassical economic theory that morality does not stand in the way of employing legal strategies to bilk people who know little and have little choice,

189. Lloyd T. Wilson, Jr., Effecting Responsibility in the Mortgage Broker-Borrower Relationship: A Role for Agency Principles in Predatory Lending Regulations, 73 U. Cin. L. Rev. 1471, 1517-19 (2005) (arguing to impose duties on mortgage brokers as if the broker were agent and the borrower the principal). The level of actual trust should justify application of Restatement section 161(d), requiring disclosure where a relationship of trust and confidence exists. RESTATEMENT (SECOND) OF CONTRACTS § 161(d) (1981).

190. U.S. Gen. Accounting Office, supra note 61, at 4 ("These include, among other things, charging excessive fees and interest rates, lending without regard to borrowers’ ability to repay, refinancing borrowers’ loans repeatedly over a short period of time without any economic gain for the borrower and committing outright fraud or deception—for example, falsifying documents or intentionally misinforming borrowers about the terms of a loan."); see Linda S. Finley, Here’s a Subprime Primer: How Did the Mortgage Lending Community Fall Apart? Many Are to Blame, LEGAL TIMES, Sept. 24, 2007, at 37 ("The FBI reports that mortgage fraud is the country’s fastest-growing white-collar crime. More damaging is ‘fraud for profit,’ where real estate scam artists take advantage of modern underwriting standards with lax review thresholds. Fraud for profit makes up about 80 percent of the total number of reported mortgage fraud cases.")
but are treated as hard-bargaining, rational market participants. A call for return to some sort of conventional morality may assume too much—that there ever was a moral structure that reined in pure greed.

IV. CONCLUDING THOUGHTS

The first part of this article pulled a number out of the air and suggested that deficiency liability from subprime foreclosures might run forty billion dollars. The subprime issues are far more complex than deficiency judgments vel non, and nonrecourse characterization of home mortgages may be more significant for prime borrowers who have more assets at risk than subprime borrowers. But as the dominoes fall on the real estate finance and sales industries, receivers and trustees in bankruptcy may be obliged to pursue all potential assets to satisfy creditors. So what is to be done?

Preserving trust as a public good requires that the entire legal system, courts as well as legislatures, increase supervision over unbalanced transactions to be sure the transaction itself is fair. Law may be described as an autopoietic system that moves through time, reinforces practices that replicate from day to day, changes

191. See Havard, supra note 60, at 271 ("One way of defining economic justice is by looking to institutional economics and its focus on the relationship of institutions to individuals. Because neoclassical economics values efficiency, it focuses on the actions and choices of the individual. The notion of the individual's rational choice obliterates any inquiry into whether the transaction is just or fair.").

192. For a more optimistic view, see Aaron-Andrew Bruhl, Public Reason as a Public Good, 4 J. L. Soc'y 217 (2003).

193. Securitization of subprime and prime mortgages caused part of the problem, and makes the future even more uncertain as to matters such as pursuit of deficiencies. See Engel & McCoy, supra note 154, at 2078-79.


According to Gunther Teubner, legal pluralism is no longer "a set of conflicting social norms but . . . a multiplicity of diverse communicative processes in a given social field that observe social action under the binary code of legal/illegal." Teubner focuses on the symbolic systems inscribed in legal orders. He extends Moore's notion of law as process as he describes the legal system as an autopoietic system of interwoven domains and circular relations continually being modified.

Id.
incrementally, and moves on. It is the system itself that is wrong about recourse liability in home mortgage transactions. Those individuals who participate in the game of law from time to time as lawyers, judges, legislators, borrowers, and lenders, are for the most part decent, moral human beings who play their roles honestly and competently. They do not choose to be oppressive, fraudulent, or cruel. Few people who work in the lenders' offices know what the documents say or mean in lawspeak. Few judges think or look beyond the traditional rule when entering judgment. Few real estate lawyers challenge it, knowing the challenge is likely to fail.

A single court's declaration that standard mortgage documents are ambiguous or misleading on account of concealment will not avert forty billion dollars worth of misery. Abstract rules of law do not have much effect on real people's lives if they have to be researched, argued, and applied in individual lawsuits where expensive lawyers have to represent individual borrowers in cases where the amount in controversy may not equal the lawyer's fee.

Lenders are not going to give up their ten cents worth of deficiency advantage, no matter how many dollars it costs hapless borrowers. Some sort of automatic class protection is indicated. Public choice theory paints a dismal picture of legislative (in)action in a world where lenders can use their political and economic power to convince legislators to leave current rules intact. Retroactive legislation that changes the legal relations of parties may invoke constitutional problems. The Uniform Acts that would prospectively eliminate personal liability for deficiency after home mortgage foreclosure have not been widely adopted, and few states have


In large political units the institutional manifestation of the active promotion of economic interest is the pressure group . . . . In the face of observable pressure-group activity with its demonstrable results on the outcome of specific issues presented and debated in legislative assemblies, the behavioral premise that calls for the legislator to follow a selfless pursuit of the "public interest" or the "general welfare" as something independent of and apart from private economic interest is severely threatened.

Id.

196. See Freyermuth, supra note 185, at 1207.
followed the lead of the antideficiency states in recent years. The beauty of the common law is that a decision can be made that departs from the past with the assertion that the law itself has not changed, but the application to the particular case produces an unexpected result. The law of recourse obligation would remain the same. But the particular documents would simply be interpreted as nonrecourse. To have substantial effect on lenders, a class action would be required.

Class action lawsuits brought on behalf of borrowers would be problematic, but possible. Some class actions against predatory lenders have been brought and settled short of trial. To accomplish institutional change, such suits should not stop with settlement, however tempting the terms might be for attorneys seeking to pay their own rent. In particular, any settlement that sets aside money for disclosure or "education" for borrowers is useless.

197. Only nine states have any kind of antideficiency statutes: Alaska, ALASKA STAT. § 34.20.100 (2006); Arizona, ARIZ. REV. STAT. ANN. § 33-729A (2007); California, CAL. CIV. PROC. CODE § 580(b), (d) (West 2006); Idaho, IDAHO CODE ANN. § 45-1512 (2003); Minnesota, MINN. STAT. ANN. § 582.30 (West 2000); North Carolina, N.C. GEN. STAT. ANN. § 45-21.38 (West 2007); North Dakota, N.D. CENT. CODE § 32-19-03 (Supp. 2007); Ohio, OHIO REV. CODE ANN. § 5313.10 (West 2004); and Oregon, OR. REV. STAT. § 86.770(2) (2007).


199. See, e.g., California Predatory Lending Settlement, supra note 198 ("[T]he settlement requires full, clear disclosure regarding interest rates, discount points, prepayment penalties and other loan or refinancing terms."). There was no mention of disclosure of deficiency liability.

200. See, e.g., id. ("[T]he settlement requires Ameriquest to pay $30 million to the settling states to cover their costs, and to fund consumer education and enforcement programs."); see also PRACTICING LAW INSTITUTE, CORPORATE LAW AND PRACTICE COURSE HANDBOOK SERIES, COUNTRYWIDE SETTLEMENT AGREEMENT (UNSIGNED) 159, 164-65 (2007) (detailing an education program for Countrywide to follow, but nowhere mentioning disclosure of the possibility of deficiency).
limitations of the human brain are such that we might as well burn the money as add another disclosure statement at closing.\textsuperscript{201} A successful class action against the major secondary market purchasers and mortgage insurers for declaratory judgment that standard mortgage documents are nonrecourse might establish a nationwide rule of law that would be honored as to other mortgagees and secondary market purchasers. The burden is on lawyers and judges to change the system.

This article ends with a call for individual trial judges to declare that the most familiar mortgage documents create nonrecourse debt, thereby forcing appellate courts to face the issue whether home mortgage deficiencies are based on consent or fiat.\textsuperscript{202} If fiat, it is unfair and should be nullified. Today, the liability is fiat, pure and simple. Carl Sandburg gets the last word:

\begin{quote}
The work of a bricklayer goes to the blue.  
The knack of a mason outlasts a moon.  
The hands of a plasterer hold a room together.  
The land of a farmer wishes him back again.  
Singers of songs and dreamers of plays  
Build a house no wind blows over.  
The lawyers—tell me why a hearse horse snickers  
hauling a lawyer’s bones.\textsuperscript{203}
\end{quote}

Carl Sandburg (1878-1967)

\textsuperscript{201} Burlingame, \textit{supra} note 11, at 480-82; U.S. GEN. ACCOUNTING OFFICE, \textit{supra} note 61, at 13.

GAO review of literature and interviews with consumer and federal officials suggest that consumer education by itself has limits as a tool for deterring predatory lending. First, mortgage loans are complex financial transactions, and many different factors—including the interest rate, fees, provisions of the loan, and situation of the borrower—determine whether a loan is in the borrower’s best interests. \textit{Id.} No mention is made of the potentiality of deficiency liability after foreclosure.

\textsuperscript{202} Leonard Kaplan, a former colleague and legal activist, said of all possible jobs he would most like to be a federal district judge. With life tenure, he could decide cases in a way that would force appellate courts to face social issues that are ordinarily masked by “correct” holdings by obedient trial courts.\textsuperscript{203}  

\textsuperscript{203} SANDBURG, \textit{supra} note 1, at 86.