Obeying the Letter and Violating the Spirit

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Abstract

Tens of millions of home mortgage loans, with a face value running into the trillions of dollars, may not be collectable. Furthermore, the owners of those homes may not be able to get clear title in the event that they pay off the mortgage.

The Mortgage Electronic Recordation System is a foundational piece of the modern American mortgage system, and is thus at the base of the financial system as a whole. This system has come under substantial legal challenges in recent years. In some forums MERS has prevailed; in others it has not. The uncertainty surrounding transfers of interests in land made via the MERS system threatens the financial system as a whole, by casting doubt as to the value of the ubiquitous Residential Mortgage Backed Security (RMBS), and by causing homeowners to doubt whether they can pay their mortgage with confidence (whether they are paying the correct entity) and whether their purported mortgage holder can ever give them clear title. Up to 33 million mortgage loans could be affected by the legal challenges to MERS. Even if MERS is technically

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2 An RMBS is a security where the cash flow comes from residential debt such as mortgages and home equity loans. See http://www.investopedia.com/terms/r/rmbs.asp. (Accessed December 2, 2010)
4 Examining the Consequences at 5.
operating within the boundaries of the law, the existence of a private system to manage transfers of interests in land is contrary to the fundamental public policy purpose of public records. The issue of compliance with existing State law is doubtful at best in some states, as this paper will show. The solution to these problems is for the several states, preferably acting on the advice of the National Conference of Commissioners on Uniform State Laws, to enact statutes banning private book transfers and providing mechanisms to clean up the existing confused situation. This will benefit both individual citizens and financial institutions, by ensuring that existing securitized mortgage debt is collectable and by giving ordinary borrowers the ability to pay with confidence. Without correcting the problem the ultimate collectability of a large number of mortgages will be called into doubt, thus undermining the financial system. Also, without clarification of title with regard to mortgages transferred through the MERS system, ordinary debtors will have reason to doubt their lender’s ability to give good title when they pay off the mortgage.

Introduction

The American system of home purchase and financing has changed substantially in recent decades. Once, most home mortgage loans were originated by a local bank.\(^5\) These loans were sometimes sold to one of the quasi-governmental agencies, Fannie Mae (Federal National Mortgage Association)\(^6\) and Freddie Mac (Federal Home Loan Mortgage Association)\(^7\). Many were simply held in a portfolio by the originating bank.\(^8\)


In recent years, a secondary market for mortgages has developed. Mortgages are now
often used to create investment instruments called Mortgage Backed Securities.\(^9\) Many
mortgages are sold multiple times.\(^{10}\) A cornerstone of the modern mortgage system is a
private recordation system called the Mortgage Electronic Recordation Systems (MERS).
However, recent litigation has highlighted some problems with the modern system.
There have been disputes as to the actual legal standing of MERS and the validity of
transfers made through the MERS system. These disputes cast a shadow over most
American homeowners, because if MERS transfers are invalid, then how can a
homeowner have confidence that his payments are being properly applied, and that the
purported mortgagee can give clear title in the even of a payoff? This paper will examine
whether the MERS system is actually in compliance with the law, and if its method of
operation is good public policy even if it is within the letter of the law. If MERS
operations were widely found to not be legal then in an extreme case, the validity of
approximately 33 million mortgage loans would be called into doubt.\(^{11}\) As of June 2010,
total US outstanding residential mortgage debt was $10.6 trillion; this breaks down into
$5.7 trillion in government sponsored enterprise (GSE) (i.e. Fannie, Freddie, etc.), $1.4
trillion in non-GSE RMBS, and $3.5 trillion in non-securitized debt.\(^{12}\)

The traditional operation of the mortgage industry has been substantially altered,
especially over the last few years during the housing bubble. Loans were originated by
many different entities, including brokers who were not loaning any of their own money
and banks whose business model was based on originating loans and then immediately

\(^{10}\) *Examining the Consequences* at 4.
\(^{11}\) *Examining the Consequences* at 5.
\(^{12}\) *Examining the Consequences* at 53.
-selling them to another investor. Many loans were still purchased by the Fannie Mae and Freddie Mac, but a large private securitization market developed.

In the private securitization market financial firms, including many of the biggest names on Wall Street, bought up loans from originators. These loans were then placed into trusts, and the trusts were used to back the issuance of RMBS. These RBMS were then sold to institutional investors around the world. Many tranches of RMBS received triple-A ratings from the major ratings agencies. They functioned like high quality bonds, and formed a part of the asset portfolio of a wide variety of investors, including many pension funds. Many RMBS were also bought by banks, and became part of their capital.

Banks that had once simply lent money to homebuyers and held the resulting loan in their own portfolio as an asset now engaged in much more complicated transactions; these new transactions enabled the banks to use their capital more efficiently and make greater profits. These banks originated mortgage loans, and then sold pools of loans to large financial firms for fee income. The originating banks then used that income to buy RMBS, and held those as part of their capital. At the time, this seemed like a good idea. By selling the loans they had originated, the banks got rid of the responsibility of allowing for defaults. A bank that originates a loan and holds it in house is obliged to make an allowance for losses. A bank that sells its loans and buys RMBS does not have to make an allowance for loss. Thus the bank can use the full value of the RMBS as part of its regulatory capital for lending purposes, rather than the discounted value that it would have to use for a portfolio of self originated loans. A bank which sells its own

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loans and buys someone else’s in the form of RMBS has a competitive advantage, because all of its capital can be used as the basis for profitable lending, without the need to retain some in reserve for losses. Because a bank’s lending limit is a multiple of its capital base, being able to use even a few more percentage points of capital to lend with give the possibility of significantly higher loan volumes (and thus profits) when leverage is taken into account.

One important underpinning of this system is a capacity to repeatedly sell a particular mortgage loan. Loans are sold several times in the course of the securitization process, as they are initially bundled in RMBS and thus RMBS are then traded on the open market like bonds. Congress recently noted that: “There are at least three points at which the mortgage and the note must be transferred during the securitization process in order for the trust to have proper ownership of the mortgage and the note and thereby the authority to foreclose if necessary.”

Traditionally, when a mortgage is created or transferred, the mortgagee must record the debt in county land records. This requirement seems to impose a significant impediment on the securitization of mortgages, because the need to record every transfer would create a significant administrative burden on the entities trading in mortgages. Millions of mortgages have been securitized in the United States, so the administrative burden of tracking all the transfers of ownership through the initial securitization process and the subsequent sale and resale of the resulting RMBS would be very large. However, private enterprise seemed to provide a solution. In 1995, the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), the Government National Mortgage Association (Ginnie Mae), and the Mortgage Bankers Association of America created a private

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16 Examining the Consequences at 64.
mortgage recordation company; it is called Mortgage Electronic Recordation Systems (MERS). MERS operations allow the transfer of ownership interests while bypassing the county property offices.\textsuperscript{17} According to their website, the mission of MERS is to register every mortgage loan in the US on the MERS system.\textsuperscript{18} MERS acts as nominee in the county land records for the lender and servicers; they are the party show in the public records, no matter what institution (so long as that institution is a member of MERS) actually owns the mortgage.\textsuperscript{19} MERS remains the nominal mortgagee for the whole life of the loan, no matter to whom or how many times the servicing is traded.\textsuperscript{20} The claimed advantage of MERS is that, by using the system, assignments do not need to be filed in county land records. Once a loan is entered into the system, MERS remains the mortgagee of record and all transfers of the loan between parties in the secondary market are made by private book recording at MERS. This system offers administrative simplicity and lower cost, as recording fees do not need to be paid in every county courthouse.

The Existing Legal Framework: Recordation and Assignment

\textit{General Principles}

A party other than the originating lender, who wishes to foreclose on a debtor must have an assignment in hand in order to do so. The assignment transfers the contractual rights the lender obtained at the time of the origination to the new owner of

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\textsuperscript{17} \textit{Examining the Consequences} at 4.


\textsuperscript{19} \textit{Id.}

\textsuperscript{20} \textit{Id.}
the mortgage. The note must be assigned to the party seeking to foreclose on the property; absent this, even if they hold the mortgage they cannot foreclose.\textsuperscript{21}

\textit{Curative Acts}

Many states have curative acts that allow defects in title to be fixed. For example, in the State of Wyoming, the Comprehensive Curative Act\textsuperscript{22} provides that defective instruments affecting the title to real estate become valid after having been recorded for 10 years. New York also provides for curing of defects. N.Y Real Property Law § 306 provides that any recorded conveyance shall be deemed to have been duly acknowledged after 10 years.\textsuperscript{23} Curative statutes generally validate conveyances retroactively as between the original parties and their successors.\textsuperscript{24} However, existing curative acts seem to be mostly intended to correct administrative errors. MERS, in seeking to facilitate technical compliance with the recording laws while allowing member entities to circumvent their spirit and conduct what are essentially private transfers, raises a different sort of problem.

\textit{Debtor Obligations}

In \textit{Cervantes v. Countrywide Home Loans, Inc.} 2009 WL 3157160 (D.Ariz) the Federal District Court held that “Any lack of notice in the public records… to future buyers of Plaintiff’s mortgages does not alter Plaintiff’s obligations under the mortgages.”\textsuperscript{25} This case concerned plaintiffs who were attempting to avoid payment on their MERS registered mortgages. Thus, even though MERS book recordings might not provide notice to third parties the borrowers themselves were bound to repay under the

\begin{itemize}
\item \textsuperscript{21} See, e.g. \textit{Fleet Nat'1 Bank v. Nazareth} 818 A.2d 69, 71.
\item \textsuperscript{22} W.S. 1977 §34-8-103
\item \textsuperscript{23} \textit{N.Y.Real Property Law} § 306.
\item \textsuperscript{24} See e.g. \textit{Mills v. Damson Oil Corp.} 686 F.2d 1096
\item \textsuperscript{25} \textit{Cervantes v. Countrywide} 2009 WL 3157160 (D.Ariz.) at 11.
\end{itemize}
mortgage. This begs the question, however, of who exactly the borrowers are paying? If the holder of a mortgage which has been transferred via MERS does not in fact have an enforceable interest, then where exactly is the borrower’s money going? These questions are very important. If the MERS transferee does not in fact have an enforceable interest, then the mortgage or RMBS the investor has bought is worth far less than its face value. If the borrower cannot be sure that the party they are paying can in fact grant them clear title when the mortgage is paid off, then they have a powerful incentive to stop paying at all.

**Recent Litigation Concerning MERS**

*MERS Transfers Upheld by Courts: The Letter of the Law Dominates*

The cases in this section are instances where MERS transfers, and more generally the MERS system of operations, have been upheld by the courts. Not all courts have done so; there is significant divergence in the treatment of MERS by the court of the several States. Some State courts, while considering similar matters, have reached very different results. There is a very real problem taking shape, where courts in different States are producing very different outcomes when considering suits brought by similarly situated borrowers. Those cases will be discussed in the section following this one.

These holding share the general characteristic of being quite narrow. Courts which have upheld MERS have generally done so by sticking closely to the letter of the law, and often times constructing fairly elaborate structures of prior precedent. In all of these cases the majority opinion more or less explicitly rejects public policy considerations in favor a narrow reading of the law and the court’s own powers. Given
that these decisions were handed down by the high courts of such traditionally liberal States as New York and Minnesota, this judicial restraint in interested, to say the least. These are cases when the courts have “made it work,” and declined to take action that would threaten the interests of established powerful entities.

One important recent case concerning MERS took place in New York in 2006; this is particularly significant because so many financial institutions are located in New York. This case is important because it shows the convoluted path it was necessary for the Court of Appeals to take in order to uphold the MERS system. Typically of cases where MERS operations were upheld, a narrow reading of the law and a perhaps over-technical focus on the statutes was used by the courts to uphold a mode of operation which seems at first impression to be a facial violation of the relevant law. The New York Court of Appeals (the highest court in the state of New York) in MERSCORP v. Romaine 861 N.E.2d 81 (2006), found that County Clerks were required to record MERS assignments and discharges. The Suffolk County Clerk had ceased to record MERS instruments in 2001, citing an informal opinion of the Attorney General which concluded that recording a MERS instrument violated New York law and frustrated the legislative intent of the recording provisions. The County contended that MERS was not a proper mortgagee and that MERS documents could not be considered proper conveyances for the purposes of the recording statutes. This was because MERS was an entity with no interest in the property or the loan. The Court of Appeals held that “[t]he Clerk lacks the statutory authority to look beyond an instrument that otherwise satisfies the limited requirements of the recording statute [and] therefore, the County Clerk must accept the

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26 MERSCORP v. Romaine 861 N.E.2d 81, 83 (NY 2006)  
27 Id.
MERS mortgage when presented for recording.”\textsuperscript{28} Additionally, with respect to MERS assignments and discharges, the Court held that “[a]s nominee for the mortgagee of record or for the last assignee, MERS acknowledges the instrument and therefore, the County Clerk is required to file and record the instrument.”\textsuperscript{29} The Court thus interpreted the New York statutes to allow the private recording service book transactions to be given effect at the County Clerk’s office when MERS presented the documents. With regard to discharges of MERS registered mortgages, the Court again found that the MERS system was operating within the statute. “The MERS discharge complies with the statute by stating that the ‘mortgage has not been further assigned of record’ and, therefore, the County Clerk is required to accept the MERS assignments and discharges of mortgage for recording.\textsuperscript{30}

This case featured both a concurrence and a dissent which drew attention to public policy concerns about the accuracy and amount of data in the public records, the possibility of noteholders being isolated from liability, and the loss of revenue to the Counties.\textsuperscript{31} This cases raises substantial issues of public policy, because a private business operating in a fashion that appears to be facially violative of the recording statues had its operations upheld in court in a decision which focused on technicalities in an almost willful rejection of consideration of the underlying purpose of the statutes. Even though MERS was found to be operating within the letter of New York law, its whole purpose violates the spirit of the public records. If a nominee is allowed to remain on the records while transfers of ownership occur in private records, then no third party

\footnotesize{\textsuperscript{28} MERSCORP, at 84
\textsuperscript{29} Id,
\textsuperscript{30} Id, at 85 (emphasis in original)
\textsuperscript{31} MERSCORP, at 86-88.}
not part of the private system can truly know who the owner of the mortgage is. In the event of a dispute, the homeowner could have considerable difficulty determining who the correct party to contact or serve is. Additionally, both the concurrence and the dissent noted that the recording statute had not been amended for 50 years and raised the possibility that Legislative action might be necessary on the issue. The American system of home finance has changed a great deal in the last 50 years, and by noting this the Court seems to be signaling that the Legislature should reexamine the structure in place in New York, even thought the Court declined to impose modernization via judicial activism in this instance.

Thus, even though this case upheld the validity of the MERS book transfers in New York, the opinion as a whole indicates that at least some members of the Court had serious public policy concerns. Also, the hints at Legislative action raise the possibility of some action which might reduce or remove the ability of a private entity to make these sort of transfers in its private books. The possibility that state legislatures might take action to void MERS mortgages and favor debtors was discussed in more detail above.

The Minnesota Supreme Court also recently considered issues related to MERS. In *Jackson v. Mortgage Electronic Registration Service, Inc.* 770 N.W.2d 487 (MN 2009), the Minnesota Supreme Court considered the ability of a nominee mortgage to foreclose on a property. This goes to the heart of the MERS system; if MERS as nominee can foreclose on defaulting debtors then there is no reason to worry about the security of the payment stream flowing to RMBS holders; if, however, MERS as nominee cannot foreclose then the security of the payment stream is called into doubt because the enforcement method has been compromised.

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32 *Id.*
This case began in Federal Court; the District Court of Minnesota certified over to Minnesota Supreme Court the question:

“Where an entity, such as defendant [Mortgage Electronic Registration Systems, Inc], serves as mortgagee or record as nominee for a lender and that lender’s successors and assigns and there has been no assignment of the mortgage itself, is an assignment of the ownership of the underlying indebtedness for which the mortgage serves as security an assignment that must be recorded prior to the commencement of a mortgage foreclosure by advertisement \(^{33}\) under Minn. Stat. ch. 580?\(^{34}\) This question is directly on point for our current inquiry, because it concerns the legal standing of MERS as the recorded owner of the interest in land and the powers that MERS has as nominee. The Minnesota Supreme Court answered the certified question in the negative, holding that “transfers of the underlying indebtedness do not have to be recorded to foreclose a mortgage.”\(^{35}\)

The facts of the case are typical of many matters currently arising before the various courts of the United States. There were four plaintiffs, and each plaintiff’s property had gone into the mortgage foreclosure process.\(^{36}\) The foreclosures were all instituted on behalf of MERS.\(^{37}\) The plaintiffs claimed that MERS had failed to record assignments of their mortgages as required under the relevant Minnesota statutes.\(^{38}\)

The Court discussed the functioning of the MERS system: “Publically available documents, namely pooling and servicing agreements filed with the Securities and

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\(^{33}\) “Foreclosure by advertisement” is, under Minnesota law, a non-judicial foreclosure procedure using a power-of-sale clause in the mortgage. The lender must publish notice for six (6) weeks in a newspaper in the county where the property is located. Then the lender can foreclose and have the property sold at a sheriff’s sale. See http://www.foreclosure.com/statelaw_MN.html. (Accessed November 12, 2010)

\(^{34}\) Jackson v. Mortgage Electronic Registration Systems, Inc. 770 N.W.2d 487, 489 (Minn. 2009)

\(^{35}\) Id.

\(^{36}\) Id.

\(^{37}\) Id.

\(^{38}\) Jackson, at 489.
Exchange Commission, suggest that when loans are transferred between MERS members, an assignment of the promissory note is executed but an assignment of the security instrument is not—*although the original security instrument is physically delivered along with the promissory note.*” Thus, even though the transferee obtained physical custody of the security instrument they did not necessarily obtain the legal rights of the holder of the security instrument. The Court noted “that a transfer of an interest in a mortgage loan between two MERS members is unknown to those outside the MERS system.” Furthermore, “If…a MERS member transfers an interest in a mortgage loan to a non-MERS member, MERS no longer acts as the mortgagee of record and an assignment of the security instrument to the non-MERS member is drafted, executed, and typically recorded in the local land recording office.” The normal operating procedure in the MERS system is for each member to have someone on staff become a certified MERS officer with authority to sign on behalf of MERS; MERS does not draft or execute paperwork on behalf of its members. “This procedure allows the member that owns the indebtedness to assign or foreclose the mortgage loan in the name of MERS, eliminating the need to either work through a third party or to execute an assignment of the security instrument from MERS back to the member.”

The Minnesota Legislature amended the Minnesota Recording Act to expressly permit nominees to record “an assignment, satisfaction, release, or power of attorney to foreclose.”

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39 *Jackson* at 491 (emphasis added).
40 *Id.*
41 *Id.*
42 *Id.*
43 *Jackson* at 491.
44 *Jackson* at 492, quoting 2004 Minn. Laws 76, 76-77 (codified at Minn. Stat. § 507.413 (2008))
Each plaintiff had executed a promissory note in favor of the originating lender and a mortgage deed on a standard form, the “Minnesota Single Family Fannie Mae/Freddie Mac UNIFORM INSTRUMENT WITH MERS.” The deed designated MERS as the mortgagee of record acting as nominee for the Lender and the Lender’s successors and assigns. The form granted MERS the power of sale.

MERS instituted foreclosure by advertisement proceedings against the plaintiffs after they had gone into default. All land office records and notices of foreclosure sale listed MERS as the mortgagee and did not indicate that an assignment of the mortgage had been made. “Because several of the original lenders for the named plaintiffs have gone out of business, plaintiffs surmise that their original lenders at some point sold their indebtedness to another party.” The plaintiffs sued and sought an injunction against all non-judicial mortgage foreclosure sales “in which MERS is the nominal mortgagee ‘until MERS [could] establish compliance with Minnesota law.’” Minnesota law governing non-judicial mortgage foreclosure requires, in pertinent part “that the mortgage has been recorded and, if it has been assigned, that all assignments thereof have been recorded.” There is an additional requirement that “the notice of foreclosure include ‘the name of the mortgagor, the mortgagee, each assignee of the mortgage, if any,’”

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45 Jackson at 492  
46 Id.  
47 Id.  
48 Id.  
49 Jackson at 492  
50 Id.  
51 Id.  
52 Jackson at 492, quoting Minn. Stat. § 580.02  
53 Id at 493, quoting Minn. Stat. § 580.04
claimed that because MERS had not recorded and given notice of transfers within the MERS system, it was not in compliance with the law and could not foreclose.\textsuperscript{54}

The Minnesota Supreme Court opened its legal discussion by observing that “MERS has developed a system of structuring mortgage transactions that presents a potential conflict with some of our traditional assumptions and principles governing real property law.”\textsuperscript{55} The Court analyzed the MERS amendment to the recording statute (see above) and concluded “that it does not change the requirements of the foreclosure by advertisement statute.”\textsuperscript{56} The MERS statute suggests legislative approval of MERS’s practices, but it does not resolve the issue of compliance with the foreclosure by advertisement statutes.\textsuperscript{57} The Court then set out to analyze the foreclosure by advertisement statutes. The Court held that “the use of the term mortgage throughout [the relevant statutes] does not refer to the promissory note but to the security instrument itself.”\textsuperscript{58} The Court then noted that there is no evidence in the record that the security instruments have been assigned.\textsuperscript{59} The Court then held that, while the plaintiffs have reason to believe that the promissory notes have been assigned, the assignment of the notes does not have to be recorded under the plain language of the relevant statutes.\textsuperscript{60} Only assignments of the security interest must be recorded. The Court then considered Minnesota case law on assignments. The Court held that Minnesota case law “establishes that a party can hold legal title to the security instrument without holding an interest in

\begin{footnotes}
\item[54] Id.
\item[55] Jackson at 494.
\item[56] Id.
\item[57] Id.
\item[58] Id. At 496
\item[59] Id.
\item[60] Id.
\end{footnotes}
the promissory note.”

“The cases demonstrate that an assignment of only the promissory note, which carries with it an equitable assignment of the security instrument, is not an assignment of legal title that must be recorded for purposes of a foreclosure by advertisement.” Thus, any disputes between a mortgagee who holds legal title and an assignee holding a promissory note, and thus equitable title, do not affect the status of the mortgagor for non-judicial foreclosure purposes. Finally, the Supreme Court held that “even though an assignment of the promissory note with no accompanying assignment of the security instrument constitutes a mere equitable assignment of the mortgage, it does not by operation of law need to be recorded to meet the requirements necessary to commence a foreclosure by advertisement.”

The Court also rejected plaintiffs’ policy argument that as a matter of equity the Court should require recording of promissory note assignments. The Court simply stated that the equitable issue is beyond the scope of the matter before it, and that it must interpret the statute as written. This interpretation of the Court’s power seems like a dodge; they are faced with a difficult issue of public policy and decline to address it, preferring to engage in narrow reading of the issues. The public policy question lies at the heart of the MERS controversy. Even if the operations of the MERS system are within the letter of the law, they seem to violate the spirit of the recording statutes.

There is a short dissent which argued that it is against public policy when the only thing disclosed in the public records “is the identity of the holder of bare legal title to the

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61 Jackson at 500.
62 Id at 500-501.
63 Id. At 501.
64 Id.
65 Jackson at 502.
66 Id.
mortgage and if all others who have had an interest in the mortgage can remain undisclosed.\textsuperscript{67}  The purpose of the public records is to avoid confusion and guard and protect interests of record in real property.\textsuperscript{68}  The dissent also noted that the majority holding limits the mortgagor’s ability to assert defenses to foreclosure because the identity of the assignee is not known.\textsuperscript{69}  Also a lender holding a now worthless note might want to know the identity of previous holders.\textsuperscript{70}  The dissent concluded that “neither borrowers nor lenders will ever be able to hold anyone in the chain of transfers accountable.”\textsuperscript{71}

The dissent seems to make a strong case. The majority held to a narrow reading of the statute, and consciously set aside equitable considerations, in order to allow the foreclosures to proceed. However, the public policy considerations are very serious. Allowing certain private actors to construct a parallel system of recordation undermines the fundamental purposes of the public records. The public records are intended to allow all parties to know who has an interest in specific pieces of land. They are open to all, and they are supposed to record all interests. By allowing powerful actors to arrange transfers in private, MERS undermines this system. Parties who are outside the MERS consortium are at an informational disadvantage to members of the consortium. Even if the MERS system’s practices are narrowly within the boundaries of the law that does not mean that allowing them to continue is in the public interest.

The U.S. Bankruptcy Court for the Western District of Missouri, in \textit{In re Tucker}\textsuperscript{72} dealt with a motion for relief of stay. Again, the outcome of this case turns on the status

\textsuperscript{67} Jackson. At 504.
\textsuperscript{68} Id.
\textsuperscript{69} Id.
\textsuperscript{70} Id.
\textsuperscript{71} Id.
\textsuperscript{72} \textit{In re Tucker} 2010 WL 3733916 (Bkrtcy.W.D.Mo.)
and powers of MERS as nominee for the lender. Debtor Tucker had filed for Chapter 7 bankruptcy protection in April of 2010.\textsuperscript{73} Aurora Loan Services, a lender, filed a motion for relief from the automatic stay with respect to the Debtor’s residence; this motion was challenged by the Trustee on the ground that Aurora did not have standing.\textsuperscript{74} The Trustee asserted that the Deed of Trust was unenforceable because Aurora did not hold both the Deed and the Note on the date of the debtor’s filing.\textsuperscript{75}

The Debtor had signed a Note in October 2005, and on the same day executed a Deed of Trust.\textsuperscript{76} New Century Mortgage Corporation was listed the Lender and the Grantee, respectively, on these documents.\textsuperscript{77} The Deed states that MERS is the beneficiary of the Deed as “nominee” for the Lender and its successors and assigns.\textsuperscript{78} The Deed was properly recorded.\textsuperscript{79} New Century subsequently assigned the Note, and it then was reassigned several times.\textsuperscript{80} All of the assignees were members of MERS.\textsuperscript{81} None of these assignments were recorded; on the date of the Debtor’s filing the public records still showed New Century as grantee under the Deed, and MERS as the nominee and beneficiary.\textsuperscript{82}

At the date of the Debtor’s filing, Aurora was the physical possessor of the Note; the loan was owned by Fannie Mae and Aurora was servicing the loan for Fannie.\textsuperscript{83} The

\begin{itemize}
\item \textsuperscript{73} Id.
\item \textsuperscript{74} Id.
\item \textsuperscript{75} Id.
\item \textsuperscript{76} Id.
\item \textsuperscript{77} Tucker at 1.
\item \textsuperscript{78} Id.
\item \textsuperscript{79} Id.
\item \textsuperscript{80} Id.
\item \textsuperscript{81} Id.
\item \textsuperscript{82} Id.
\item \textsuperscript{83} Tucker at 1.
\end{itemize}
servicing agreement “directed and authorized Aurora to act in Aurora’s name on Fannie Mae’s behalf.”

In May 2010, after the Debtor’s filing, MERS assigned its interest in the Deed to Aurora; a few days later Aurora filed the motion for relief from the automatic stay. When Aurora filed their motion they were the record owner of the Deed and the physical holder of the note, but they had not become record owner of the Deed until after the Debtor’s filing.

The Trustee made two arguments against the motion for relief. First, the Trustee argued that the structure of MERS meant that no noteholder ever had a valid lien on the residence because the ownership of the Note and the Deed was split at the time New Century made the initial loan. Secondly, the Trustee argued that New Century was the holder of the Deed on the date of the bankruptcy filing, and that the automatic stay precluded the recording of the assignment for MERS (on behalf of New Century) to Aurora. Under this theory, Aurora would not be a creditor holding a valid interest in the debtor’s real property on the date of the filing and would thus lack standing to bring a motion for relief.

The Bankruptcy Court relied on Bellistri v. Ocwen Loan Servicing (see below) to determine applicable Missouri law. Failure to properly transfer the note along with the deed rendered the interest unenforceable. The holder of the note would not be entitled to

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84 Id.
85 Tucker at 1.
86 Tucker at 2.
87 Id.
88 Id.
89 Id.
notice of a tax sale or of a foreclosure by another creditor unless the noteholder had a validly recorded assignment of the deed of trust. The identification of MERS as the beneficiary under a deed of trust for the benefit of a noteholder does not create a split between the note and the deed of trust, so long as the noteholder is a member of MERS, because membership in MERS creates an agency relationship. Thus, Aurora in this matter had standing to move for relief of the automatic stay.

The foregoing cases show that in certain states MERS operations have been held to be within the letter of the law. Other courts in other states have held differently. However, these decisions rest on narrow readings of the state statutes in question, and generally ignore or minimize the public policy implications. Taking a step back from the technicalities of the law, it should be apparent that MERS operating method is a violation of the spirit and public policy purpose of the recording statutes, even if its operations are cleverly constructed to stay within the boundaries of black letter law.

MERS Transfers Rejected by Courts: The Spirit of the Law Triumphs

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90 In re Tucker at 5.
91 In re Tucker at 6.
92 Id.
93 Id.
94 In Re Tucker at 7.
95 Id.
The following cases are ones in which MERS operations have in general not been upheld by Courts. These cases share the unifying characteristic of considering the matter more broadly. They often give more weight to public policy considerations, and to not get bogged down in the technicalities of the law. These cases show the danger of constructing a private system intended to substantially circumvent the public records system established by law.

The Kansas Supreme Court has also recently considered MERS. In *Landmark National Bank v. Kesler*\(^96\) the court considered whether MERS was a necessary party in a foreclosure action. This is important because it goes to the heart of MERS status, and impacts how much power MERS has to act on behalf of its members. By holding that MERS did not have an interest in foreclosure actions, the Kansas Supreme Court called into question all MERS operations in the State of Kansas.

Mr. Kesler was a homeowner with a first and a second mortgage. The first mortgage was with Landmark National Bank, and the second mortgage was with Millennia Mortgage Corp.\(^97\) Both mortgages were registered in Ford County, KS, where the real property securing them was located.\(^98\)

The second mortgage documents indicated that the mortgage was made between Kesler-as “Mortgagor” and “Borrower”- and MERS.\(^99\) MERS was described as “acting solely as nominee for Lender, as hereinafter defined, and Lender’s successors and assigns.”\(^100\) The mortgage documents identified Millennia as the Lender.\(^101\) After the

\(^{96}\) 216 P.3d 158 (KS 2009)  
\(^{97}\) *Id.* at 161.  
\(^{98}\) *Id.*  
\(^{99}\) *Id.*  
\(^{100}\) *Id.*  
\(^{101}\) *Landmark* at 161.
closing of the loan, the mortgage was apparently assigned to Sovereign Bank.\textsuperscript{102} There was no assignment of the mortgage registered in Ford County, but Sovereign may have physically taken possession of the note.\textsuperscript{103}

Kesler subsequently filed for bankruptcy, and named Sovereign as one of his creditors.\textsuperscript{104} The record suggests that Sovereign received constructive notice of default via the bankruptcy filing.\textsuperscript{105} Landmark then filed a petition to foreclose on its first mortgage, and named Kesler and Millennia (the recorded holder, not Sovereign) as defendants.\textsuperscript{106} Neither defendant answered the petition, and the relevant trial court entered a default judgment against Kesler and Millennia.\textsuperscript{107} The trial court then filed an order of sale; notice of sale was published in a local newspaper.\textsuperscript{108} The property was sold at a sheriff’s sale and Landmark filed a motion to confirm sale of the property.\textsuperscript{109}

On the same day that Landmark filed its motion to confirm the sale, Sovereign filed an answer to the foreclosure petition; in this answer Sovereign asserted that it was the successor in interest to Millennia’s interest in the real property.\textsuperscript{110} Sovereign subsequently filed a motion to set aside the default judgment and an objection to the confirmation of the sale.\textsuperscript{111} Sovereign’s motion asserted that MERS was a contingently necessary party under Kansas law, and that because Landmark had not named MERS as a defendant Sovereign had not received proper notice.\textsuperscript{112} Cross motions concerning the

\textsuperscript{102} Id.\textsuperscript{103} Id.\textsuperscript{104} Id.\textsuperscript{105} Id.\textsuperscript{106} Id.\textsuperscript{107} Id.\textsuperscript{108} Id.\textsuperscript{109} Id.\textsuperscript{110} Id.\textsuperscript{111} Id.\textsuperscript{112} Id.
surplus from the sale and the confirmation of the sale were then variously filed by Kesler, Landmark, and Sovereign.\footnote{Id.}

The relevant trial court ultimately found that MERS was not a real party in interest and that Landmark was not required to name it as a party in the foreclosure action.\footnote{Id.} The trial court further found that MERS was only an “agent or representative” of Millennia, and that Sovereign’s failure to register its interest with the Ford County Register of Deeds prevented it from assert rights to the mortgage.\footnote{Id.} The matter then progressed through the intermediate court of appeal to the Kansas Supreme Court.

The Supreme Court analyzed the second mortgage; quoting from the document at length to set out the obligations and relationships between Kesler, MERS, and Millennia.\footnote{Landmark at 164-65.} The Court noted that the document stated that MERS acted “solely as nominee” for the lender and its successors and assigns.\footnote{Id. at 165.} Neither the word “nominee” nor the functional relationship between MERS and the lender was defined in the document.\footnote{Id.} The court then stated that in the absence of a contractual definition, the definitions would be supplied by the court.\footnote{Id.} The court noted the meaning of the word “nominee” seemed the have varied over time, with Counsel for Sovereign asserting whatever meaning was most convenient for his client at the time.\footnote{Id. at 166.} He at various time asserted that MERS held the mortgage “in street name,” that “the nominee was the mortgagee,” that MERS was a like a trustee but that the nominee’s relationship was not a trust, that the nominee was “one designated to act for another as his representative in a
rather limited sense,” and that a nominee was like a power of attorney.\textsuperscript{121} If such confusion exists in the mind of counsel for MERS, how can a third party possibly know how to treat it?

The court then cited Black’s Law Dictionary and previous Kansas precedent to arrive at the position that “the legal status of a nominee…depends on the context of the relationship of the nominee to its principal.”\textsuperscript{122} The court cited several other opinions in different states holding that MERS is an agent of the lender.\textsuperscript{123} The court then stated that “the relationship that MERS has to Sovereign is more akin to that of a straw man than to a party possessing all the rights given a buyer.”\textsuperscript{124} The court stated that “a mortgagee and a lender have intertwined rights that defy a clear separation of interests.”\textsuperscript{125} “The law generally understands that a mortgagee is not distinct from a lender.”\textsuperscript{126} Kansas statutory law provides that assignment of the mortgage carries with it assignment of the debt.\textsuperscript{127}

MERS position was that the mortgage document gives it the same rights as the lender, but the document itself “consistently refers only to rights of the lender.”\textsuperscript{128} The document also provides consistent limitations to the role of MERS; MERS is “solely” the nominee of the lender.\textsuperscript{129} As was illustrated above, the meaning of “nominee” is far from clear, even in the mind of those representing MERS. There is an air hanging over these cases, where the powers of MERS are not defined because to be defined would be to be

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\textsuperscript{121} \textit{Id.}  \\
\textsuperscript{122} \textit{Landmark} at 166.  \\
\textsuperscript{123} \textit{Id.}  \\
\textsuperscript{124} \textit{Id.}  \\
\textsuperscript{125} \textit{Id.}  \\
\textsuperscript{126} \textit{Landmark} at 166.  \\
\textsuperscript{127} \textit{Id} at 166, citing K.S.A. 58-2323.  \\
\textsuperscript{128} \textit{Id.}  \\
\textsuperscript{129} \textit{Id.}  \\
\end{flushleft}
limited. MERS’ powers rather seem to be intended by the members of the consortium to be flexible, and able to meet any need that should arise.

The court then observed that when a mortgage loan separates the interest of the note and the deed, and the deed lies with a third party, the mortgage may become unenforceable.\(^\text{130}\) The court questioned what interest MERS could have in the outcome of a foreclosure action.\(^\text{131}\) It noted that MERS did not lend any money to Kesler, and that there is no existing statutory or contractual obligation for anyone to make payments to MERS.\(^\text{132}\) “If MERS is only the mortgagee, without ownership of the mortgage instrument, is does not have an enforceable right.”\(^\text{133}\) MERS had the opportunity at trial to demonstrate a tangible interest in the mortgage, and explicitly declined to do so.\(^\text{134}\) Indeed, at trial MERS insisted that it did not have to show a financial or property interest; MERS also did not show any harm suffered by lack of service.\(^\text{135}\)

The court then discussed the public policy arguments surrounding MERS. The court noted that, whatever efficiencies MERS provides for its members, “having a single front man, or nominee, for various financial institutions makes it difficult for mortgagors and other institutions to determine the identity of the current note holder.”\(^\text{136}\) The court continued and stated that MERS “creates a system in which the public has no notice of who holds the obligation on a mortgage.”\(^\text{137}\)

The Kansas Supreme Court upheld the trial court’s decisions. This case shows that MERS has real difficulty in showing why it should have an interest in foreclosure

\(^{130}\) *Landmark* at 167.  
\(^{131}\) Id.  
\(^{132}\) Id.  
\(^{133}\) Id.  
\(^{134}\) *Landmark* at 167.  
\(^{135}\) Id. at 168.  
\(^{136}\) Id.  
\(^{137}\) *Landmark* at 169.
actions. It also highlights the public policy concerns about a private registration system. MERS (and Sovereign, which obtained its purported interest via a private, unrecorded transfer) lost out in the matter. Had Sovereign recorded in accordance with the relevant statute, they would have received timely notice and been able to participate in the foreclosure process. Because of the nature of MERS, operating outside the public recordation system, the owner of the second mortgage wound up with nothing. Sovereign was caught out because of its reliance on the MERS system being functionally equivalent to the public records of Kansas. Sovereign was unable to defend its interest during the foreclosure proceedings because the debtor did not know that they had an interest in the property at all. Every investor which has bought a mortgage or RMBS where the loan has been transferred through MERS is at risk of a like loss. Without being an owner of an interest recorded in the public records they cannot be sure they will receive notice when their interest is threatened by legal actions affecting the property securing the debt. Because MERS is private, plaintiffs who are not members of the consortium cannot know who to serve, other than the publically recorded party. Thus MERS, intended as a convenience for members, actually poses a threat to their interests.

Another important state case is *Bellistri v. Ocwen Loan Servicing* 284 SW3d 619 (Mo.App.2009). This case highlights the difficulty of obtaining clear title to property once the mortgage on that property has been registered with MERS. This is a case concerning a tax sale purchaser’s attempt to quiet title. Plaintiff Bellistri brought an action to quiet title, and Ocwen filed motion for summary judgment. Ocwen was held to lack standing to contest Bellistri’s deed.¹³⁸ This is another case where MERS was named as beneficiary of the deed of trust, as nominee for the originating lender, BNC

¹³⁸ *Bellisri v. Ocwen Loan Servcicing* 284 S.W.3d 619, 621 (MO 2009)
Mortgage.\textsuperscript{139} The promissory note does not make any reference to MERS.\textsuperscript{140} The borrower on the BNC loan failed to pay taxes for three years.\textsuperscript{141} Bellistri purchased the property, and was issued a collector’s deed by the relevant county entity.\textsuperscript{142} Approximately 7 months after the collector’s deed was issued to Bellistri, MERS assigned the deed of trust to Ocwen.\textsuperscript{143} “The assignment of the deed of trust also contained language that this assignment also transferred any and all notes described in the deed of trust.”\textsuperscript{144} Bellistri then filed an action to quite title and eject the original debtor; he initially published notice to all unknown persons with an interest in the party and later added Ocwen as a necessary party.\textsuperscript{145} The trial court granted summary judgment in favor of Bellistri.\textsuperscript{146} Ocwen appealed on four points, the relevant one of which was that it “had standing in this quiet title action because it was the named grantee on the assignment of the deed of trust.”\textsuperscript{147}

The court considered the standing argument. Standing, under Missouri precedent, “requires that a party seeking relief have a legally cognizable interest in the subject matter and that he has a threatened or actual injury.”\textsuperscript{148} The court held that while Ocwen was the recorded grantee of the assignment of the deed of trust, it nonetheless lacked a legally cognizable interest.\textsuperscript{149}
The court discussed the nature of Ocwen’s interest, and in summation held that “the note and the deed of trust are inseparable, and when the promissory note is transferred it vests in the transferee all the interest, rights, powers, and security conferred by the deed of trust upon the beneficiary therein and the payee in the notes.”\footnote{Id (citations and internal quotations omitted)} MERS had attempted to transfer “any and all notes” with the assignment of the deed of trust\footnote{Id.} However, BNC was the holder of the note and there was no evidence that MERS held the note or had authority to transfer it.\footnote{Bellistri at 624.} MERS could not transfer the note because it lacked authority to do so and thus the language of the assignment purporting to transfer the note with the deed was ineffective.\footnote{Id.} Additionally, as MERS never held the note the assignment of the deed separate from the note had no force.\footnote{Id.} Thus, Ocwen held neither the note nor the deed; not holding either meant that they did not have a legally cognizable interest and so lacked standing.\footnote{Bellistri at 623}

This case highlights the potential pitfalls of the MERS system for the transferee of mortgage interests. After the assignment from BNC, Ocwen was listed as grantee, as servicer for Deutsche Bank.\footnote{Bellistri at 623} Deutsche Bank was in turn trustee for the registered holders of the CDC Mortgage Capital Trust\footnote{Id.}, 2002-HE1; in other words, the original BNC mortgage loan had, after a process not described in the record, wound up in an MBS.

Failure to properly transfer the note along with the deed rendered the interest unenforceable. The party ultimately bearing the loss is unknown, but ultimately the
purchasers of the MBS in question did not get the secure income stream they had presumably been expecting when they invested their capital. In this case, the MERS system is shown to be too clever by half, to the ultimate detriment of the supposed beneficiaries.

In *BAC Funding Consortium v. Jean-Jacques* mortgagors appealed a summary judgment in favor of purported note and mortgage holder. In this matter, US Bank attempted to foreclose on a mortgage; the mortgage documents identified Fremont Investment and Loan as the lender and MERS as the mortgagee. US Bank did not file an original of a purported assignment or any other document establishing that it had standing to foreclose. The Court held that there was a genuine issue of material fact as to whether US Bank had standing to foreclose. US Bank did not provide any evidence that it had purchased the note and mortgage. This case highlights the danger of paperwork errors in the high volume MERS system; MERS is sold as an efficient solution, but when its own internal recordkeeping breaks down the public records are not available to subsequent purchasers who wish to establish their interest in mortgages purchased on the secondary market.

Another summary judgment appeal dealing with the ability of purported assignees to foreclose is *Verizzo v. Bank of New York*. In this case the mortgage documents indicated that the lender was Novastar Mortgage and that MERS was the mortgagee, as nominee of Novastar. Bank of New York produced an assignment in its favor from

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158 *BAC Funding Consortium v. Jean-Jacques* 28 So.3d 936, 937. (FL 2010)
159 *Id.*
160 *Id.*
161 *Id.* at 938.
162 *Id.*
164 *Id.* at 977
MERS for the note and the mortgage.\textsuperscript{165} However, the note was actually endorsed to
JPMorgan Chase.\textsuperscript{166} There was no assignment or endorsement in the record from
JPMorgan Chase to Bank of New York or to MERS.\textsuperscript{167} “Thus, there is a genuine issue of
material fact as to whether Bank of New York owns and holds the note and has standing
to foreclose the mortgage.”\textsuperscript{168} This case also indicates that, when there is a problem with
the private record keeping, the public records are not available to substantiate the rights
claimed by parties who purchase mortgages in the secondary market.

All of these cases ultimately show the weakness of MERS and those who rely on it. In seeking to streamline their business operations, they have constructed a parallel structure to the public records. When they have a problem, they do not have the public records to fall back on. Additionally, these case show that many courts are not willing to accept MERS technical compliance with black letter law when the clear purpose of the system is to circumvent the statutorily established public recording system.

\textit{Seeking Refuge in Confusion: MERS Argues for different status when convenient}

The Nebraska Supreme Court has also recent considered the status and nature of MERS. In \textit{Mortgage Elec. Reg. Sys., Inc. v. Nebraska Depart. Of Banking}, the court considered whether MERS was subject to regulation as a mortgage broker.\textsuperscript{169} This case provides an interesting exploration into the exact nature of MERS, and illustrates confusion that exists even among its own counsel.

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{165} \textit{Id.}
\item \textsuperscript{166} \textit{Id.}
\item \textsuperscript{167} \textit{Id.} at 978.
\item \textsuperscript{168} \textit{Id.}
\item \textsuperscript{169} 704 N.W.2d 784 (NE 2005)
\end{itemize}
\end{footnotesize}
The Nebraska Department of Banking and Finance issued an order that MERS was a “mortgage banker” subject to license and registration requirements under Nebraska law.\(^\text{170}\) The Court defined MERS and described its business of maintaining a private registration system for mortgages whereby members could conduct transactions in interests in mortgage loans without recording the transfers in the public records.\(^\text{171}\) The Nebraska Department of Banking and Finance had determined that this activity made MERS a mortgage banker under relevant Nebraska law, that that it was therefore required to obtain a license.\(^\text{172}\) MERS in this matter asserted that it did not “acquire” mortgage loans and was therefore not subject to the licensing regime.\(^\text{173}\)

MERS’ argument was founded on the idea that did not acquire loans (and thus subject itself to regulation) because “it only holds legal title to member’s mortgages in a nominee capacity and is contractually prohibited from exercising any rights with respect to the mortgages (i.e. foreclosure) without the authorization of the members.”\(^\text{174}\) MERS further argued that it did not own the promissory notes, and had no rights to payments made under the terms of those notes.\(^\text{175}\) MERS described its activities as “immobilize[ing] the mortgage lien while transfers of the promissory notes and servicing rights continue to occur.”\(^\text{176}\)

The court held that MERS services “are not equivalent to acquiring mortgage loans” as defined by Nebraska statute.\(^\text{177}\) The court based this finding on the fact that

\(^{170}\) *MERS v. Nebraska*, at 785.  
^{171} Id.  
^{172} Id.  
^{173} Id. at 786.  
^{174} Id.  
^{175} Id.  
^{176} *MERS v. Nebraska* at 787.  
^{177} Id. at 788.
MERS did not extend credit or have the right to receive payments. Because MERS had “no independent right to collect any debt” they were held not to acquire mortgage loans and thus were not subject to the regulatory scheme governing mortgage bankers.

This result begs an important question. MERS asserts in other forums, as the other cases in this paper show, that it does have a right to foreclose. Are they thus simply talking out of both sides of their mouths? It seems difficult to reconcile this result with litigation in other forums where MERS asserted a right to foreclose, or be a party in foreclosure actions. This case also provides further highlighting of the fundamental tension between MERS practices and state recording statutes; here MERS says that they “immobilize” the lien, but that transfers of the note and the servicing rights continue. These transfers take place on MERS’ own books, and are invisible to all outsiders.

**Possible Solutions and Problems Therewith**

The potential problems posed by the MERS system could be solved by either State of Federal action. Each of these potential solution sources will be discussed in turn.

*Action by the Individual States*

The states could act individually to correct the problems. State legislative action could clarify the matter, and give legal effect to private book transfers. Real estate recordation is a traditional area of State competence, and this problem goes to the heart of the recording system. A solution based on State action would thus fit within the traditional division of powers between the States and the Federal government. Additionally, because each State already maintains a recordation system, the States have the administrative machinery in place to deal with the problem. State legitimization of

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178 Id.
179 Id.
private book transfers could be overseeing in practice by county clerks and by the personnel that already oversee the recording of liens. While there might well be temporary backlogs, there would be no need to create a fundamentally new bureaucracy, and the administrators with the key core competencies would already be on staff in most places.

However, a solution based on state by state action is not without problems. There are two key issues which could hamper a state by state solution. These are the problems of coordinating action, and the problem of incentives to favor debtors.

There are fifty states in the United States, as well as several other non-state entities such as the District of Columbia; each of these with its own legislature. This may sound like a truism, but it is important to recognize that coordinated rapid action by all, or even most, of the states is difficult to arrange. The National Conference of Commissioners on Uniform State Laws, which promulgates the various Uniform model statutes, is an example of effective interstate legislative coordination.\(^ {180} \) This body however moves very slowly. In order for the states to enact a reasonably uniform solution on a state by state basis, the Governors of the several states would probably have to work closely together, and the various legislatures would have to lay aside local interests in service of a uniform solution. Uniformity is important to prevent regulatory arbitrage and to ensure equitable treatment of similarly situated citizens of different states.

The importance of local interests raises another obstacle to the efficient enactment of a reasonably uniform solution by the states. The state legislatures would have to overcome local political pressure in favor of debtors. For most voters, their single largest

\(^ {180} \) See [www.nccusl.org](http://www.nccusl.org) (accessed December 3, 2010).
debt is their home mortgage. If the people begin to perceive that there is a way to escape this debt, there may well be considerable pressure on legislatures to allow them to make their escape. Furthermore, many of the large financial institutions which now hold the RMBS are located in either the New York metropolitan area, or overseas. There could well be considerable pressure to favor local homeowners at the expense of “foreign” RMBS holders. Additionally, a public perception that the rules were being rewritten retroactively to favor big financial interests who had made a mistake and now needed help from the government to fix it could lead to public opposition. TARP has proven unpopular with the public, and the party which controlled Congress when it was passed has lost its majority in the recent midterms.

A legislature in a state hard hit by foreclosures might even consider positive action to void mortgages. Such a statute could take that form of legislation which said, in effect, that all mortgages in the state which had been sold in the secondary market without an assignment being done in accordance with the state’s recording statute were void. This would at least in the short term provide great benefit to many voters in the state, as their mortgages would seem to disappear. The effect on financial institutions of such action would likely be dire. Banks, and all other institutions which had bought RMBS, would have part of their capital wiped out in a stroke. This would cause financial losses, and might send some otherwise healthy firms into bankruptcy. Even those firms which survived would be less able to lend (because of the loss of capital) and less inclined to lend (because of the political risk). The overall effect on the national economy would likely be negative.

*Action by the Federal Government*
The Federal government could act in place of the States, if State action appeared to be too difficult to coordinate or States began to enact mortgage voiding statutes to “protect” local debtors. A Federal solution would have the advantage of uniformity, as the solution would apply across all fifty States. This would greatly simplify matters from a business point of view. A single piece of legislation, establishing national rules, would be cheaper and easier to comply with than 50 different State acts. Also, it would in some ways be more equitable. A Federal solution would mean that all homeowners were treated equally. If State by State action was the dominant mode, then in the case of two mortgage registered with MERS, homeowners in one State might find their mortgage voided, while homeowners in another State, who had identical mortgages from the same institution might find it affirmed. This difference would likely anger many people. The possibility exists of a race to the bottom, wherein different State legislatures competed to void their citizens’ mortgages on the broadest base of affected loans, seeking a boost in popularity from debtor voters. Once one State began, other States would be hard pressed to avoid following suit, especially if the first State to act were a large one such as California or Florida. As discussed above, the consequences of mass mortgage voiding for the banking system and the economy as a whole would likely be dire.

A Federal solution might also be appropriate because the issue certainly appears to involve interstate commerce, and thus be within the scope on Congressional regulation.\textsuperscript{181} While the problem might appear initially to be strictly a state law issue, the true problem exists because of the transfer of mortgages between financial institutions; there is a large and active interstate market in RMBS. The ability of the debt holder to secure repayment impacts the financial markets in general, on a national and even

\textsuperscript{181} US Const Art. I Sec 8.
international basis. Thus, it would be Constitutionally permissible for the Federal
government to use its power over interstate commerce to impose a solution on this
matter, which affects the interstate trade in various securities.

There are several potential problems with a Federal solution, each of which could
prevent it from taking effect.

A federal solution would possibly constitute a substantial expansion in the power
of the central government. This issue of debt recordation has traditionally been handled
by the states. Proponents of a Federal solution could certainly construct a Commerce
Clause argument, but the Commerce Clause is not an unlimited mechanism for the
expansion of Federal regulation. The issue of the permissibility of a Federal solution
would likely turn on how the issue is framed. If it is framed as a straight recordation
issue, affecting only title to land and compliance with State recording statutes, then the
Federal government would probably be overstepping its bounds. If the issue is framed as
one of the interstate commerce in securities, the Federal government might be able to act.
The ability to enforce payment and maintain the income stream on RMBS could be
characterized as a necessary action to ensure the functioning of the interstate financial
markets.

Even if Federal action were Constitutionally allowable in a theoretical way, a
Federal solution might well run into substantial practical political difficulties. The
Federal government has been very active since 2008 in assisting the financial sector.
This assistance has never had really broad support, and its popularity continues to
decline. The big banking sector is seen in many sections of the population as a having
already benefited from the Federal government, and thus the taxpayers, covering up for
its mistakes. A proposal for Federal legislation that once again “bails out” the big banks (even if it was a sound proposal on its own merits) could attract substantial political opposition.

Furthermore, the current Congress and Administration have been declining in popularity for some time. This paper is not a political piece; however any proponent of increased action by the Federal government will have to content with the outcome of the 2010 midterms, which transferred control of the House of Representative to the Republican Party, and reduced the Democratic majority in the Senate. However, prudence requires the author to note that the President and the Congressional leadership are seen in a negative light in many quarters. If legislation were proposed that was seen or could be presented as benefiting the “well-connected” at the expense of the “struggling little guy” there could well be intense opposition that was more or less unrelated to the substance of the bill.

Solutions Reexamined: A Model Statute

State action, on the balance, is probably preferable to Federal action. Real estate and property law is a traditional area of State competence, and the States already have much of the administrative machinery in place.

A State might resolve many of the issues surrounding MERS and title to land by enacting a statute to cure those problems. A statute to address the problems caused by private book transfers and lack of compliance with recordation statutes might include some or all of the features discussed below. It would be best if such a statute were promulgated by an organization like the National Conference of Commissioners on Uniform State Laws, in order to obtain the maximum harmony between State solutions
and minimize opportunities for regulatory arbitrage. The statute would need to both clean up the existing mess in the recordation system, and protect borrowers and enable them to pay with confidence.

Recordation

All interests in land should be recorded in accordance with applicable law. Private book transfers or assignments of interests in land should be banned in the implementing state after a grace period; perhaps 180 days from the enactment of the statute would be appropriate. Any transfer or assignment of an interest in land, made after the effective date, which is not recorded according to law, shall be void. This is a necessary reaffirmation of the existing recording statute, and should clearly require the actual beneficial owner to record, not a nominee. Parties which hold an interest in land, which they have acquired via a private transaction which was not recorded in accordance with applicable law, must record in order for their interests to be valid. This allows current MERS transferees to record and bring their interests within the letter and the spirit of the law. All interests which are not recorded by the effective date are deemed to be voidable; thus, those holding privately transferred interests which are not recorded cannot enforce them against debtors. All interests which are recorded under the statute will have priority based on the date they are recorded according to applicable law.

Interests recorded under this statute shall have inferior priority with respect to properly recorded interests which were recorded in the interval between the date of the recordation of the original interest by the original mortgagee (or nominee thereof) and the date at which the current mortgagee records. If, for example, a tradesman has placed a mechanic’s lien on a home in the interval between the initial mortgaging of the home and
the MERS transferee recording, then that mechanic’s lien will be in first position and the mortgage in second position.

*Mortgagor Protection and Relief*

The people must be able to pay with confidence. If ordinary homeowners do not believe that their mortgage payments are being properly applied to their debt, and/or that their purported mortgagee will be unable to grant them clean title in the event of a payoff, then there is a real danger of a large number of strategic defaults. A strategic default is a type of efficient breach; it occurs when a borrower who is current on their mortgage decides that further payment is economically unwise under the circumstances. The borrower voluntarily ceases payment and the loan goes into default even thought the borrower is not in the sort of distress which traditionally leads to default. Thus, under the reform statute, mortgagors should be able to initiate interpleader actions in order to resolve who the proper payee of their mortgage is. Mortgagors who wish to initiate an interpleader action should be able to give notice to the mortgagee (or nominee thereof) listed in the public records; ordinary citizens should not bear the burden of determining if the party listed in the public records is in fact the mortgagee. People should be able to rely on the public records. Notice given to the party appearing in the public records should be deemed sufficient to all parties who may have been assigned the mortgage in a private transfer not recorded in accordance with applicable law.

In the event that the mortgagee (or nominee thereof) listed in the public records is no longer the holder of the mortgage, they should be required to make all reasonable efforts to notify the current holder. In no event should a plaintiff-mortgagor be liable to a claimant-mortgagee, after the decision of the Special Master as provided below, who
asserts a claim based on lack of notice, when that claimant-mortgagee’s claim of lack of
notice is based on a transfer or assignment which was not recorded in accordance with
applicable law.

The trial court should have the authority to appoint Special Masters as needed, in
order to resolve interpleader actions related to privately transferred interests in land
which were not recorded in accordance with applicable law, if the Court decides that such
an appointment would be in the public interest and in the interest of judicial economy.
Given the fact that so many mortgages have been registered with MERS, and thus
logically might have been subject to a privately recorded transfer, the volume of
interpleaders could be very high. A Special Master system would prevent these actions
from clogging the courts and allow the process to be supervised by an individual with
specialized knowledge necessary for both efficiency and equity.

Parties wishing to assert a claim against a plaintiff-mortgagor should have sixty
(60) days to file such a claim with the Court or the Special Master, as appropriate. The
Court or the Special Master, as appropriate, should render a decision on the matter within
sixty (60) days of the expiry of the period for filing claims. This timeline of one hundred
and twenty (120) total days was not chosen arbitrarily. A typical residential mortgage
requires four missed payments in a row to go from current status to default. Thus, by
requiring the matter to be resolved in four months the proposed statute would produce an
outcome where the proper payee was known in no more than the time it would take a
homeowner to default in a case where the homeowner stopped paying at the
commencement of the interpleader action. The proper owner could then take appropriate
action against the homeowner (i.e. foreclose). The interpleader system is intended to
allow the homeowner to pay with confidence; it is not intended to allow them to avoid payment altogether.

Each state adopting this solution should establish a State Mortgage Payment Trust. The highest court of the state should appoint a Trustee to oversee this Trust. The Trustee should have the authority to contract with private mortgage servicers to conduct the day to day operations of the Trust, if the Trustee believes such an arrangement would be in the public interest. The Trustee should probably select at least two large commercial servicing firms to operate the Trust; that way mortgages in question where one commercial servicer is a party in the interpleader action can be assigned to the other servicer in the Trust.

The highest court of the state should have the authority to create streamlined procedures for the use by Special Masters appointed by the trial courts in matters related to privately transferred interests in land which were not recorded in accordance with applicable law. The procedures used by the Special Masters should be uniform in all the trial level judicial subdivision of the state.

Mortgagors who initiate interpleader actions should make their payments to the Mortgage Payment Trust. At the conclusion of the interpleader action, the Trustee should disburse the plaintiff-mortgagor’s mortgage payments to the appropriate claimant-mortgagee(s). Mortgagees and their agents should be forbidden from assessing late fees or other penalties on mortgagors who are making their payments into the Trust. Mortgagees and their agents should be forbidden from reporting a delinquency to the credit reporting agencies while the plaintiff-mortgagor is making his payments to the Trust. The Trustee should report current or delinquent payments, as appropriate, to the
credit reporting agencies while the plaintiff-mortgagor is making payments into the Trust. The terms of the mortgage should not be altered by the plaintiff-mortgagor’s filing of an interpleader action under this statute. The plaintiff-mortgagor should be obligated to continue paying under the terms of the mortgage in exactly the same fashion as if they had not initiated the action. In the event that the plaintiff-mortgagor becomes delinquent while paying into the Trust, the Trustee should be authorized to take such action as the mortgagee would have been able to take under the terms of the mortgage.

Conclusion

The MERS system is a foundational piece of the modern American mortgage system, and is thus at the base of the financial system as a whole. This system has come under substantial legal challenges in recent years. In some forums MERS has prevailed; in others it has not. The uncertainty surrounding transfers of interests in land made via the MERS system threatens the financial system as a whole, by casting doubt as to the value of the almost ubiquitous RMBS, and by causing homeowners to doubt whether they can pay their mortgage with confidence and whether their purported mortgage holder can ever give them clear title. Even if MERS is technically operating within the boundaries of the law, the existence of a private system to manage transfers of interests in land is contrary to the fundamental public policy purpose of public records. The solution to these problems is for the several states, preferably acting on the advice of the National Conference of Commissioners on Uniform State Laws, to enact statutes banning private book transfers and providing mechanisms to clean up the existing confused situation. This will benefit both individual citizens and financial institutions; by
ensuring that existing securitized mortgage debt is collectable and by giving ordinary borrowers the ability to pay with confidence.