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Fixing The 'Funk' Of Delinquent Loan Holders In Md.

By **Laurence Platt, Gus Avrakotos and Kristie Kully** (August 8, 2018, 3:11 PM EDT)

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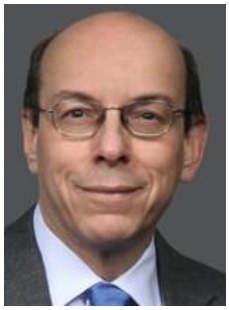

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It has been 25 years since the last revision of the Funk & Wagnalls dictionary, a reference source that is over 100 years old and that likely is lost on those who live in an internet world. A decision last week by the Maryland Court of Appeals, the highest court in Maryland, may fuel a revival in dictionary sales by private holders of delinquent loans secured by residential properties located in Maryland. Relying in part on the definition of "doing business" contained in the Funk & Wagnalls dictionary, the court of appeals held that Delaware statutory trusts are *not* required to be licensed under the Maryland Collection Agency Licensing Act in order to commence foreclosure on residential mortgage loans that were delinquent at the time of acquisition by the holder seeking foreclosure.

The opinion reverses lower court rulings that called for such licensing and should end the confusion surrounding the ability of a state trust to foreclose in Maryland on a loan held for its own account that it had acquired in default. According to the opinion, the plain language of the act is ambiguous as to whether the Maryland General Assembly intended foreign statutory trusts, acting as special-purpose vehicles in the residential mortgage industry, to obtain collection agency licenses. The court conducted a fulsome review of the original legislative history, subsequent legislation and related statutes in order to discern legislative intent.

The act regulates the activity of debt collectors and certain "debt buyers" engaged in business in Maryland by requiring a person to obtain a license prior to engaging in business as a "collection agency." A "collection agency" generally is defined as a person who engages directly or indirectly in the business of collecting for, or soliciting for another, a consumer claim or collecting a consumer claim the person owns if the claim was in default when the person acquired it. Maryland courts had extended the term "consumer claim" to encompass mortgage debt. Unlike some state collection agency licensing laws, the act is not limited to those collecting mortgage debt for another but also applies to persons that acquire delinquent loans to collect for their own account. The act exempts national banks and trust companies, among others, from the collection agency license requirement.

The court of appeals addressed a consolidated appeal of different actions. In the case of Sharma, the lower court held in May 2017 that a Delaware statutory trust did not qualify as an exempt trust

company and needed a collection agency license in order to foreclose on a loan that it had acquired in default. The lower court also stated that foreclosure actions taken are void, including both presale and post-sale matters. This case had an odd set of facts, though.

There were two different trustees, a federal savings association and a state-chartered nonbank, neither of which held title to the loan in foreclosure. Most state trusts that hold residential mortgage loans, whether a common law trust or a statutory trust, use a national bank as trustee, on which the owners rely to assert that the trust itself is not subject to state licensing. The addition of a state chartered, nondepository as a trustee of the trust provided no meaningful foundation to assert exemption from state licensing and diluted the argument that the use of a federal savings association provided such a foundation.

This odd set of facts caused some practitioners to assert that the holding should be read narrowly and should not apply in cases where the sole trustee of a state-created trust is a national bank. The court in the case of Altenburg, however, relied on the Sharma decision, even though there was a single national bank trustee of the state trust.

These decisions jarred the market for private holders of delinquent loans in Maryland. Trusts generally believed that the mere passive holding of loans did not involve engaging in the business of collecting debt, even if they instructed licensed mortgage servicers to commence foreclosure. They feared that the rulings could spill over into state mortgage lender licenses where the mere holding of loans requires licenses in some states. Obtaining nationwide state licenses would be costly, inefficient, time consuming and potentially subject trusts to the substantive practice requirements contained in state licensing law, notwithstanding that the trusts simply are passive holders of loans.

The rulings did not impact the standard Fannie Mae, Freddie Mac or Ginnie Mae market, because none of these entities acquires or pools delinquent debt and the holders were not statutory trusts. But, in the private market, particularly for buyers of nonperforming loans, including buyers of such loans from Fannie Mae, Freddie Mac, the Federal Housing Administration or banks, statutory trusts were commonplace.

Following these decisions, foreclosure firms in Maryland essentially went on a “sit-down” strike. They were concerned about their own legal and ethical risk if they pursued a foreclosure on behalf of a state trust that had acquired the loan in default but did not have a collection agency license at the time of filing for foreclosure. It did not matter if the trust was a common law trust or a statutory trust, although some firms were willing to pursue a foreclosure on behalf of an unlicensed trust if title to the loan was held in the name of the national bank as trustee on behalf of the trust rather than in the name of the trust itself. Other foreclosure firms stressed over whether they could proceed to foreclose on loans that the trusts had purchased at the time of default, reinstated and then relapsed again into default. Even if a foreclosure firm were willing to pursue a foreclosure on behalf of a trust that had acquired the loan in default, title insurance was not always available to protect the buyer.

Adding to the confusion was that Maryland did not have any readily available mechanism to license state trusts, since the trusts did not have the features or elements for which the state looked when licensing collection agencies. Over time the state developed a protocol to license trusts as collection agencies, but many trust owners decided to wait and see if the highest court in Maryland would overturn the Sharma and Altenburg decisions.

Finding that the original impetus for licensing was to address abuses in the debt collection industry, the

court of appeals held that the General Assembly did not intend for foreign statutory trusts to obtain a collection agency license under the act before its substitute trustees filed foreclosure actions in various circuit courts. As a result, the court held that the circuit courts improperly dismissed the foreclosure actions simply because the two foreign statutory trusts that had acquired the delinquent mortgage loans were not licensed under the act before the substitute trustees instituted the foreclosure proceedings. Of particular interest in the opinion is the conclusion that a foreign statutory trust is not "doing business" as a collection agency. The court wrote:

Applying that definition of 'business' as used in [the Maryland Collection Agency Licensing Act] to the consolidated cases before us presents further ambiguity. Specifically, the foreign statutory trusts that own the mortgage loans in the cases sub judice do not have any employees or offices, do not have any registered agent, and do not have any specifically identified pursuit in the State of Maryland. Instead, LSF9 and Ventures Trust both act solely through trustees and substitute trustees. Therefore, it would be hard for this court in the first instance to conclude that the foreign statutory trusts engage, either directly or indirectly, in the business of a collection agency when it is hard to deduce if these entities are even conducting 'business' under Funk and Wagnall's definition.

Underlying all of the confusion was the general industry view that a trust simply is not "doing business" as a matter of law, and thus a state does not have jurisdiction to require the licensing of the trust. Consistent with this view are the state versions of the Model Business Corporation Act that provide that simply holding promissory notes and enforcing the collateral pledged as security do not constitute "doing business" or "transacting business" under state laws requiring out-of-state corporations to qualify to do business as a foreign corporation. Indeed, some believe that a state does not have the constitutional power and authority to exercise jurisdiction over a company not "doing business" in that state.

Yet, earlier Maryland opinions added to the confusion by following a twisted logic that a trust may not be "doing business" in the state as a matter of Maryland law on foreign qualifications but is "doing business" as a collection agency. The plain-speaking Maryland Court of Appeals concluded that doing business means doing business and not doing business means not doing business — a logical conclusion that is elegant in its simplicity.

While it is possible that the plaintiffs may file a motion for reconsideration, this decision is a final one, although the Maryland legislature could consider a statutory amendment.

The use of trusts to hold residential mortgage loans is a hallmark of mortgage securitization and private whole loan ownership. The industry generally has believed that trusts do not need state licenses, because either the use of a national bank as trustee provides a direct or indirect exemption from licensing or the trust is not required to be licensed because it is not "doing business" in a state as a passive holder of loans or the U.S. Constitution prevents states from asserting jurisdiction over legal entities not located in or doing business in a state. The now overturned Maryland cases raised questions whether delinquent mortgagors would routinely seek to slow down or prevent foreclosures by raising a trust's lack of a license as a defense. While the cases involved a more specialized state collection agency license rather than the more common state mortgage banking licenses, the "doing business" question was top of mind. A dictionary over 100 years old helped put that concern to rest.

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