IN THE UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF ARKANSAS
FAYETTEVILLE DIVISION

IN RE: MATTHEW AND LINDA SCHIEFER, Debtors **No. 5:13-bk-73404**
Ch. 13

MATTHEW AND LINDA SCHIEFER **PLAINTIFFS**

v. **5:14-ap-7061**

WELLS FARGO BANK, N.A. **DEFENDANT**

ORDER

Before the Court are the debtors' complaint and Wells Fargo Bank, N.A.'s answer. The complaint is based on a promissory note the debtors, Matthew and Linda Schiefer, executed in favor of First Western Mortgage, Inc. [First Western] in November 2004 and a related mortgage on their home the debtors gave to First Western to secure the note. The subsequent history of that note and mortgage gives rise to this adversary proceeding.

The debtors filed their voluntary chapter 13 bankruptcy petition on October 10, 2013. In their petition, they listed Wells Fargo Home Mortgage as a secured creditor with a claim of $119,197.00. Wells Fargo Home Mortgage's security was listed as the debtors' primary residence, the same home on which they gave First Western a mortgage in 2004. The creditor, Wells Fargo Bank, N.A. [Wells Fargo] filed its proof of claim on February 5, 2014, in the amount of $118,499.69. The following month, on March 17, 2015, the debtors objected to Wells Fargo's proof of claim arguing that Wells Fargo is not the entity entitled to enforce the note that encumbers the debtors' home.

On August 5, 2014, the debtors filed the current adversary proceeding and alleged three counts: (1) that Wells Fargo does not own the note and, hence, does not have an interest in the mortgage on the debtors' home; (2) that Wells Fargo committed fraud on the Court by identifying itself as a creditor in the debtors' bankruptcy case; and (3) that Wells

Fargo also committed fraud on the Court by filing a document the debtors allege to be fraudulent and not legally binding. Wells Fargo responded by arguing that it is a creditor because it has possession of the note and mortgage at issue. It further argued that the debtors do not have standing to object to the assignment of the note and mortgage from Washington Mutual Bank f/k/a Washington Mutual Bank, FA [Washington Mutual] to Wells Fargo.

The Court set the complaint for trial on September 28, 2015. At the beginning of trial, the debtors withdrew their previously filed objection to Wells Fargo's proof of claim that was filed in the main case on March 17, 2015. However, they did not withdraw the similar allegations contained in their adversary proceeding.

This case centers on the note and mortgage that the debtors entered into in 2004 and the subsequent ownership of that note through various alleged transfers. Based on the testimony and other evidence presented at trial, including the transfer documents of record filed in the state court clerk's office, interrogatories, and answers to requests for admissions, there are three possible scenarios concerning the debtors' note and mortgage. The first scenario is based on filed documents and related testimony concerning those documents. In this scenario, Wells Fargo, which has possession of the note and mortgage, is the owner of the note and mortgage according to an Assignment of Mortgage from Washington Mutual Bank f/k/a Washington Mutual Bank, FA [Washington Mutual] in 2007 (Wells Fargo Ex. D) and the subsequent endorsement in blank that was added to the note in 2013.

The second scenario is based on the testimony of Robert Bateman, a Loan Verification Analyst for Wells Fargo. In this scenario, either Wells Fargo is the owner of the note and mortgage based on Bateman’s unequivocal testimony at trial or, based on an affidavit offered by Bateman after the conclusion of the trial, Fannie Mae is the owner of the note

and Wells Fargo is the servicer.[1] The third scenario is based on the interrogatories and answers to the debtors' requests for admissions. Under this scenario, Fannie Mae is the stated owner of the note and mortgage and Wells Fargo is the servicer.

Considering all of the evidence and the contradictory testimony by Wells Fargo, the Court can establish the following time line:

1. The original note and mortgage between First Western and the debtors were executed and filed of record in November 2004.

2. The mortgage and note were then transferred to Washington Mutual by an Assignment of Mortgage filed of record in December 2004 (Wells Fargo Ex. C) and then to Fannie Mae.[2] At this time, Washington Mutual would presumably have been the servicer of the note for Fannie Mae.[3]

3. In 2007, Washington Mutual assigned the mortgage and note to Wells Fargo. (Wells Fargo Ex. D.) In addition, according to Bateman, Wells Fargo obtained physical possession of the note and mortgage at that time. With the assignment, Wells Fargo became either the owner of the note and mortgage or, if Fannie Mae was the owner, then Wells Fargo became the servicer of the note. Regardless, at the time of the assignment, the note was not indorsed either in blank or to Wells Fargo. Under Arkansas law, the assignment would not have been concluded (or negotiated) until the note was indorsed. Ark. Code Ann. § 4-3-203(c) ("if an instrument is transferred for value and the transferee does not become a holder because of lack of indorsement by the transferor . . . negotiation of the instrument does not occur until the indorsement is made.").

4. At some point, Washington Mutual went into receivership and JP Morgan

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[1] The affidavit was attached to Wells Fargo's written closing argument, which was filed on October 16, 2015.

[2] Wells Fargo introduced an assignment of mortgage from First Western to Washington Mutual that was filed in December 2004 and Bateman testified that Fannie Mae became the owner of the note in January 2005. However, neither party introduced any document that evidenced transfer of ownership of the note to Fannie Mae.

[3] "Fannie Mae and Freddie Mac are privately-owned and publicly-traded for-profit entities created by Congress to generate financial stability in the secondary market for residential mortgages. Fannie Mae and Freddie Mac buy mortgages originated by third-party lenders, gather them into bundles, and sell them as securities." *Vadnais v. Fed. Nat. Mortgage*, 754 F.3d 524, 526 (8th Cir. 2014).

Chase Bank [JP Morgan] was appointed receiver.[4]

5. According to Wells Fargo's response to the debtors' requests for admissions, in February 2013 Wells Fargo added the second indorsement (the indorsement in blank) pursuant to a limited power of attorney from JP Morgan. The indorsement in blank was signed by Leta Hutchinson as Assistant Vice President of Washington Mutual Bank, FA. According to Hutchinson's deposition (Dbs.' Ex. G), Hutchinson was employed by Washington Mutual in February 2013. Hutchinson also stated that she previously was an Assistant Vice President of Washington Mutual but ceased that position in May 2006. When asked in the deposition what her job responsibilities were at Washington Mutual, she stated that she was the department manager for the documentation department but did not state when she held that position or what her job title was in February 2013.

6. As stated above, the debtors filed their voluntary chapter 13 petition on October 10, 2013, and Wells Fargo filed its proof of claim on February 5, 2014.

Based on the above time line and the evidence presented at trial, the Court makes the following findings of fact that are relevant to the Court's decision. First, at the time the debtors filed their bankruptcy petition, Wells Fargo was either the owner of the note and mortgage (based solely on recorded state court documents) or was the servicer of the note (based on testimony and interrogatories that identify Fannie Mae as the owner). Second, at the time the debtors filed their petition, the note contained an indorsement in blank from Washington Mutual (even though the note that was attached to Wells Fargo's proof of claim did not include the indorsement). Third, the indorsement in blank was signed by Leta Hutchinson pursuant to a power of attorney between JP Morgan Chase Bank, successor in interest from the FDIC as Receiver of Washington Mutual Bank and Wells Fargo.[5] And fourth, at the time the indorsement in blank was added–in February

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[4] The only evidence before the Court of the receivership is a limited power of attorney dated July 8, 2011, that is attached to the *Response to Plaintiffs' First Set of Interrogatories to Wells Fargo Bank, N.A.* (Dbs.' Ex. D.) The power of attorney appoints Wells Fargo Bank, N.A. as "Servicer" for JP Morgan Chase Bank as "Investor" and "*the successor in interest from the FDIC as Receiver of Washington Mutual Bank.*"

[5] The Court finds as a matter of law that the debtors failed to prove by a preponderance of the evidence that Wells Fargo did not have the authority to indorse the

2013–Hutchinson was not an Assistant Vice President of Washington Mutual but was an employee of Washington Mutual.

Based on the time-line set forth above and the stated findings of fact, the Court finds that Wells Fargo is in legal possession of the note and mortgage and that Wells Fargo either owns the note and is a creditor outright or is the servicer of the note for Fannie Mae. As the mortgage servicer, Wells Fargo would have standing "'to participate in a bankruptcy case by virtue of its pecuniary interest in collecting payments under the terms of the note and mortgage.'" *In re O'Kelley*, 420 B.R. 18, 23 (D. Haw. 2009) (discussing constitutional and prudential standing and quoting *In re Eads*, 417 B.R. 728, 739 n.12 (Bankr. E.D. Tex 2009)). Regardless, either as a creditor or servicer, Wells Fargo is a party in interest with standing to file a proof of claim in the debtors' case.

The debtors primary argument in support of their objection to Wells Fargo's status as a secured creditor relates to the apparent contradiction between the proof of claim that Wells Fargo filed in this case and the note that was attached to the proof of claim. Specifically, the attached note did not contain an indorsement in blank from Washington Mutual. Through discovery, the debtors obtained another copy of the note that did contain an indorsement from Washington Mutual. The debtors dispute the validity of the indorsement, without which a valid transfer between Washington Mutual and Wells Fargo could not have occurred. Without a valid transfer, Wells Fargo would not be a holder in due course and would not have standing to file its claim as a creditor or servicer in the debtors' case.

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note in blank on behalf of Washington Mutual. First Western assigned the note to Washington Mutual and JP Morgan was the apparent successor in interest from the FDIC as receiver of Washington Mutual. As successor in interest, JP Morgan authorized Wells Fargo under a power of attorney to effectuate "[t]he assignment of any Mortgage or Deed of Trust and the related Mortgage Note, in connection with the repurchase of the mortgage loan secured and evidenced thereby." The indorsement in blank completed the transfer that began in 2007 when Washington Mutual initially assigned the mortgage and note to Wells Fargo.

The facts before the Court do not support the debtors' argument. Assuming for a minute that Wells Fargo has filed a prima facie claim in the debtors' case, in claims litigation the debtors would then have the burden of proving by a preponderance of the evidence that Wells Fargo's claim was unenforceable against the debtor and property of the estate under applicable law. 11 U.S.C. § 502(b)(1); *In re Muller*, 479 B.R. 508 (Bankr. W.D. Ark. 2012). Even though the debtors withdrew their objection to Wells Fargo's claim at the beginning of trial, the Court believes the same burden would apply toward their first count: "Objection To Secured Status of the Claim." In this instance, the debtors failed to meet that burden. The evidence is that Wells Fargo has physical possession of the note and mortgage and that in February 2013 the assignment of the note and mortgage was completed–negotiated–when Washington Mutual indorsed the note in blank pursuant to a power of attorney between JP Morgan, successor in interest from the FDIC as Receiver of Washington Mutual, and Wells Fargo.[6] All of this occurred prior to the debtors filing their bankruptcy petition.

Troubling for the debtors is the validity of Hutchinson's indorsement in blank. Because Hutchinson never worked for JP Morgan, the debtors argue that JP Morgan would not have had the authority to authorize Wells Fargo to sign Hutchinson's name to a financial instrument. And, again, without a valid signature, the indorsement would be a nullity. However, two facts work against the debtors' argument. First, at the time the indorsement in blank was added to the note in February 2013, Hutchinson was an employee of Washington Mutual. Second, at the time the indorsement was added, JP

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[6] Under Arkansas law, negotiation means "a transfer of possession, whether voluntary or involuntary, of an instrument by a person other than the issuer to a person who thereby becomes its holder." Ark. Code Ann. § 4-3-201(a). A negotiation is not complete until an indorsement is made. According to the Arkansas Code, "[u]nless otherwise agreed, if an instrument is transferred for value and the transferee does not become a holder because of lack of indorsement by the transferor, the transferee has a specifically enforceable right to the unqualified indorsement of the transferor, *but negotiation of the instrument does not occur until the indorsement is made*." Ark. Code Ann. § 4-3-203(c) (emphasis added).

Morgan was acting as successor in interest from the FDIC as Receiver of Washington Mutual. Under the power of attorney given by JP Morgan to Wells Fargo, Wells Fargo was empowered to negotiate the assignment of a note and mortgage. In this case, the indorsement in blank was the final step required to complete the transfer that was begun in 2007. Although Hutchinson was not Assistant Vice President at the time the indorsement was added, she was employed by Washington Mutual and could have been acting in an agency capacity.

However, if Hutchinson was not acting in an agency capacity, then without corporate authority as Vice President, she may be "liable on the instrument to a holder in due course that took the instrument without notice that the representative was not intended to be liable on the instrument." Ark. Code Ann. § 4-3-402(b)(ii). That liability can be overcome, though, with proof that Washington Mutual (or JP Morgan as successor in interest) and Wells Fargo did not intend for Hutchinson to be personally liable on the instrument. *Id.* Regardless, to the extent Hutchinson's signature was found to be an unauthorized signature, it may be ratified by the parties. Ark. Code Ann. § 4-3-403(a).

The only evidence before the Court is that the note is indorsed in blank and signed by an employee of Washington Mutual, all pursuant to Washington Mutual's Receiver's power of attorney. There is no evidence that this is an unauthorized signature or, if it is, that the signature has not been ratified by the parties. Without more, the Court cannot find that the indorsement in blank that was added in February 2013 is not a valid indorsement. For these reasons, the Court denies count one of the debtors' complaint. At the time the debtors filed their petition, Wells Fargo was either the servicer of the note or the owner of the note. In either capacity, Wells Fargo had standing to file a proof of claim in the debtors' case.

The debtors' second and third counts both relate to an allegation of fraud on the Court. Count two identifies Wells Fargo's proof of claim as an "untruthful sworn statement" that misleads not only the Court but also the debtors. Count three concerns the assignment

from Washington Mutual to Wells Fargo filed with the state court in March 2007. According to the debtors, the persons whose signatures appear on that document were not officers of Washington Mutual and were not authorized to transfer assets of Washington Mutual.

A finding of fraud on a court is an extremely serious matter that is "justified only in the most egregious misconduct directed to the court itself." *Woodcock v. U.S. Dept. of Ed.* (*In re Woodcock*), 326 B.R. 441, 448 (B.A.P. 8th Cir. 2005). It typically involves "bribery of a judge or jury or fabrication of evidence by counsel, and must be supported by clear, unequivocal and convincing evidence." *Pfizer Inc. v. Int'l Rectifier Corp.* (*In re Coordinated Pretrial Proceedings in Antibiotic Antitrust Actions*), 538 F.2d 180, 195 (8th Cir. 1976) (citations omitted). Wells Fargo may have been disorganized, confused, corrective, sloppy, and empowered with multiple stories at its beck and call relating to the debtors' note and mortgage, but this Court cannot find that Wells Fargo committed fraud on the Court.

The Court has already determined that Wells Fargo is a party in interest with standing to file its proof of claim, which negates the debtors' count two. Regarding count three, the debtors did not introduce any evidence to support their claim that the persons whose signatures appear on the 2007 assignment (Wells Fargo Ex. D) were not officers of Washington Mutual and had no authority to transfer the assets of Washington Mutual. However obfuscatory Wells Fargo may be in its record keeping and ability to glean the truth from its records, the activity presented to the Court does not rise to the level required for a finding of fraud on the Court.

For the reasons stated above, the Court denies the debtors' complaint in its entirety and dismisses the adversary proceeding.

IT IS SO ORDERED.

cc: Todd F. Hertzberg, attorney for the debtors
Kevin D. Rogers and Aaron D. Caldwell, attorneys for Wells Fargo Bank, N.A.
Joyce B. Babin, chapter 13 trustee