ARIZONA SUPREME COURT

Julia Vasquez, Plaintiff, v. Deutsche Bank National Trust Company, as Trustee for Saxon Asset Securities Trust 2005-3; Saxon Mortgage, Inc.; and Saxon Mortgage Services, Inc., Defendants.	No. CV 11-0091-CQ United States Bankruptcy Court Case No. 4:08-bk-15510-EWH

BRIEF OF *AMICUS CURIAE* STATE OF ARIZONA

Thomas C. Horne
Attorney General
Firm State Bar No. 14000

Carolyn R. Matthews (S.B. # 013953)
Dena R. Epstein (S.B. # 015421)
Donnelly A. Dybus (S.B. #013819)
Assistant Attorneys General
Public Advocacy Division
1275 W. Washington
Phoenix, Arizona 85007-2997
602) 542-7731
(602) 542-4377 (fax)
consumer@azag.gov

Attorneys for *Amicus Curiae*
State of Arizona

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STATEMENT OF INTEREST

The Arizona Attorney General is the chief legal officer of the State of Arizona. As such, he has a significant interest in the enforcement of Arizona statutory requirements, especially those related to consumer protection. The Attorney General is responsible for enforcing the Arizona Consumer Fraud Act, A.R.S. §§ 44-1521 to 1534 (the "Act"). The Act makes it unlawful to engage in fraudulent or deceptive practices in connection with the sale or advertisement of merchandise, including real estate. A.R.S. § 44-1522(A) (unlawful practices) A.R.S. § 44-1521(5) (defining "merchandise" to include real estate).

The Attorney General has a significant interest in this case because it involves statutory requirements related to foreclosures. Foreclosures, especially those conducted outside the court system like the one noticed in this case, have proliferated in Arizona in recent years and profoundly impacted an untold number of Arizona consumers. Depending on the measure, Arizona ranks either 2nd or 3rd among states hardest hit by the foreclosure crisis.[1] According to the Final Report

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[1] RealtyTrac, "Foreclosure Activity Off 29 Percent for First Half of 2011," July 14, 2011, *available at* www.realtytrac.com/content/news-and-opinion/midyear-2011. According to RealtyTrac, Arizona had the 2nd highest foreclosure *rate* and the 3rd highest total *number* of foreclosure filings in the first half of 2011. *Id.* The Arizona Children's Action Alliance recently reported that 8% of children in Arizona live in families impacted by foreclosure, twice the national rate and the 3rd highest rate of this measure in the country. *See* 2011 Kids Count Data Book, released August 17, 2011 *available at* http://www.azchildren.org/display.asp?pageId=51&parentId=10. For a general discussion of the housing

of the Financial Crisis Inquiry Commission, which was charged with investigating the causes of America's current financial and economic crises, the housing crisis is "the worst" in the so-called "sand states" – Arizona, Nevada, Florida, and California – states that had the biggest housing booms and that now have the highest numbers of serious mortgage loan delinquencies.[2] A recent "Spotlight" report from the United States Department of Housing and Urban Development described the Phoenix/Mesa/ Glendale Statistical Area, which includes Maricopa and Pinal counties, as "one of the hardest hit areas in the nation following the housing market downturn."[3] More than 50% of Arizona homes are in a negative

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crisis including its impact in Arizona, see "The State of the Nation's Housing 2011," prepared by Joint Center for Housing Studies of Harvard University, *available at* www.corelogichttp://www.corelogic.com/aboutus/researchtrends/asset_upload_file549_8247.pdf.

[2] "The Financial Crisis Inquiry Report," Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States (Jan. 27, 2011), *available at* http://fcic.law.stanford.edu/report, at 215, 393. *See also* November Oversight Report, Congressional Oversight Panel, "Examining the Consequences of Mortgage Irregularities for Financial Stability and Foreclosure Mitigation" (Nov. 16, 2010) ("Congressional Oversight Panel Report"), *available at* http://www.senate.gov/general/common/generic/COP_redirect.htm at n. 11 (foreclosures are concentrated in certain states, including the "sand states" of Arizona, California, Nevada, and Florida). The Congressional Oversight Panel was created as part of the law enacting the Troubled Asset Relief Program, and by statute was terminated in March 2011. *See* The Final Report of the Congressional Oversight Panel (Mar. 16, 2011), *available at* http://www.senate.gov/general/common/generic/COP_redirect.htm at n. 11.

[3] "Spotlight on the Housing Market in: Phoenix- Mesa-Glendale, Arizona," May 2011, *available at* http://portal.hud.gov/hudportal/documents/

equity position, meaning the amount owed on the mortgage loan exceeds the home's value.[4] And the Associated Press' Stress Index which analyzes foreclosure, unemployment, and bankruptcy rates among states, noted recently that Arizona had the 3rd highest stress score nationwide, despite improvements from previous reports.[5]

Given the scope of the foreclosure crisis, it is not surprising that mortgage related issues have consistently topped the list of consumer complaints received by the Attorney General's Office.[6] Many consumer complaints relate to mortgage lending practices, ranging from loan origination to servicing issues, where

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huddoc?id=PhoenixScorecard.pdf, at 1. As of March 2011, Maricopa County had the 4th largest number of mortgages in the nation that were 90 days delinquent or in the process of foreclosure. *Id.* at 2.

[4] CoreLogic, "New CoreLogic Data Shows 23% of Borrowers Underwater with $750 Billion Dollars of Negative Equity," March 8, 2011, *available at* http://www.corelogic.com/about-us/news/new-corelogic-data-shows-23-percent-of-borrowers-underwater-with-$750-billion-dollars-of-negative-equity.aspx (Data showed that Arizona had the second highest negative equity percentage after Nevada, with 51% of properties underwater).

[5] "AP: US economic stress eased in February," April 14, 2011, *available at* www.azcentral.com/business/articles/2011/4/14. *See generally* http://hosted.ap.org/specials/interactives/_national/stress_index/.

[6] The Arizona Attorney General's Annual Report for 2010 shows that consumer complaints regarding loan modification and mortgage companies topped the list of complaints received (totaling approximately 3,273, compared to the next highest measure of 3,163 for general services complaints). *See* http://www.azag.gov/annual.html (2010 report at 28). In the Arizona Attorney General's Annual Report for 2009, mortgage and loan modification complaints ranked sixth of the top ten consumer complaint categories reported, demonstrating a significant increase from 2009 to 2010. Although the 2011 Annual Report has not yet been issued, mortgage related complaints are expected to again top the list.

consumers describe how their mortgage loan servicers have mishandled their requests to modify their loans in order to avoid potential foreclosure. Frustrated with their lenders, many consumers have resorted to paying up-front fees to foreclosure "rescue" companies who promised to negotiate for them, and then filed complaints with the Attorney General's Office once they discovered the promises were false.

In response to these issues, the Attorney General's Office has prosecuted a number of mortgage fraud cases both civilly and criminally over the last five years.[7] The Attorney General obtained settlements with Wells Fargo Bank, NA

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[7] The Arizona Attorney General website and Annual Reports describe numerous civil and criminal mortgage fraud enforcement actions, including actions taken against foreclosure rescue companies, lenders and servicers, and individuals involved in various real estate fraud schemes. *See* www.azag.gov and http://www.azag.gov/annual.html. For instance, the Attorney General sued and obtained a judgment against individuals operating Asset Creation, LLC, a foreclosure rescue company that advertised heavily in the Spanish-language media. Among other things, the company falsely claimed it could reduce borrowers' mortgage loan payments by 50%. *See* http://www.azag.gov/press_releases/jan/2010/ Press%20Release-%20Asset%20Creation.html. A consumer fraud case against a number of parties involved in a complex mortgage investment and rent-to-own scheme eventually led to criminal indictments of two of the principals. *See* http://www.azag.gov/press_releases/july/2009/Arizona%20Investments%20Release.pdf (describing the original consumer fraud lawsuit against AZI Rent2Own L.L.C) and http://www.azag.gov/press_releases/oct/2010/Press%20Release%20-%20Tucson%20Home%20Fraud%20Indictment%2010-26-10.html (announcing criminal indictments and estimating that the scheme led to approximately $2.9 million in foreclosure losses). In addition, the Arizona Attorney General reached a settlement with Home Loan Center, Inc. in November, 2010, in connection with its allegedly deceptive advertisements of payment option adjustable rate loans.

("Wells") and Chase Home Finance, LLC ("Chase"), both of which required those companies to make significant improvements in their mortgage loan servicing standards.[8] In December 2010, the Attorney General sued Bank of America Corporation ("Bank of America") and Countrywide Financial Corporation ("Countrywide") and affiliates, for violating the Consumer Fraud Act and a 2009 Consent Judgment entered against Countrywide as a result of predatory lending

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Among other things, the settlement required the company to pay $1.15 million to the State. *See* http://www.azag.gov/press_releases/oct/2010/Press%20Release%20-%20Home%20Loan%20Center%20Settlement.html.

[8] In October, 2010, the Arizona Attorney General obtained a $2.1 million settlement with Wells in connection with payment option adjustable rate mortgage ("POA") loans sold by Wachovia Corporation ("Wachovia") and Golden West Financial Corporation ("Golden West"), companies acquired by Wells. Arizona's investigation, conducted in cooperation with seven other states, was based on concerns that Wachovia's and Golden West's marketing of POA loans violated the Consumer Fraud Act because the companies did not fully explain that the minimum payment due in the first years of the loan did not cover the full amount of accrued interest, which in turn would increase the amount of the debt (sometimes referred to as negative amortization). Wells agreed to a number of servicing commitments for eligible, at-risk borrowers who bought POA loans, including providing adequately staffed help lines, providing a single, primary point of contact to assist borrowers seeking modifications under the agreement, making decisions on modifications within 30 days of receiving a complete application, and establishing a formal appeal process for borrowers who are turned down for a modification.

In December, 2010, the Attorney General negotiated a settlement agreement with Chase that requires the company to improve loan modification practices for all borrowers, including responding to loan modification requests within 30 days of receiving necessary documentation, assigning one person as a point of contact for a borrower requesting assistance, and refraining from foreclosure proceedings while loss mitigation requests are being considered. The agreement also sets forth time frames within which Chase must acknowledge and respond to consumer complaints filed with the Attorney General's Office, as well as reporting requirements.

practices.[9] In that lawsuit, which is now being actively litigated, the State alleges (among other things) that Bank of America repeatedly deceived consumers about the process, timing, and substance of its loss mitigation programs.[10]

Hundreds of consumer complaints filed with the Attorney General's Office illustrate the "dual track" problem, where servicers initiate or continue the foreclosure process while a loan modification request is pending. Public policy, articulated in both state and federal law, encourages loss mitigation in lieu of foreclosure when possible.[11] Many borrowers who attempt to work out loan modifications, however, have reported receiving a notice of trustee's sale or even being foreclosed on while they are making trial payments that are supposed to lead to a loan modification. Confusion runs rampant because a borrower may be primarily communicating about a loan modification with one entity (their loan servicer), receive a notice of trustee's sale from another entity (the trustee), and read that the notice is recorded on behalf of a third entity, the purported lender (the beneficiary). The Attorney General has an interest in the *Vasquez* case because the

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[9] Bank of America acquired Countrywide in July 2008.

[10] For more information about the Bank of America lawsuit, including the Complaint, see the Attorney General's website, at: http://www.azag.gov/press_releases/dec/2010/Press%20Release%20-%20Bank%20of%20America.html.

[11] *See* A.R.S. § 33-807 (lender's duty to contact the borrower to explore options to avoid foreclosure before recording a notice of trustee's sale) and http://www.makinghomeaffordable.gov/pages/default.aspx (website of the U.S. Departments of Treasury and Housing & Urban Development Making Home Affordable Program).

failure of banks to properly record deed of trust assignments before initiating foreclosure contributes to the dual track problem that so many Arizona consumers have reported.

In their "Procedural Motion," the Defendant banks claim that a ruling in the homeowner's favor will unjustly reward delinquent borrowers, whom they pit against innocent third party purchasers. First, as explained more fully below, Arizona law protects bona fide purchasers for value. *See* A.R.S. § 33-811(B) and § III(A) *infra*.

Second, while the Attorney General does not condone the conduct of borrowers who strategically default, this Office receives hundreds of reports from housing counselors and homeowners who genuinely attempt to meet their obligations to repay their loans but who cannot get their servicers to make decisions on their loan modification requests. Many borrowers report to this Office that they contact their servicers before missing payments, anticipating, for example, that a reduction of work hours will reduce their income and future ability to pay the entire amount. In addition, the Office has reviewed complaints and documentation from many borrowers who were victims of predatory lending practices whereby lenders sold them adjustable rate mortgages they did not realize they would be unable to afford once the interest rate re-set to a much higher

amount, significantly increasing their monthly mortgage payment.[12] These borrowers or their housing counselors approach their servicers in good faith to work out loan modifications to maintain their good credit, and they are often forced to spend many months re-sending the same documents to their servicers, getting passed from one customer representative to the next, and making trial payments on time and often for much longer periods of time than promised. After all of this, borrowers are frequently then told they must start the process all over again to obtain a permanent loan modification, or they are simply never told that their modification request has been denied or why. This Office has received dozens of complaints from borrowers and housing counselors that follow this pattern, many of which include documentation supporting the complaints.[13]

The banks' equitable argument, that a ruling in the homeowner's favor will unjustly reward delinquent borrowers, fails because it completely ignores their own misconduct. The Attorney General's Office has been actively involved with the 50-State Attorney General Foreclosure Investigation, an unprecedented

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[12] *See supra* notes 7-8 for examples of Attorney General enforcement actions involving payment option adjustable rate loans.

[13] Moreover, the Office's files reflect that during 2009 and 2010, many borrowers stopped making payments on their mortgages in the first place because they were (wrongly) told to do so by their servicers, some of whom told borrowers that loan modification requests would not be considered unless borrowers were behind on their payments. According to the Office's review of consumer complaints and responses, this practice does not seem to be as prevalent as it was previously.

investigation in which all 51 Attorneys General have partnered with the United States Department of Justice and other federal agencies to investigate the default servicing practices of residential mortgage servicing companies. Although that investigation has not yet concluded, in April 2011, the Federal Reserve System, Office of the Comptroller of the Currency ("OCC"), and Office of Thrift Supervision issued findings regarding their examination of foreclosure processing at the nation's largest 14 mortgage loan servicers.[14] These agencies found "critical" weaknesses in foreclosure processes throughout the industry, in violation of state and federal laws, presenting "widespread" risks and consequences for the national housing market and consumers:

> The reviews found critical weaknesses in servicers' foreclosure governance processes, foreclosure document preparation processes, and oversight and monitoring of third party vendors, including foreclosure attorneys. While it is important to note that findings varied across institutions, the weaknesses at each servicer, individually or collectively, resulted in unsafe and unsound practices and violations of applicable federal and state law and requirements. The results elevated the agencies' concern that widespread risks may be presented – to consumers, communities, various market participants and the overall mortgage market. The servicers included in this review represent more than two thirds of the servicing market. Thus, the agencies consider problems cited within this

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[14] Interagency Review of Foreclosure Policies and Practices (Apr. 2011), *available at* http://www.occ.gov/news-issuances/news-releases/2011/nr-occ-2011-47a.pdf ("Interagency Review"). The Congressional Oversight Panel Report explains the development of the "robo-signing" scandal, the lenders' responses, and ensuing government investigations. *See supra* note 2 at 10-14.

> report to have widespread consequences for the national housing market and borrowers.

Interagency Review, at 2-3.

The Interagency Review identified "significant weaknesses" in several areas, including "underdeveloped and insufficient" foreclosure processes. *Id.* at 3. Significantly to this case, the agencies found "inadequate monitoring and controls to oversee foreclosure activities conducted on behalf of servicers by external law firms or other third party vendors." *Id.* Examiners also found deficient affidavit and notarization practices, including a failure to comply with state law notary requirements by the "majority" of servicers. *Id.* Further, examiners noted cases of wrongful foreclosure, including instances where borrowers were qualified for or were making payments in accordance with a trial loan modification.[15] *Id.* In sum, servicers' staffing levels, procedures, and internal controls were insufficient to manage the risks of increased foreclosure volume. Because Arizona's non-judicial foreclosure procedures rely almost exclusively on the integrity of information provided by the servicers, these findings, as well as the OCC's enforcement actions taken as a result, militate in favor of a ruling protecting borrowers.[16]

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[15] Other cases in which foreclosure should not have occurred involved borrowers who were covered by the Servicemembers Civil Relief Act (Public Law 108-189) and borrowers who had filed for bankruptcy. Interagency Review at 3.

[16] Based on the Interagency Review, the federal regulators obtained Consent Orders from the 14 servicer companies audited. Among other things, the Orders require the servicers to conduct a look-back to identify and provide redress to

ARGUMENT

I. Certified Question #1: Is the Recording of an Assignment of Deed of Trust Required Prior to the Recording of a Notice of Trustee's Sale Under A.R.S. § 33-808 When the Assignee Holds a Promissory Note Payable to Bearer?[17] Answer: Yes.

A. An Assignee and Holder of a Promissory Note Made Payable to Bearer and Secured by a Deed of Trust Must Have a Beneficial Interest of Record in the Deed of Trust Before It Can Direct the Trustee to Initiate a Trustee's Sale.

1. The statutory scheme is designed to ensure that persons who have authority to foreclose on deeds of trust can be identified from the local public record.

The State agrees with and joins in the answer to this question given by the Plaintiff. As explained by Plaintiff, Arizona statutory and decisional law require

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borrowers harmed by their practices. For more information about the Consent Orders, *see* http://www.occ.gov/news-issuances/news-releases/2011/nr-occ-2011-47.html. Other governmental reports have criticized servicers' responses to the foreclosure crisis. These reports contend, among other things, that had servicers established more efficient, non-deceptive loan modification processes for reviewing borrower eligibility for governmental and in-house modification programs, more borrowers might have remained in their homes, reducing the economic and psychological costs of foreclosures. *See, e.g.*, "Analysis of Mortgage Servicing Performance," Data Report No. 4 (Jan. 2010), issued by State Foreclosure Prevention Working Group, *available at* http://www.state.ia.us/government/ag/latest_news/releases/jan_2010/Foreclosure_Prevention_REPORT.pdf.

[17] This question appears to assume that an assignment of deed of trust has been executed before a notice of sale is recorded and asks whether the assignment must also be recorded before the notice of sale is recorded. According to the stipulated facts in this case, however, Saxon Mortgage, Inc. ("Saxon") had not even executed an assignment of the Deed of Trust to Deutsche Bank National Trust Company, as Trustee for Saxon Asset Securities Trust 2005-3 ("Deutsche Bank") before the Notice of Trustee's Sale was recorded.

that the public record accurately reflect the identities of the beneficiary and trustee of a deed of trust before a trustee's sale can be initiated. *See Eardley v. Greenberg*, 164 Ariz. 261, 265, 792 P.2d 724, 728 (1990) ("statutory scheme is designed to insure that the identities of beneficiaries and the authority of a trustee can be ascertained from an examination of the record"). For example, A.R.S. § 33-411.01 requires that any document evidencing the sale or transfer of real estate or any legal or equitable interest therein (which would include a deed of trust) must be recorded within 60 days of the transfer. A.R.S. §§ 33-804(C) and (F) require that notices of substitution or resignation of trustee must be recorded and must be acknowledged by all beneficiaries or their agents. A.R.S. § 33-808 requires that a notice of trustee's sale must be recorded and must include the names and addresses of the beneficiary and the trustee as of the date the notice is recorded.

Similarly, A.R.S. § 33-411(A) states that "[n]o instrument affecting real property gives notice of its contents to subsequent purchasers or encumbrance holders for valuable consideration without notice, unless recorded as provided by law in the office of the country recorder of the county in which the property is located." And A.R.S. § 33-818 provides that an "assignment of beneficial interest under a trust deed" and other instruments "shall from the time of being recorded impart notice of the contents to all persons, including subsequent purchasers and encumbrances for value." *See also* A.R.S. § 33-809 (after recording notice of

trustee's sale, trustee must provide copy of the notice to each person who appears on the records of the county recorder to have any interest in the trust property).

The importance of recordation before foreclosure is initiated is further demonstrated by the fact that virtually all requirements for pursuing a trustee's sale are keyed to the date of recordation of the notice of trustee's sale. *See, e.g.,* A.R.S. § 33-807(D) (providing that power of sale shall not be exercised prior to the ninety-first day after the notice of trustee's sale is recorded); A.R.S. § 33-809 (prescribing times in which trustee must provide additional disclosures of the notice of sale; all are keyed to the date the notice of trustee's sale is recorded); *id.* (procedure for requesting copies of notice of sale under a trust deed refers to time "subsequent to the recording of the trust deed and prior to the recording of a notice of sale pursuant thereto").

2. This Court can and should determine that, if a deed of trust has been assigned, the assignment must be recorded before a notice of trustee's sale can be recorded.

The State acknowledges that there is no statute expressly requiring that an existing assignment of deed of trust must be recorded before a notice of trustee's sale can be recorded. The absence of a specific statute, however, does not mean that the requirement does not exist. *See Eardley*, 164 Ariz. at 264, 792 P.2d at 727 (refusing to infer legislative intent from the absence of express permission for an agent to execute a notice of substitution of trustee); *Newman v. Fidelity Savings &*

Loan Association, 14 Ariz. 354, 358-59, 128 P. 53, 55 (1912) (holding that, although the statutory scheme does not expressly require assignment of mortgages to be recorded to protect assignee against later claims, such a requirement appears in the statute "by clear implication"). To the contrary, it is clear from the overall statutory scheme that the requirement is implicit: A trustee cannot record a notice of trustee's sale unless the public record first accurately reflects the identities of the beneficiary and the trustee under the deed of trust.

B. Requiring Recordation of a Deed of Trust Assignment Before an Assignee Can Validly Record a Notice of Sale Will Serve the Public Interest.

Numerous important policy considerations compel the conclusion that the current beneficiary of real property in foreclosure must be identifiable from the public record. Recordation of documents gives notice to the world of the content of the documents. A.R.S. § 33-818. Likewise, failure to record a deed of trust deprives the borrower facing foreclosure (and any junior lienholders) of official notice that the entity purporting to foreclose is actually the entity with the right to foreclose. Arizona citizens have "the right to presume that public records speak the truth and to act thereon in all matters affected by instruments required by law to be recorded." *See Newman,* 14 Ariz. at 357, 128 P. at 54.

Given the recording and disclosure requirements of the statutory scheme, the summary nature of trustee's sales, the complete lack of judicial oversight over

them, and the enormous consequences they have on homeowners, the statutory scheme demands that the public record accurately reflect the entity entitled to conduct a trustee's sale before the sale is initiated.

1. Accurate identification in the public record of who owns the loan and who has the power to foreclose can facilitate loss mitigation and avoid foreclosure.

It is the public policy of the State of Arizona to avoid foreclosing on homeowners when possible. In 2010, the Arizona Legislature enacted a statute that requires lenders to explore alternatives to foreclosure with homeowners who obtained first mortgages between 2003 and 2008 before proceeding with trustee's sales. A.R.S. § 33-807.01(A).

Given today's market, in which residential loans are frequently bought and sold, and given the prevalence in recent years of foreclosure rescue scam artists,[18]

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[18] In many cases, foreclosure rescue companies solicit consumers with mailed solicitations that refer to the consumer's mortgage loan "lender" and in some cases create the appearance of being from the lender itself. In December, 2010, for instance, the Attorney General sued Principal Reduction Group, LLC, and its owner in connection with their "principal reduction" program that promised to reduce homeowner's mortgage payments (for an advance fee of approximately $6,000). The Principal Reduction Group allegedly mailed hundreds of thousands of mailers designed to appear as if they were from the homeowners' lenders announcing the lenders' principal reduction program and the possibility that the homeowners might qualify for it. *See* http://www.azag.gov/press_releases/dec/2010/Press%20Release%20-%20Goddard%20Sues%20Two%20Companies%20over%20'Principal%20Reduction'%20Services.html. The Office filed a similar lawsuit against Queen Creek Mortgage, alleging that the company sent mailers entitled "Principal Reduction Prequalification Program Notice" to Arizona consumers, suggesting eligibility for a government program that would lower their

homeowners can be certain they are negotiating with the correct lender under this statute only if the historical practice of recording evidence of ownership transfers is followed. Knowing the correct identity of the lender also allows the borrower to determine if the negotiation requirement is triggered in the first place and may impact whether or not a loan workout is possible under the circumstances. *See* A.R.S. § 33-807.01(C)(4) (contact and workout provisions do not apply to "lenders compliant with the United States department of treasury home affordable modification program") and A.R.S. § 33-807.01(D) ("[n]othing in this section requires a servicer to violate contractual agreements for investor-owned loans"). If a borrower on the verge of default cannot find out who has the authority to modify the loan, it may be impossible to negotiate a modification or a short sale, even if it would be beneficial to both the borrower and the lender. Compliance with A.R.S. §

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mortgage payments. Last year, a lawsuit filed against another foreclosure rescue company alleged that the company falsely represented itself as being associated with consumers' lenders and as being endorsed by government entities. *See* http://www.azag.gov/press_releases/june/2010/Press%20Release%20-%20Discount%20Mortgage%20Relief%20Complaint%206-3-10.html (announcing consumer fraud lawsuit against INQB8, LLC). Most recently, the Attorney General filed a consumer fraud lawsuit against Robert Hayes and Camerin Hawthorne for a number of deceptions in connection with mortgage loan modification services, including allegedly falsely representing that one of their companies (Metropolis Loans) was affiliated with consumers' lender, CitiMortgage. (For more information and a copy of the complaint, *see* http://www.azag.gov/press_releases/april/2011/DeceptiveMortgage%204-28-11.html.) Many borrowers understand that there are federal programs available to assist them if they are facing foreclosure. If borrowers cannot verify through accurate, public records the correct identity of their current lender, they may be susceptible to fraud.

33-411.01, requiring recordation of assignments of deeds of trust, will provide notice to borrowers that will enable them to ascertain the true identity of the entity that may ultimately decide whether they can avoid foreclosure.

In addition, recordation may help ameliorate the "dual track" problem discussed above. This Office has reviewed documentation of many homeowners at risk of foreclosure who have modification requests pending at the same time they are on the foreclosure track (meaning that a trustee's sale has been noticed and may have been continued, but has not yet been canceled or held). Dual track presents special problems because borrowers are promised they will not be foreclosed on while a modification request is pending, but then remain on the dual track of both modification and foreclosure. This Office has received complaints from many borrowers who have been foreclosed on while they believed their modification requests were still pending. If borrowers can at least determine from the public record who currently owns their loans, they may be able to communicate directly with their lenders and negotiate modifications before the dual track results in avoidable foreclosure.

2. An accurate public record may avoid wrongful foreclosures.

Slipshod and careless loan transfer and foreclosure practices have in some cases led to wrongful foreclosures according to federal regulators. *See* Interagency Review, *supra* note 14, at 3. In the absence of judicial oversight, strict compliance

with Arizona law is an important tool to help prevent fraudulent or wrongful foreclosures. Given that borrowers facing foreclosure often lack the technical knowledge and the financial resources to contest a wrongful foreclosure, strict compliance with the statutory requirements is the only means to ensure that borrowers receive the few protections provided by law.

3. An accurate public record will facilitate certainty of title and the sale of real estate.

As set forth in more detail in Section III.C, *infra,* it is important for the real estate market and the Arizona economy as a whole that recording requirements be followed, particularly in the context of non-judicial foreclosures. Prospective buyers and their title insurers must be able to rely on the public record to verify that good title is being conveyed. If, on the other hand, lenders are allowed to continue to circumvent land title recording laws, these practices may continue to nurture an unstable and uncertain real estate market.

II. Certified Question #2: Must the Beneficiary of a Deed of Trust Being Foreclosed Pursuant to A.R.S. § 33-807 Have the Right to Enforce the Secured Obligation? Answer: Yes.

A. A Beneficiary of a Deed of Trust Being Foreclosed Pursuant to A.R.S. § 33-807 Must Have the Right to Enforce the Secured Obligation.

A "mortgage may be enforced only by, or on behalf of, a person who is entitled to enforce the obligation that the mortgage secures." Restatement (3d) of Property (Mortgages) § 5.4. The reason for this generally accepted rule is clear. If

the beneficiary of the deed of trust does not have the right to enforce the promissory note, then it cannot suffer a default, and it is the default of the underlying note that gives rise to the right to foreclose on the security. A.R.S. § 33-807(A) (power of sale is conferred on trustee after a breach of the contract for which the trust deed is conveyed as security); A.R.S. § 33-805 (deeds of trust may be executed as security for performance of a contract).

> [I]n general a mortgage is unenforceable if it is held by one who has no right to enforce the secured obligation. For example, assume that the original mortgagee transfers the mortgage alone to A and the promissory note that it secures to B. Since the obligation is not enforceable by A, A can never suffer a default and hence cannot foreclose the mortgage. B, as holder of the note, can suffer a default. However, in the absence of some additional facts creating authority in A to enforce the mortgage for B, B cannot cause the mortgage to be foreclosed since B does not own the mortgage.

Restatement (3d) of Property (Mortgages) § 5.4 cmt. e; *see also Krohn v. Sweetheart Properties, Ltd.*, 203 Ariz. 205, 214, ¶ 38, 52 P.3d 774, 783 (2002) (en banc) (3-1) (adopting Restatement (3d) of Property (Mortgages) § 8.3 in absence of prior decisional or statutory law). *Cf.* A.R.S. § 33-805 (Arizona statutes that refer to mortgages as security instruments are deemed to also include deeds of trust unless the context otherwise requires).

As the State understands the stipulated facts and the documents provided by the bankruptcy court, when the Notice of Trustee's Sale was recorded, it was

Saxon, not Deutsche Bank, that was actually the beneficiary of the Deed of Trust. *See* Order Certifying State Law Questions to the Arizona Supreme Court, filed April 4, 2011 ("Bankruptcy Court Order"), Exs. B and E. Before the Notice of Trustee's Sale was recorded, Saxon had apparently assigned the underlying promissory note,[19] but not the deed of trust, to Deutsche Bank. Therefore, the stipulated facts indicate that Deutsche Bank recorded the Notice of Trustee's Sale without authority to do so and incorrectly identified itself as beneficiary, since the deed of trust assignment was not executed until two months later. *See* Bankruptcy Court Order, Ex. E.

If the bankruptcy court certified only a theoretical question—that is: Had Saxon (the actual beneficiary under the Deed of Trust) recorded the Notice of Trustee's Sale as beneficiary, would it have been necessary for Saxon to have had the right to enforce the secured obligation (the Note), before it recorded the Notice of Trustee's Sale?—then the answer must be yes. At the time the Notice of Trustee's Sale was recorded, Saxon had no interest in the underlying promissory note (because it had previously assigned it to Deutsche Bank), so it could have suffered no injury to enforce. Restatement (3d) of Property (Mortgages) § 5.4.

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[19] The State assumes that the Note was validly and effectively assigned to Deutsche Bank before the Notice of Trustee's Sale was recorded, because it appears that the parties have so stipulated. The State offers no opinion as to whether the assignment in blank was valid or effective to assign Saxon's interest in the Note to Deutsche Bank.

Because Saxon had no interest in the promissory note, it would have had no legal authority to foreclose on the property securing the Note. *Id. Cf. De Anza Land & Leisure Corp. v. Raineri*, 137 Ariz. 262, 266, 669 P.2d 1339, 1343 (App. 1983) (holding that same statute of limitation that bars an action on the debt also bars an action to foreclose the mortgage), *as explained in Stewart v. Underwood*, 146 Ariz. 145, 148, 704 P.2d 275, 278 (App. 1985) (holding that A.R.S. § 33-816 explicitly extends *De Anza* to deeds of trust, providing that same limitations period applicable to action on the debt also applies to action to foreclose the deed of trust).

Because it was Deutsche Bank, not Saxon, that recorded the Notice of Trustee's Sale, the certified question appears to be hypothetical only. But the answer must be yes. Arizona law requires a beneficiary under a deed of trust to have the right to enforce the secured obligation in order to foreclose on the deed of trust.

B. A Subsequent Holder of a Promissory Note Payable to Bearer Must Receive an Assignment of the Deed of Trust Before it Can Notice a Trustee's Sale.

According to the stipulated facts and the exhibits, it was Deutsche Bank—who was not then the Deed of Trust beneficiary—that both appointed the successor trustee and noticed the trustee's sale. Deutsche Bank lacked the legal right to foreclose because it was not the beneficiary of the Deed of Trust at the time the

Substitution of Trustee and Notice of Sale were recorded. Although Deutsche Bank was the assignee or subsequent holder of the Note secured by the Deed of Trust, it was required to have received an assignment of the deed of trust before it could properly foreclose on the real property.

Arizona's summary, non-judicial foreclosure process is strictly a creature of statute. Only the beneficiary under a deed of trust has the power to appoint a successor trustee and to direct a trustee to execute the trustee's power of sale. A.R.S. § 33-804(A) ("beneficiary may appoint a successor trustee"); A.R.S. § 33-807(A) (beneficiary has the option of determining whether to foreclose under statutory provisions for foreclosure of a mortgage (judicial foreclosure) or provisions for foreclosure of a deed of trust (non-judicial foreclosure)); A.R.S. § 33-801(1) ("beneficiary" defined as the person named in trust deed as the person for whose benefit a trust deed is given). The statutory scheme confers no similar authority on the holder or assignee of the underlying promissory note. *See* A.R.S. §§ 33-801 to 821.

In this case, the stipulated facts are that the Deed of Trust was not assigned to Deutsche Bank until months after the Substitution of Trustee and Notice of Trustee's Sale were recorded. Without a valid assignment, Deutsche Bank lacked authority to appoint a successor trustee to foreclose the Deed of Trust. *See* A.R.S.

§ 33-804(A). And without a valid assignment, Deutsche Bank lacked authority to direct the trustee to initiate foreclosure proceedings.[20] A.R.S. § 33-807(A).

C. Public Policy Demands Strict Compliance With the Law.

The legal requirements described above have been well known and unambiguous for many years. Lenders should not be excused for failing to ensure that their business practices conform to Arizona law, especially in the inherently legal arena of establishing, transferring, and exercising security interests in land. "A mistake as to the requirements of the law is no excuse for a failure to meet its requirements." *Newman*, 14 Ariz. at 359, 128 P. at 55 (holding that lender was entitled to rely on publicly recorded release of mortgage, even though fraudulent, when prior assignment of mortgage securing same property had not been recorded as required by law). Consistent compliance with the law promotes certainty, and everyone, including innocent purchasers, benefits from that.

Arizona's non-judicial foreclosure process features few procedural safeguards, no judicial oversight, and can be completed in as few as 91 days. Because of the complete absence of judicial oversight, the ease and speed of trustee's sales, and the drastic disparity between lenders and individual

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[20] Further, A.R.S. § 33-808(C)(5) requires a notice of trustee's sale to identify the name and address of the beneficiary under the deed of trust "as of the date the notice of sale is recorded." According to the stipulated facts, the Notice of Trustee's Sale failed to identify the correct beneficiary. It identified Deutsche Bank, when in fact the actual beneficiary on the date the Notice was recorded was Saxon.

homeowners in both sophistication and financial resources, it is particularly important for this Court to continue its longstanding policy of strictly construing the few statutory requirements that do exist in favor of notice to the borrower. *See, e.g., Patton v. First Federal Savings & Loan Association*, 118 Ariz. 473, 477, 578 P.2d 152, 156 (1978) (because the non-judicial foreclosure process "strip[s] borrowers of many of the protections available under a mortgage," "lenders must strictly comply with the Deed of Trust statutes," and those statutes "must be strictly construed in favor of the borrower"), *cited with approval in Krohn,* 203 Ariz. at 208, ¶ 10, 52 P.3d at 777.

Simple fairness demands that lenders be required to strictly follow the non-judicial foreclosure law, particularly considering that Arizona's process allows lenders to summarily deprive homeowners of their property with no judicial oversight. Careless practices in documenting ownership and noticing trustee's sales are not an excuse for failing to follow the law. It is important for the public to know that the law applies to lenders and servicers as well as to homeowners. The *quid pro quo* for allowing lenders to use Arizona's quick and inexpensive trustee's sale process is that lenders must strictly follow the statutory requirements. *See, e.g., Patton*, 118 Ariz. at 477, 578 P.2d at 156 (holding that the statutory requirements for non-judicial foreclosure must be strictly complied with because, compared with judicial foreclosure, they make it "far easier for lenders to forfeit

the borrower's interest in the real estate securing a loan, and also abrogate the right of redemption" that is guaranteed after judicial foreclosure).

For all of the public policy reasons discussed herein, lenders and servicers must be required to strictly comply with the law governing non-judicial foreclosures, must ensure they have the legal right to foreclose before noticing a trustee's sale, and must ensure that the chain of title is properly ascertainable from the public record.

III. The Banks' Fears of Disastrous Economic Results Are Greatly Overstated.

The Banks' claims that answering "yes" to the certified questions will cause a "parade of horribles" are exaggerated and do not warrant ignoring the minimal protections provided for consumers in the statutory scheme. Although a court in equity has authority to undo a trustee's sale in the event of fraud or other extraordinary event, a number of court decisions have held that trustee's sales will not be invalidated for non-prejudicial defects in the sale process when property is purchased by one who has no notice of the defect. *See, e.g., Hills v. Ocwen Federal Bank, FSB (In re Hills)*, 299 B.R. 581, 585-86 (Bankr. D. Ariz. 2002) (absent grounds for equitable relief "based on serious sale defects, including deliberate notice failure, fraud, misrepresentation, or concealment," trustee's sale cannot be set aside against a bona fide purchaser for value without notice); *Krohn*, 203 Ariz. at 208, ¶ 10, 52 P.3d at 777 ("absent special circumstances, sales to bona

fide purchasers are not upset by the courts,"); *Main I Ltd. Partnership v. Venture Capital Construction & Development Corp.*, 154 Ariz. 256, 259, 741 P.2d 1234, 1237 (App. 1987) (refusing to set aside sale for defects in notice to third parties that did not prejudice borrower).

A. A Trustee's Sale That Fails to Comply With Arizona Law Will Not Jeopardize Property Rights of Purchasers or Their Tenants.

Three types of purchasers are potentially affected by a trustee's sale that fails to comply with Arizona law. They are: (1) the unrelated third party who purchases the property at the trustee's sale for value and without actual notice of any defect; (2) the lender who purchases the property at the trustee's sale by credit bid; and (3) the unrelated third party who purchases the property from the lender after the trustee's sale, where the third party is a bona fide purchaser for value and without actual notice. Contrary to the banks' cries that "the sky is falling," affirmative answers to the certified questions will not require innocent buyers to be thrown out of their homes in any of these situations or call into question the title of properties previously foreclosed.

1. The third party who purchases at the trustee's sale.

A bona fide purchaser for value and without actual notice of any defect in the trustee's sale is protected by the statutory scheme. *See, e.g.*, A.R.S. § 33-811(B) ("A trustee's deed shall constitute conclusive evidence of the meeting of [the deed of trust and statutory] requirements in favor of purchasers or

encumbrancers for value and without actual notice."); *Main I Ltd. Partnership*, 154 Ariz. at 259, 741 P.2d at 1237 (trustee's deed is conclusive evidence of compliance with deed of trust statutes); *see also* Kent E. Cammack, *et al.*, *Ins and Outs of Foreclosures* § 2.2.9, at 2-47 (State Bar of Ariz., 3d ed., 2010) ("The conveyance is absolute and without right of redemption."). Thus, absent extraordinary circumstances, a bona fide purchaser for value and without actual notice of a defect in the trustee's sale is protected against claims of defect in the sale upon delivery of the trustee's deed.

2. The lender/beneficiary who purchases at the trustee's sale.

If the purchaser is the lender, and the lender recovers the property as the successful bidder at the trustee's sale, then one of two results will occur. If the lender is a bona fide purchaser for value and without actual notice of any irregularity in the sale, it will take title to the property by receipt of the trustee's deed and will be protected by A.R.S. § 33-811(B) ("Knowledge of the trustee shall not be imputed to the beneficiary."). If the lender is not a bona fide purchaser for value without notice, then no innocent third parties are impacted and there is no reason not to invalidate the trustee's sale and require the lender to document its ownership correctly before any subsequent sale.[21] In such a case, the lender can

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[21] A number of states and county recorders have alleged that lenders and servicers have avoided millions of dollars in county recording fees for assignments that were never recorded. *See, e.g.*, First Amended Complaint, *State of Hawaii ex*

either re-do the trustee's sale in compliance with the law after documenting its ownership, or if it cannot demonstrate a proper chain of title, then it can initiate a judicial foreclosure.

3. The subsequent third party purchaser.

If the lender buys the property at the trustee's sale and then sells it to a third party bona fide purchaser for value and without actual notice, then the rationale for protecting bona fide purchasers from a trustee's sale applies with even greater force to the subsequent bona fide purchaser. See, e.g., *Krohn*, 203 Ariz. at 213, ¶ 34, 52 P.3d at 782 (noting that "the balance of equities would be considerably different if the person who acquired the property [at a trustee's sale] for a grossly inadequate price sold it to a bona fide purchaser"). Absent extraordinary circumstances, the Court should rule based on common sense, common law, and equity that the subsequent purchaser is protected. See, e.g., id.; *Hills*, 299 B.R. at 585-86 (bona fide purchaser for value holds good title by means of the trustee's deed and sale will be set aside only if there are grounds for equitable relief based on serious sale defects); see also *infra*, § III.A.1. *Cf. Sprang v. Petersen Lumber,*

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rel. Barry Bates v. First Hawaiian Bank, et al., Civil No. 10-1-0160-01 (5th), in the Circuit Court of the First Circuit, State of Hawaii (8/17/10); *see also* Congressional Oversight Panel Report, *supra* note 2 at 29 (local jurisdictions may bring lawsuits to recover unpaid mortgage recording fees). If lenders have indeed profited from avoidance of recording fees, then it is only fair for them to bear any cost that may result from their failure to ensure that their practices have conformed to Arizona law.

Inc., 165 Ariz. 257, 798 P.2d 395 (App. 1990) (setting aside a sale to subsequent third party bona fide purchaser following judicial foreclosure because seller never had title to convey); A.R.S. § 33-412 (unrecorded deed of trust is void as to subsequent purchaser for value and without notice).

4. Borrowers who are foreclosed on do have some protection.

It is worth noting that, in addition to purchasers, homeowners also are protected from actions against them following a trustee's sale, by the anti-deficiency statute, A.R.S. § 33-814(G). *See Baker v. Gardner*, 160 Ariz. 98, 104, 770 P.2d 766, 772 (1988) (holding that lender cannot avoid effect of the statute by waiving the security and suing on the note, and noting that the statute evinces the Legislature's desire to protect homeowners "from the financial disaster of losing their homes to foreclosure plus all their other nonexempt property").

In addition, the homeowner who is wrongfully foreclosed upon is not without a remedy. Although he cannot in most circumstances usurp the bona fide purchaser without notice, he can file an action for damages against the beneficiary and/or trustee following the sale. *See In re Hills,* 299 B.R. at 586 (if borrower shows there are irregularities with the sale, the remedy is to proceed against the secured creditor or trustee under the deed of trust); *cf. Krohn*, 203 Ariz. at 209, 212, ¶¶ 13, 29, 52 P.3d at 778, 781 (stating that "courts of equity are open to ensure debtors receive not only procedural but fundamental fairness" and holding

that *gross* inadequacy of price is proof of unfairness). In addition, a homeowner may be able to stop a foreclosure sale by demonstrating sufficient defects in ownership by the foreclosing entity or in the notice. A.R.S. § 33-811(C).

B. A Ruling In the Homeowner's Favor Will Not Stop Foreclosure Activity.

Lenders who have not recorded deed of trust assignments as required by Arizona law can proceed with foreclosures by properly documenting and recording their interests in the real property and then re-doing their notices of trustee's sale to reflect the correct legal and equitable interests in the property. If they cannot do that, then they can proceed via the judicial foreclosure process. Lenders who act responsibly and document and properly record deed of trust assignments and other transfers before they foreclose can use the expedited trustee's sale process, but lenders who engage in careless practices could only proceed with foreclosure through the judicial process with its increased oversight and procedural safeguards.

C. There is No Basis for the Banks' Assertion That Requiring Compliance with the Law Will Have a Chilling Effect on the Sale of Real Property.

The banks' argument that affirmative answers to the certified questions will chill the sale of real property fails. Indeed, a similar argument was rejected by this Court in the *Krohn* case. *See Krohn,* 203 Ariz. at 210, ¶ 20, 52 P.3d at 779. In that case, the Arizona Trustee Association urged the Court to uphold a trustee's sale where the price paid was less than twenty percent of the fair market value. *Id.* at

207, 209, ¶¶ 5, 15, 52 P.3d at 776, 778. In holding that a trustee's sale can be set aside when the price paid was grossly inadequate, the Court rejected the Association's arguments that the limited judicial oversight inherent in the court's ruling would chill the market and discourage bidders at trustee's sales. *Id.* at 210-11, ¶¶ 19-23, 52 P.3d at 779-80.

If lenders are required to comply with the law and properly document and record sales and transfers of their interests in real property, it will make the job of prospective purchasers and title insurers easier, in that they would be able to verify ownership from the public record, as was intended by the recording statutes in the first place. *See, e.g.*, A.R.S. § 33-411.01 (requiring recordation of all documents evidencing the sale or transfer of any legal or equitable interest in real estate). Contrary to the banks' argument, the efficiency of the market does not require relaxing legal requirements—that would only increase title disputes and confusion. The market requires certainty. Purchasers must be able to rely on sellers' compliance with legal requirements. And, contrary to the banks' argument, it is not the requirement to record, but the failure to record beneficial interests in deeds of trust prior to noticing trustee's sales that is likely to have a chilling effect on third party bidders at the sale, because failure to record would put potential buyers on notice that the beneficiary under the deed of trust is not the same as the beneficiary identified in the notice of trustee's sale, making buyers less inclined to

buy the property The people of Arizona will be better served by a bright-line requirement that lenders must strictly follow the law if they want to avail themselves of the benefit of the expedited non-judicial foreclosure process.

Recording evidence of changes in ownership imparts notice to the borrower and the world. A.R.S. §§ 33-416, -818. This clears title and facilitates the transfer of real property. If a borrower not in default wants to sell his property, it can be difficult to establish good title without a public record of assignments of the deed of trust, thus discouraging or inhibiting sale. Requiring lenders who assign deeds of trust to record transfers of ownership before initiating trustee's sales allows borrowers facing foreclosure to confirm that the entity from which they receive a notice of trustee's sale or an inquiry regarding potential modification actually owns the beneficial interest and has the right to modify or foreclose.

Traditionally, Arizona and other states have required parties to record transfers of property interests. *See U.S. Bank National Association v. Ibanez*, 941 N.E.2d 40, 55 (Mass. 2011) (describing the legal principles requiring banks to establish authority to foreclose before proceeding with a power of sale as "well established").[22] "All that has changed is the [banks'] apparent failure to abide by

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[22] See also Congressional Oversight Panel Report, *supra* note 2 at 16 (describing how each of the 50 states, and every county in the country, maintains records of who owns land in the county, transfers of ownership, and related mortgages of deeds of trust). "While each state's laws have unique features, their

those principles and requirements in the rush to sell mortgage backed securities." *Id.* ; *see also* National Law Center amicus brief filed in this matter at 25-30 (noting that Arizona law has required recording of property interests since statehood).[23]

D. The Court's Decision Need Not Cloud Years of Real Property Transactions.

Although unlikely, to avoid any confusion that could be caused by challenges to many years' worth of prior trustee's sales, the Court could limit its ruling to prospective cases only or impose other limitations. *See, e.g., Turken v. Gordon*, 223 Ariz. 342, 351, 224 P.2d 158, 168 (2010) (Although decisions normally operate retroactively, the Court will consider whether its opinion overrules settled precedent, establishes a new legal principle whose resolution was not foreshadowed, or whether retroactive application would produce substantially inequitable results.). While the Attorney General does not believe that answering the certified questions affirmatively would change existing law or produce

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basic requirements are the same, consistent with the notion that the purpose of the recording system is to establish certainty regarding property ownership." *Id.*

[23] In fact, the banking industry itself is moving in the direction of following traditional state foreclosure and recording laws. A July 21, 2011 policy announcement from the Mortgage Electronic Registrations Systems, Inc. ("MERS") announces that, going forward, no foreclosure proceeding may be initiated in the name of MERS. Policy Bulletin Number 2011- 5, *available at* http://www.mersinc.org/files/filedownload.aspx?id=734&table=ProductFile. Further, this bulletin announces that Certifying Officers (representatives of member banks) must execute assignments of the security instrument from MERS "before initiating foreclosure proceedings" and must promptly send them "for recording in the applicable public land records." *Id.*

inequitable results, this is a policy question for the Court to decide in its discretion. *Id.*

CONCLUSION

For the foregoing reasons, the State respectfully requests that the Court answer both of the certified questions in the affirmative.

Respectfully submitted this 19th day of August, 2011.

Thomas C. Horne
Attorney General

Carolyn R. Matthews
Dena R. Epstein
Donnelly A. Dybus
Assistant Attorneys General

Attorneys for *Amicus Curiae*
State of Arizona

CERTIFICATE OF COMPLIANCE

Pursuant to ARCAP 14, I certify that the attached brief uses proportionally spaced type of 14 points or more, is double-spaced using a roman font, and contains 8,757 words.

Dated this 19th day of August, 2011.

Carolyn R. Matthews
Assistant Attorney General

CERTIFICATE OF SERVICE

Original and seven copies of the foregoing [hand-delivered or mailed] this 19th day of August, 2011, to:

Arizona Supreme Court
1501 West Washington
Phoenix, AZ 85007-3235

And two copies of the foregoing mailed the same day to:

Beverly Parker, Esq. Anthony Young, Esq. Southern Arizona Legal Aid 2343 East Broadway, Suite 200 Tucson, AZ 85719-6007 *Attorneys for Plaintiff*	Lori Angus Wilson, Esq. 4215 East Cooper Street Tucson, Arizona 85711 *Attorney for Amicus Curiae for NCLC/SWFHC*
Vince Rabago, Esq. 500 N. Tucson Blvd., Ste. 100 Tucson, AZ 85716 *Attorney for Amicus Curiae for NCLC/SWFHC*	Carrie Pixler Ryerson, Esq. Timothy Berg, Esq. Fennemore Craig , P.C. 3003 N. Central Ave., Ste. 2600 Phoenix, AZ 85012 *Attorneys for Amicus Mortgage Bankers Association*
Ronald E. Warnicke, Esq. Gordon Silver One East Washington, Ste. 400 Phoenix, AZ 85004 *Attorney for Amicus Amici Stauffer & Buchna*	Robert A. Mandel, Esq. Gilbert Rudolph, Esq. E. Jeffrey Walsh, Esq. Julie R. Barton, Esq. Greenberg Traurig, LLP 2375 E. Camelback Rd., Ste. 700 Phoenix, AZ 85016 *Attorneys for Defendant*
William A. Nebeker, Esq. Valerie R. Edwards, Esq. 3200 N. Central Ave., Ste. 2300 Phoenix, AZ 85012 *Attorneys for Amicus Curiae AZ MDL Plaintiffs*	C. Bradley Vynalek, Esq. Brian A. Howie, Esq. Michael S. Catlett, Esq. Quarles & Brady, LLP Renaissance One Two N. Central Ave.

	Phoenix, AZ 85004 *Attorneys for Amici AZ Bankers Association, Greater Phoenix Chamber of Commerce, AZ Chamber of Commerce and Industry*
Beth K. Findsen, Esq. 7279 E. Adobe Dr., Ste. D120 Scottsdale, AZ 85255 *Attorney for Amici Stauffers & Buchnas*	Eric J. McNeilus, Esq. Huerlin Sherlock Panahi 1636 Swan, No. 200 Tucson, AZ 85712 *Attorney for Plaintiff*
Paul M. Levine, Esq. McCarty Holthus Levine 8502 E. Via de Ventura, Ste. 200 Scottsdale, AZ 85258 *Attorney for United Trustees Association*	Eileen W. Hollowell U.S. Bankruptcy Court District Court of Arizona 38 S. Scott Ave. Tucson, AZ 85701

By: