MERS Weathers

— by THOMAS M. SCHEHR AND ANDREW J. KOLOZSVARY —

In case after case, the MERS legal framework is passing muster in the courts. The basic business model is being affirmed despite challenges brought by defaulting borrowers.

In recent years, Mortgage Electronic Registration Systems Inc. (MERS), Reston, Virginia, has been the subject of a persistent onslaught of attacks brought on behalf of defaulting borrowers seeking to forestall eviction after valid foreclosure proceedings. ¶ Those attacks have come in a variety of forms, yet share basic themes challenging core aspects of MERS' business model—including its presence in the chain of title to security instruments filed in county recording offices throughout the United States. ¶ Recent decisions from state and federal courts across the country show a continuing trend toward affirming MERS' business model in the face of such attacks. This article discusses some of those decisions, which suggest that MERS has largely weathered the storm and that similar challenges are unlikely to succeed in the future.

ILLUSTRATION BY DANIEL HERTZBERG

The Storm

The MERS framework

In the mid-1990s, key participants in the mortgage banking industry began evaluating the potential for an industry-sponsored central repository to electronically register and track mortgage loans on the secondary market. Out of that evaluation, the industry endorsed the formation of MERS and its parent company, MERSCORP Holdings Inc.

The MERS® System, owned by MERSCORP Holdings, is an electronic database that tracks changes in servicing rights and beneficial ownership interests in mortgage loans. MERS is a separate corporation appointed by lenders to serve as mortgagee of record and nominee for the beneficial owner(s) of the mortgage loan, with rights to enforce the mortgage on behalf of the beneficial owner(s).

When MERS appears in uniform security instruments, MERS is formally designated as the mortgagee (or "grantee" or "beneficiary," depending on whether state law recognizes a mortgage, security deed or deed of trust as the security instrument), as nominee for the original lender and the lender's successors and assigns.

In essence, MERS acts as a limited agent of the beneficial owner(s) and holders of the underlying debt, and holds legal title to the mortgage recorded in the public land records. The lenders or their successors and assigns, in turn, own the beneficial interest in the mortgage. This agency relationship between MERS and the beneficial owner(s) and holders allows servicing rights for loans to be bought and sold without the need to also record an assignment of the mortgage with the applicable county recording office with each such exchange. MERS remains the mortgagee as nominee for the owner(s) of the beneficial interest in the loan, no matter who owns the loan at any given point in time.

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A feature, not a bug

The MERS System—and MERS' role in it—reduced administrative burdens and simplified the process for tracking mortgage loan transactions by "immobilizing" the mortgage, and thus eliminating the need to execute and record mortgage assignments, while the associated note is freely exchanged among real estate finance industry participants.

This apparent "separation" of the mortgage from the underlying debt is not really a separation in any legal sense. The glue that holds the security instrument and the secured debt together is MERS' status as nominee, and the agency relationship it denotes between MERS and the owner(s) of the indebtedness.

Nonetheless, those seeking to challenge MERS' role have latched onto this feature, promoting the view that this apparent separation of the mortgage and the note is real and is a bug to be exploited, rather than a feature to be understood and accepted as valid under basic agency principles.

Several related prongs to this erroneous separation argument are that MERS mortgages are invalid, that MERS lacks the authority to foreclose a mortgage because it has no interest in the underlying debt or that MERS cannot assign mortgages without the note. As we will discuss, these challenges are being rejected with greater and greater regularity.

Courts are upholding MERS' role

The placement and volume of favorable MERS decisions in courts across the United States, at both the state and federal level, is remarkable and show a trend that recognizes the validity of MERS in terms of its consistency with basic principles of mortgage and agency law. It also does not bode well for future challenges to the core aspect of that system.

In *Eaton v. Federal National Mortgage Association* (2012), the Massachusetts Supreme Judicial Court recognized that the mortgage and note need not be held by the same entity, and when they are held by different entities, the holder of the mortgage has a bare legal interest while the note holder has the beneficial interest in the mortgage.

Addressing the question of authority to foreclose, the court concluded that the foreclosing mortgagee need not have physical possession of the note so long as it acts as the agent of the note holder: "[W]e do not conclude that a foreclosing mortgagee must have physical possession of the mortgage note in order to effect a valid foreclosure. There is no applicable statutory language suggesting that the legislature intended to proscribe application of general agency principles in the context of mortgage foreclosure sales."

As such, the court interpreted the foreclosure statute to "permit one who, although not the note holder himself, acts as the authorized agent of the note holder, to stand 'in the shoes' of the 'mortgagee.'" Thus, MERS' role as mortgagee of record and custodian of the legal interest in the mortgage as nominee for the note holder "fit comfortably with each other and fit comfortably within the structure of Massachusetts mortgage law" (*Culhane v. Aurora Loan Services,* 1st Circuit Court, Feb. 15, 2013).

Similarly, in *Residential Funding Co. LLC v. Saurman* (2011), the Michigan Supreme Court affirmed the basic validity of MERS mortgages and the authority of MERS to foreclose. The borrowers claimed that foreclosures conducted in the name of MERS were invalid because MERS, although the mortgagee, did not also own an "interest in the indebtedness" as required under Michigan's statute.

The Michigan Supreme Court rejected that argument based on long-standing precedent holding that the identity of the mortgagee is a "matter of convenience," and the mortgage and note need not be in the same hands to be valid. This decision reversed a Court of Appeals opinion that purported to invalidate every foreclosure conducted by MERS across the state.

The Rhode Island Supreme Court, in *Bucci v. Lehman Bros. Bank* (March 29, 2013), also held that, as a matter of contract and statutory law, MERS has authority to foreclose on behalf of the ultimate owner of the underlying loan. As a matter of contract, the court held that provisions in the mortgage granting MERS the power of sale and laying out the capacity in which MERS held title authorized MERS to foreclose. As a matter of statutory law—pursuant to which the "mortgagee" has the right to foreclose—the court held that the mortgage's definition of MERS as mortgagee and nominee provided the requisite statutory authority to foreclose.

The court went further and held that, because of the agency relationship that existed between MERS and the note holder by virtue of MERS' status as nominee, MERS could foreclose based upon its status as mortgagee even if it did not also possess the underlying note. Simply put, the agent of the note holder can foreclose on behalf of the note holder, and where that agency relationship exists, the rights of the mortgagee may be fulfilled by the mortgage holder or the owner of the note.

The 9th Circuit, in *Cervantes v. Countrywide Home Loans Inc.* (Arizona, 2011), rejected a class action alleging that MERS was a "sham beneficiary" based upon a supposed "irreparable split" between the notes and deeds of trust.

The court relied on fundamental agency principles: "[T]he notes and deeds [mortgages] are not irreparably split: the split only renders the mortgage unenforceable if MERS or the trustee, as nominal holders of the deeds, are not agents of the lenders." Again, the nominee/agent status of MERS denudes the argument that there is an invalid separation of the mortgage and note.

The decision in *Cervantes* was recently relied upon by the 9th Circuit in *Walton v. Mortgage Electronic Registration Systems Inc*. (Feb. 11, 2013), to dismiss similar claims of "lack of authority" because "MERS' role and the lender's authority to substitute the trustee were disclosed to [the borrower] in the deed of trust."

Another layer of attacks on MERS' role has focused on the assignment of mortgages from MERS to the foreclosing party.

MERS assignments are valid

Another layer of attacks on MERS' role has focused on the assignment of mortgages from MERS to the foreclosing party. These attacks come in different forms, two of the most common being 1) the allegation that MERS cannot validly assign a mortgage given its lack of interest in the note, and 2) the allegation that the persons executing mortgage assignments on behalf of MERS lack authority to do so, or are engaging in so-called robo-signing.

In *Culhane,* the 1st Circuit thoroughly examined and upheld the MERS framework recently in the context of a challenge to MERS' ability to assign the mortgage to the foreclosing entity. The court began by noting that the MERS agency relationship was "faithful to age-old tenets of mortgage law. . ." and that "[t]here is no reason to doubt the legitimacy of the common arrangement whereby MERS holds bare legal title as mortgagee of record and the note holder alone enjoys the beneficial interest in the loan." In sum, "the mortgage and the note are separate instruments; when held by separate parties, the mortgagee holds a bare legal interest and the note holder enjoys the beneficial interest. The mortgagee need not possess any scintilla of a beneficial interest in order to hold the mortgage."

The court went on to hold that "MERS had the authority twice over to assign the mortgage." First, MERS derived that authority by virtue of its status as equitable trustee of the mortgage for the owner of the beneficial interest—i.e., for the note holder. Second, as a matter of contract, the language of the mortgage unambiguously replicated this authority when it designated MERS as the nominee for the lender and the lender's successors and assigns. A nominee, as the court noted, is simply the holder of legal title for the owner of the beneficial interest.

In *Conlin v. Mortgage Electronic Registration Systems Inc*. (Michigan, 2013), the 6th Circuit affirmed the dismissal of a wrongful-foreclosure case that featured these attacks on MERS assignments. The decision is remarkable for its sweeping and fundamental rebuke of an array of common claims raised in these sorts of cases, both in Michigan and elsewhere.

The court confirmed that, under Michigan law, borrowers are barred from challenging a foreclosure following the expiration of the redemption period unless they meet a high bar that includes both a clear showing of fraud or irregularity and actual prejudice as a result of the alleged defect in the foreclosure process.

With respect to assignment-based challenges, the 6th Circuit held that borrowers lack standing to challenge an assignment to which they are not a party, and rejected, on the pleadings alone, the claim that the assignment from MERS to the foreclosing entity was "forged" or "robo-signed." This result is similar to that reached in the 8th Circuit in *Karnatcheva v. JPMorgan Chase Bank NA* (Minnesota, 2013), which rejected theories under Minnesota law that the assignments were "invalid" or "unauthorized" at the outset of the case for failure to meet basic pleading requirements.

The rejection of forgery, robo-signing and other similar challenges to the validity of MERS assignments at such an early stage of these cases should be significant outside the forum states of Michigan and Minnesota.

Similar results have also been reached in state courts addressing challenges to MERS assignments. For example, in *Montgomery v. Bank of America* (March 29, 2013), the Georgia Court of Appeals affirmed the dismissal of a wrongful-foreclosure case that was based upon the common dual challenge to MERS assignments. The plaintiffs alleged both that MERS lacked the ability to assign the mortgage without the note and that the person executing the assignment on behalf of MERS lacked authority.

The court held that the language in the security deed expressly conveyed title to the rights and interests in it to MERS, and authorized MERS to assign those rights and interests. Further, MERS' lack of interest in the note did not invalidate the assignment because, under Georgia law, the foreclosing entity need not possess the note. Lastly, the court held that the borrowers lacked standing to challenge the assignment.

Even defeats are not resounding blows

A recent case out of the Washington Supreme Court has been trumpeted by borrowers as a significant blow to MERS. That claim is overstated.

In *Bain v. Metropolitan Mortgage Group Inc*. (Aug. 16, 2012), the court answered certified questions regarding MERS' role as trust deed beneficiary under Washington law. The court held that MERS did not meet the definition of "beneficiary" under state law because MERS was not the "holder of the instrument." However, the court stated MERS is most likely an agent for the beneficiary, and that Washington law (and the Deed of Trust

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Act) permits agents to take action on behalf of principals.

The court did not address the effect of this ruling on title to the property, but found no merit in the borrower's argument that the designation of MERS as beneficiary invalidated the trust deed.

Washington courts post-*Bain* have confirmed that non-judicial foreclosures may move forward regardless of MERS' designation as beneficiary of the trust deed so long as the note holder is directing the foreclosure. See *Lynott v. Mortgage Electronic Registration Systems* (Nov. 30, 2012): "U.S. Bank is the beneficiary of the deed because it holds plaintiff's note, not because MERS assigned it the deed. . . . [P]ossession of the note makes U.S. Bank the beneficiary; the assignment merely publicly records that fact. Because U.S. Bank is the proper beneficiary, it is empowered to initiate foreclosure following plaintiff's default."

Moreover, the court in *Bain* went on to hold that "the mere fact MERS is listed on the deed of trust as a beneficiary is not itself an actionable injury." Rather, in order to state a claim based upon MERS' designation as the beneficiary of the trust deed, a borrower would have to establish all elements of a consumer-protection claim, including a specific deceptive act, causation and damages.

MERS is being legally tested, and it is passing those tests.

Post-*Bain,* courts have affirmed the dismissal of consumer-protection claims against MERS. See *Peterson v. Citbank NA, et al.* (Sept. 17, 2012).

Thus, although the court in *Bain* adopted a minority view in its non-acceptance of MERS' role as "beneficiary," the practical effect of that ruling appears to be limited. Recently, the Oregon Supreme Court issued two related opinions—*Brandrup v. Recontrust Company NA,* No. S060281 (June 6, 2013), and *Niday v. GMAC Mortgage LLC,* No. S060655 (June 6, 2013)—that are similar to *Bain* in terms of substance and practical effect. As in *Bain*, the Oregon Supreme Court held that MERS did not qualify as a beneficiary under the applicable statute, but that nothing prevented MERS from acting on behalf of the beneficiary under agency principles.

Summing up

The cases described here are just a sampling of the clear trend across courts affirming the core aspects of the MERS System and MERS' role in it. In short, MERS is being legally tested, and it is passing those tests. Although these and other challenges are likely to continue to be brought, the weight of authority suggests that the claims will be rejected. **MB**

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