THE CASE AGAINST ALLOWING MORTGAGE ELECTRONIC REGISTRATION SYSTEMS, INC. (MERS) TO INITIATE FORECLOSURE PROCEEDINGS

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INTRODUCTION

Few American homeowners know much about the small, Virginia-based company that has revolutionized the mortgage industry over the past fifteen years. Yet, Mortgage Electronic Registration Systems, Inc. (MERS) is the named mortgagee on nearly two-thirds of all newly originated residential mortgages in the United States.[1] Industry leaders—including Freddie Mac, Ginnie Mae, and a host of private lenders—created MERS in the mid-1990s to help facilitate a burgeoning market in mortgage-backed securities.[2] Prior to the creation of MERS, when one lender wanted to sell her interest in a mortgage to another lender, she had to execute a written assignment of the mortgage, which the purchaser would record in the local land records.[3] This process

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[1] *See* Jackson v. Mortg. Elec. Registration Sys., Inc., 770 N.W.2d 487, 491-92 (Minn. 2009) (noting that MERS claims to be "the nominal mortgagee on approximately two-thirds of all 'newly originated' residential loans nationwide").

[2] Mortgage industry leaders created MERS in the mid 1990s,

> as a vehicle for reducing the costs associated with transferring mortgages on the secondary mortgage market. MERS . . . maintains a registry of mortgages each with a unique identifying number. Entities that are members of MERS register individual mortgages with MERS, with the goal that the MERS registration will eliminate the need for recording in the applicable local real estate records the frequent and multiple assignments of the security instruments. MERS thus seeks to be an efficient central repository of mortgage data, and in some sense to serve as the mortgagee "of record."

FRANK S. ALEXANDER, GEORGIA REAL ESTATE FINANCE AND FORECLOSURE LAW § 5:4 (2010-2011 ed. 2009) (footnotes omitted); *see infra* Part I.C for a detailed discussion of MERS operating procedures.

[3] Every state has adopted a recording act that governs the process of publically documenting transfers of interests in land, including mortgages. The recording acts have two primary objectives. "First and foremost, [they] are designed to protect purchasers who acquire interests in real property for a valuable consideration and without notice of prior interests from the enforcement of those claims." Devine v. Town of Nantucket, 870 N.E.2d 591, 597 (Mass. 2007) (internal quotation marks omitted). As the Colorado Supreme Court has observed, "[r]ecording

protected the purchaser of the mortgage against adverse claims by subsequent transferees from the original seller of the mortgage, because the land records reflected the purchaser's ownership. It also protected her rights vis-à-vis subsequent purchasers of the property secured by the mortgage by putting purchasers on notice that the property was subject to the lender's mortgage interest.[4]

As the market for mortgage-backed securities grew, mortgage lenders and investment banks sought to make the transfer of residential mortgages cheaper and easier, and so MERS was born.[5] MERS functions as an electronic clearinghouse that allows lenders to circumvent the process of recording assignments and paying recording fees to the county clerk's office.[6] A lender that has become a member of MERS still records newly originated mortgages in the official land records as traditionally required.[7] However, instead of listing itself as the owner of the mortgage, the lender names MERS as mortgagee, but "solely as nominee"—meaning only as an agent—for the lender, and for the lender's "successors and assigns."[8] If the lender subsequently

acts have been enacted in response to a need to provide protection for purchasers of real property against the risk of prior secret conveyances by the seller." Brown v. Faatz, 197 P.3d 245, 252 (Colo. App. 2008) (quoting Page v. Fees-Krey, Inc., 617 P.2d 1188, 1192-93 (Colo. 1980)). Second, "the recording acts create a public record from which prospective purchasers of interests in real property may ascertain the existence of prior claims that might affect their interests." *Devine*, 870 N.E.2d at 597 (internal quotation marks omitted).

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> It is important for the assignee to promptly record, since his failure to record makes it possible for the original mortgagee to release the mortgage of record and for the mortgagor then to convey the property free and clear of the lien to a bona fide purchaser or encumbrancer. This is a necessary result of the policy behind the recording laws *i.e.*, that persons who rely on the record are entitled to be protected.

4-37 POWELL ON REAL PROPERTY: MICHAEL ALLEN WOLF DESK § 37.27 (Michael Allan Wolf ed., 2009) [hereinafter POWELL ON REAL PROPERTY DESK EDITION] (footnotes omitted).

5 *See* Beau Phillips, *MERS: The Mortgage Electronic Registration System*, 63 CONSUMER FIN. L.Q. REP. 262, 263 (2009) (describing how MERS was created in 1993 "[i]n response to the flood of paperwork that plagues the mortgage loan industry and impairs its productivity").

6 "MERS is a private database that simplifies the way mortgage ownership and servicing rights are originated, registered, sold and tracked. It has eliminated the need to prepare and record separate assignments when selling, trading or securitizing residential and commercial mortgage loans." *Id.*

7 MERSCORP, INC., RULES OF MEMBERSHIP Rule 2, § 5(a) (June 2009) [hereinafter MERS RULES], *available at* http://www.mersinc.org/MersProducts/publications.aspx?mpid=1 ("Each Member, at its own expense, shall cause Mortgage Electronic Registration Systems, Inc., to appear in the appropriate public records as the mortgagee of record with respect to each mortgage loan that the Member registers on the MERS® System.").

8 The standard MERS mortgage contains the following language: "TO SECURE to Lender the repayment of the indebtedness evidenced by the Note . . . Borrower does hereby mortgage, grant and convey to MERS (solely as nominee for Lender and Lender's successors and assigns) and to the successors and assigns of MERS the following described property . . . ." *See, e.g.*, Landmark Nat'l Bank v. Kesler, 216 P.3d 158, 165 (Kan. 2009). The document goes on to state that:

> Borrower understands and agrees that MERS holds only legal title to the interests granted by Borrower in this Mortgage; but, if necessary to comply with law or custom,

assigns the mortgage to another MERS member, the assignment need not be recorded because the new owner is among the original lender's "successors and assigns."[9] Consequently, newly originated mortgages are recorded only once, even if they are subsequently transferred among MERS members. Instead of tracking changes of ownership in the official land records, MERS tracks the transfer of its members' mortgages electronically in a private database.[10] MERS continues to track the mortgages until they are either satisfied or transferred to a non-MERS member, or until the borrower defaults on the loan.[11]

At the time MERS was created, a robust and lightly regulated secondary market for mortgage-backed securities seemed like a good idea.[12] The recent subprime mortgage crisis, which has impacted millions of American homeowners and played a key role in a global recession, has done much to challenge that presumption.[13] One unfortunate byproduct of the subprime mortgage crisis has been a dramatic increase in the number of American homeowners facing foreclosure.[14] For many of these homeowners, the MERS system may compound their hardships by effectively masking the identity of the owner of their loans.[15] One of the benefits of MERS membership, according to MERS, is the legal right to foreclose on a defaulting

> MERS, (as nominee for Lender and Lender's successors and assigns), has the right: to exercise any and all of those interests, *including, but not limited to, the right to foreclose and sell the Property* . . . .

Id. (emphasis added). Whether this language relating to MERS's right to foreclose is enforceable is the primary focus of this Note.

9 Mortg. Elec. Registration Sys., Inc. v. Neb. Dep't of Banking and Fin., 704 N.W.2d 784, 785 (Neb. 2005) ("MERS is a private corporation that administers the MERS System, a national electronic registry that tracks the transfer of ownership interests and servicing rights in mortgage loans. Through the MERS System, MERS becomes the mortgagee of record for participating members through assignment of the members' interests to MERS. MERS is listed as the grantee in the official records maintained at county register of deeds offices. The lenders retain the promissory notes, as well as the servicing rights to the mortgages. The lenders can then sell these interests to investors without having to record the transaction in the public record. MERS is compensated for its services through fees charged to participating MERS members.").

10 *See* Phillips, *supra* note 5, at 263-64.

11 *Id.*

12 *See* R.K Arnold, *Yes, There is Life on MERS*, 11 PROB. & PROP. 32, 34 (1997) ("As a result [of the secondary market for mortgage loans], the U.S. housing market is the envy of the entire world. Home ownership in most other countries is far less attainable, largely because financing is not as readily available. The ability of lenders to replenish their capital by selling loans in the secondary market is what makes money accessible for home ownership.").

13 *See generally* Gerald Korngold, *Legal and Policy Choices in the Aftermath of the Subprime and Mortgage Financing Crisis*, 60 S.C. L. REV. 727 (2009).

14 *See, e.g.*, David Leonhardt, *Do I Hear a Housing Rebound? Not Yet*, N.Y. TIMES, Apr. 22, 2009, at B1.

15 For example, Professor Chris Peterson suggests that MERS has played a significant role in the recent subprime mortgage crisis by "draw[ing] a 'veil' across mortgage transactions, like a 'masked executioner.'" Alvin C. Harrell, *Teaching Consumer Law*, 12 J. CONSUMER & COM. L. 8, 14 (2008). Professor Peterson also observes that "no law review articles have yet explored [the legitimacy of MERS's transactions] except those written by MERS executives." *Id.*

homeowner in MERS's name rather than in the name of the entity who actually owns the mortgage.[16] This can mean that homeowners have no way of ascertaining the identity of the party with whom they can negotiate their loans.[17]

Several state courts have considered challenges to MERS's right to initiate foreclosure actions in its own name. MERS claims to have the legal authority to initiate foreclosure proceedings throughout the United States,[18] but not every court has agreed. Some jurisdictions have expressly upheld MERS's right to foreclose,[19] while some have questioned or limited MERS's foreclosure rights.[20] Still other courts have reserved judgment,[21] expressing frustration and confusion regarding MERS's role in an increasing number of foreclosure and bankruptcy proceedings,[22] and the ostensible connection between MERS and the subprime mortgage crisis.[23]

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16 According to its website, "MERS has been designed to operate within the existing legal framework of all 50 states." *MERS Frequently Asked Questions*, MERS, http://www.mersinc.org/why_mers/faq.aspx#5 (last visited Jan. 8, 2011). This includes the legal right to foreclose. *See Foreclosures*, MERS, http://www.mersinc.org/Foreclosures/index.aspx (last visited Jan. 8, 2011) ("[MERS] is a proper party that can lawfully foreclose as the mortgagee and note-holder of a mortgage loan.").

17 *See infra* Part II.A.

18 *See supra* note 16 and accompanying text.

19 *See, e.g.*, Mortg. Elec. Registration Sys., Inc. v. Revoredo, 955 So. 2d 33 (Fla. Dist. Ct. App. 2007) (holding that MERS has standing to foreclose in Florida); Jackson v. Mortg. Elec. Registration Sys., Inc., 770 N.W.2d 487 (Minn. 2009) (holding that Minnesota's foreclosure by advertisement statute does not prohibit MERS from foreclosing in its own name without recording mortgage assignments).

20 *See*, *e.g.*, Landmark Nat'l Bank v. Kesler, 216 P.3d 158 (Kan. 2009) (noting that MERS does not have standing to intervene as a necessary party in a foreclosure action initiated by a junior lien holder, where MERS is not the owner of the note or mortgage); LaSalle Bank Nat'l Ass'n v. Lamy, 824 N.Y.S.2d 769 (N.Y. Sup. Ct. 2006) (noting that MERS does not have standing to foreclose because it does not own the note and mortgage).

21 In Georgia, courts

> have not yet addressed whether MERS has an adequate legal interest or legal authority for standing to bring foreclosure actions, and there is dicta that indicates it is not a foregone conclusion. The Georgia Supreme Court explicitly stated that whether MERS has standing to bring a foreclosure action is a question worthy of inquiry.

ALEXANDER, *supra* note 2, § 5:4. Similarly, in Florida, County Judge Walt Logan stopped accepting MERS foreclosures in 2005, when he had twenty-eight pending actions on his docket where MERS was attempting to foreclose. MERS "would not explain how it came to possess the mortgage notes originally issued by banks." Mike McIntire, *Murky Middleman*, N.Y. TIMES, Apr. 24, 2009, at B1. Although MERS eventually won the case on appeal, "it has asked banks not to foreclose in its name in Florida because of lingering concerns." *Id.*

22 The question of whether MERS has standing to lift an automatic stay in bankruptcy proceedings and initiate foreclosure is not discussed in this Note. As with the question of whether MERS has standing to foreclosure outside of the bankruptcy context, courts can come out both ways. *Compare In re* Vargas, 396 B.R. 511 (Bankr. C.D. Cal. 2008) (denying MERS motion to lift the automatic stay and initiate foreclosure for lack of standing), *with* Phillips, *supra* note 5, at 272 (claiming that "MERS . . . has standing to bring a motion for relief from the automatic stay, in order to file or continue a foreclosure action").

23 *See, e.g.*, HSBC Bank USA, N.A. v. Vasquez, 901 N.Y.S.2d 899 (N.Y. Sup. Ct. 2009) (unpublished table decision) ("Last, the Court requires a satisfactory explanation from an officer

MERS is currently a plaintiff in as many as forty percent of pending foreclosure actions in some locales.[24] This Note argues that foreclosure actions brought in MERS's name, without joining the real party in interest, are unlawful. Furthermore, this Note reveals how granting standing to MERS in foreclosure actions threatens to undermine the protections for homeowners that foreclosure law has traditionally provided, and violates important property law doctrines that ensure the proper functioning of the recording system and minimize clouds on title.

Part I discusses how the law generally treats assignments of mortgages in the context of foreclosure, and how MERS purports to alter this legal landscape. Part II.A argues that granting standing to MERS in foreclosure actions threatens to undermine the protections for homeowners that foreclosure law has historically provided. Part II.B argues that basic principles of agency prohibit MERS from legally foreclosing on behalf of an assignee when a recordable assignment of the mortgage is not executed. Part II.C discusses the interplay between MERS and local recording statutes. Part II.D demonstrates how the uncertainty surrounding MERS's standing to foreclose can place a cloud on the title to land purchased at MERS foreclosure sales. Part III concludes that the MERS System represents an attempt by the mortgage industry to usurp the proper role of legislatures in reforming foreclosure law and the recording system.

I. BACKGROUND

A. *Mortgage Assignments Generally*

In its most basic form, a home mortgage loan consists of a borrower (or mortgagor), a lender (or mortgagee), a promissory note, and a mortgage.[25] The promissory note obliges the borrower to repay the loan to the lender, and the mortgage gives the lender the right to

of HSBC as to why, in the middle of our national mortgage financial crisis, plaintiff HSBC purchased from MERS, as nominee of HSBC MORTGAGE, the instant nonperforming loan. The Court wonders if HSBC violated a corporate fiduciary duty to its stockholders by purchasing a mortgage loan that defaulted 161 days prior to its assignment from MERS . . . . It could well be that MERS, as nominee for HSBC MORTGAGE, with the acquiescence of HSBC, transferred the instant nonperforming loan, as well as others, to HSBC, as part of what former Federal Reserve Board Chairman Alan Greenspan referred to . . . as 'a once in a century credit tsunami.'").

[24] *See*, *e.g.*, *Jackson*, 770 N.W.2d at 492 (citing Michael Grover, *Fed-led Research Reveals Need for Better Twin Cities Foreclosure Data*, COMMUNITY DIVIDEND (Sept. 2006), www.minneapolisfed.org/publications_papers/pub_display.cfm?id=2200) (noting that evidence suggests approximately forty percent of foreclosure proceedings in Minneapolis/St. Paul area in 2006 named MERS as mortgagee).

[25] *See* Phillips, *supra* note 5, at 262.

foreclose on the property should the borrower default.[26] The note and the mortgage remain in the lender's possession, and the borrower makes payments directly to the lender. If the lender sells the mortgage, an assignment is executed and recorded with the appropriate county clerk.[27] If the borrower defaults, the lender has the right to initiate foreclosure proceedings pursuant to local foreclosure law.[28] In practice, this relationship often becomes much more complex. For example, the lender may choose to sell the loan to a third party while retaining the "servicing" rights to the loan. In this scenario, the borrower still makes payments to the original lender, but a third party now owns the loan, thus separating the "originating and servicing" interest from the "ownership" interest.[29] Or, the original lender may sell the servicing rights and ownership rights to two different entities.

Further complicating matters, the ownership of a single loan, or a group of loans (known as a "pool"), can be further divided through the process of "securitization."[30] In a typical securitization scenario, a group of loans originated by mortgage brokers and mortgage companies are sold to a local bank, and the local bank then sells them to an investment bank.[31] The investment bank then issues securities that represent the right to receive certain payments from the proceeds of the mortgages.[32] The terms of these securities can be exceedingly complex.[33]

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26 *See* POWELL ON REAL PROPERTY DESK EDITION, *supra* note 4, § 37.27 ("[T]he mortgagee has two interests: (1) the debt or obligation which is owed to him, and (2) the security interest in land represented by the mortgage . . . .").

27 "Assignments of mortgages are a regular occurrence. In fact, the existence of a secondary market for mortgages . . . has become an important impetus to the creation of mortgages. Many mortgages are originated with the intent that they will be sold on the secondary market almost immediately. Even mortgagees who customarily carry mortgages in their own portfolios are careful to create the mortgages on forms that have been approved by the main secondary market participants . . . ." *Id.*

28 See *infra* notes 87-90 and accompanying text for a discussion of foreclosure law, particularly the difference between judicial and non-judicial foreclosure.

29 *See* Phillips, *supra* note 5, at 262-63.

30 *Id.* "Securitization" refers to the process of converting assets into securities, such as bonds, "for resale in the financial market, allowing the issuing financial institution to remove assets from its books, and thereby improve its capital ratio and liquidity, and to make new loans with the security proceeds if it so chooses." BLACK'S LAW DICTIONARY 1475 (9th ed. 2009).

31 *See* Korngold, *supra* note 13, at 729.

32 *Id.*

33 Typical mortgage-backed securities represent

> the right to receive certain payments under the mortgages, usually slicing the right to receive portions of the income and principal payments into various tranches. Investment banks had rating agencies attest to the quality of the bonds—with the investment banks paying the rating agencies' fees—and the investment banks then sold the bonds to investors. The investors held or traded these mortgage-backed securities in an active market. Some investors sought to secure the payment of the mortgage bonds and hedge their risk; as a result, some insurance companies entered into credit-default swaps with the bondholder that guaranteed, in return for a premium payment, that the insurance company would pay the bond if the issuer defaulted.

In the securitization context, when a borrower defaults on her loan and the beneficial owner of the note wants to initiate foreclosure proceedings, issues can arise if assignments of the mortgage were not recorded in the official land records—which is often the case.[34] Generally speaking, the failure to record an assignment of a previously recorded mortgage does not bar the assignee from enforcing the note and mortgage.[35] But it will likely be necessary for the assignee to establish a chain of ownership—through a series of recorded assignments or otherwise—in order to have standing to foreclose.[36] The multiplicity of ownership interests and the complexity of the mortgage assignments can make this a cumbersome and costly endeavor for lenders, which is why the MERS system is so attractive to the mortgage industry.[37] However, as this Note demonstrates, allowing a lender to foreclose on a homeowner in the absence of recorded assignments or other proof of ownership can have serious consequences for borrowers.[38]

B. *An Example of How Foreclosure Occurs When MERS is Not Involved*

In the modern context of securitized mortgages, a typical foreclosure might result from the following fact pattern (see figure A):[39] Lender *A* makes a loan to Borrower secured by a mortgage.[40] Lender *A*

Id.

34 *See* Phillips, *supra* note 5, at 263 ("Assignments of mortgages often are not recorded. The multiplicity of interests created in a securitization scenario makes traditional recordation a practical impossibility . . . .").

35 *Id.* In other words, a borrower is not freed from her obligation to pay her loan if her lender does not record her mortgage. However, the lender may need to properly record the mortgage before having the legal authority to initiate foreclosure proceedings.

36 This point is discussed in depth, *infra* Part II.B, in the context of the requirements a loan servicer must meet in order to have standing to foreclose.

37 *See* Phillips, *supra* note 5, at 263 ("[L]arge sums of money (and other resources) are expended each year on recording and tracking assignments. The [sic] Mortgage Electronic Registration Systems, Inc. (MERS) was created to address these issues.").

38 The consequences include restricting a borrower's ability to negotiate with or sue her lender, and placing clouds on title to property sold at MERS foreclosure sales. *See infra* Parts II.A, II.D.

39 This fact pattern is taken from *U.S. Bank National Ass'n v. Ibanez*, No. 08 Misc. 384283 (KCL), 2009 WL 3297551 (Mass. Land Ct. Oct. 14, 2009), *aff'd*, 941 N.E.2d 40 (Mass. 2011), which involved three separate foreclosure sales in Springfield, Massachusetts. Massachusetts law provides for non-judicial foreclosure by advertisement. In all three foreclosure actions, the foreclosing party advertised the foreclosure sale in the *Boston Globe* rather than a local Springfield paper, and in each instance the foreclosing party was the only bidder at the sale. All three plaintiffs were unable to procure title insurance, and thus brought actions in Land Court to "remove a cloud from the title" of the properties. *Id.* at *1.

40 In *Ibanez*, the loan in question was an adjustable rate, sub-prime mortgage originally issued by Rose Mortgage. *Id.* at *5. The court defined a sub-prime mortgage as a loan that does not

immediately records the mortgage. Lender *A* then sells the note and mortgage to Lender *B*, and Lender *B* properly records the assignment.[41] Lender *B* now stands in the shoes of Lender *A*. Lender *B* then begins the process of securitizing the loan. First, Lender *B* executes an endorsement of the note "in blank,"[42] making the note "payable to bearer" and "negotiated by transfer alone until specially endorsed."[43] Under Article 3 of the Uniform Commercial Code, the holder of a mortgage endorsed in blank can be considered a holder in due course of a negotiable instrument, meaning that the physical holder of the note holds the rights to the note, akin to a blank check.[44] Lender *B* also executes an assignment of the mortgage in blank (i.e., without a specific assignee). This assignment is not recorded, nor is it recordable if the relevant recording statute requires that a recordable mortgage assignment identify the person or entity holding the mortgage and that person or entity's physical address.[45]

Lender *B* then sells the rights to the note and the mortgage to Investment Bank *C*. Investment Bank *C* receives the note (endorsed in blank), and the mortgage (also endorsed in blank), but does not record

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"'meet the customary credit standards of Fannie Mae and Freddie Mac' and are made to borrowers 'that typically have limited access to traditional mortgage financing for a variety of reasons, including impaired or limited past credit history, lower credit scores, high loan-to-value ratios or high debt-to-income ratios.'" *Id.*

41 In *Ibanez*, "Lender *B*" was a company called Option One. *Id.*

42 An "indorsement in blank," also called a blank endorsement, is an "indorsement that names no specific payee, thus making the instrument payable to the bearer and negotiable by delivery only." BLACK'S LAW DICTIONARY 844 (9th ed. 2009).

43 *Ibanez*, 2009 WL 3297551, at *5 (internal quotation marks omitted).

44 *See* U.C.C. §§ 3-104, 3-305 (2010). "In order to be a holder in due course, [the holder of the note] must have taken a negotiable instrument '(a) for value; and (b) in good faith; and (c) without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person.'" Williams v. Aries Fin., LLC, No. 09-CV-1816 (JG) (RML), 2009 WL 3851675, at *3 (E.D.N.Y. Nov. 18, 2009) (quoting U.C.C. § 3-302). A negotiable instrument cannot contain any promises other than the promise to pay money at a specified time. U.C.C. § 3-104. Courts have held that mortgages are *not* negotiable instruments when the note contains additional promises by the borrower (for example, a promise to keep the property insured). *See*, *e.g.*, Wilson v. Toussie, 260 F. Supp. 2d 530, 542-43 (E.D.N.Y. 2003) (holding that a mortgage note is a negotiable instrument when it is a separate document from the mortgage, even if the note makes reference to the mortgage). However, a mortgage note that is a separate document from the mortgage and contains no additional promises can be held in due course as a negotiable instrument, as long as it was purchased for value in good-faith, and the purchaser does not have notice that it is overdue or has been dishonored. *Id.* at 543-44.

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> [F]or a mortgage or assignment of a mortgage to be recordable in Massachusetts, the mortgage or assignment must "contain or have endorsed upon it the residence and post office address of the mortgagee or assignee if said mortgagee or assignee is a natural person, or a business address, mail address or post office address of the mortgagee or assignee if the mortgagee or assignee is not a natural person."

Ibanez, 2009 WL 3297551, at *5 (quoting MASS. GEN. LAWS ANN. ch. 183, § 6C (West, Westlaw through 2010 2d Ann. Sess.). "Moreover, since the blank mortgage assignments failed to name an assignee, they were ineffective to transfer any interest in the mortgage." *Id.*

the mortgage.[46] Investment Bank *C* then transfers the loan (along with hundreds of other loans purchased from Lender *B*) to its fully-owned subsidiary, Bank *D*.[47] Bank *D* receives the note in blank and the mortgage in blank. Bank *D* then transfers the loan to Mortgage Loan Trust (also a subsidiary of Investment Bank *C*), and the trust names Bank *E* as Trustee.[48] Bank *E* receives the note and the mortgage, still endorsed in blank. In the parlance of mortgage securitization, Lender *B* plays the role of "originator" for Investment Bank *C*, who is the "sponsor" or "seller." Mortgage Loan Trust is the "depositor."[49]

Mortgage Loan Trust then "pools" the loan with several other loans, and converts the loans to "certificates" that can be sold, each of which entitle the purchaser to a particular rate of return on her investment. Mortgage Loan Trust sells the certificates back to Investment Bank *C*, who then sells them to qualified investors.[50] The loans in Mortgage Loan Trust are administered by several "servicers," one of which is Lender *B*.

46 In *Ibanez*, "Lender *C*" was Lehman Brothers. *Id.*

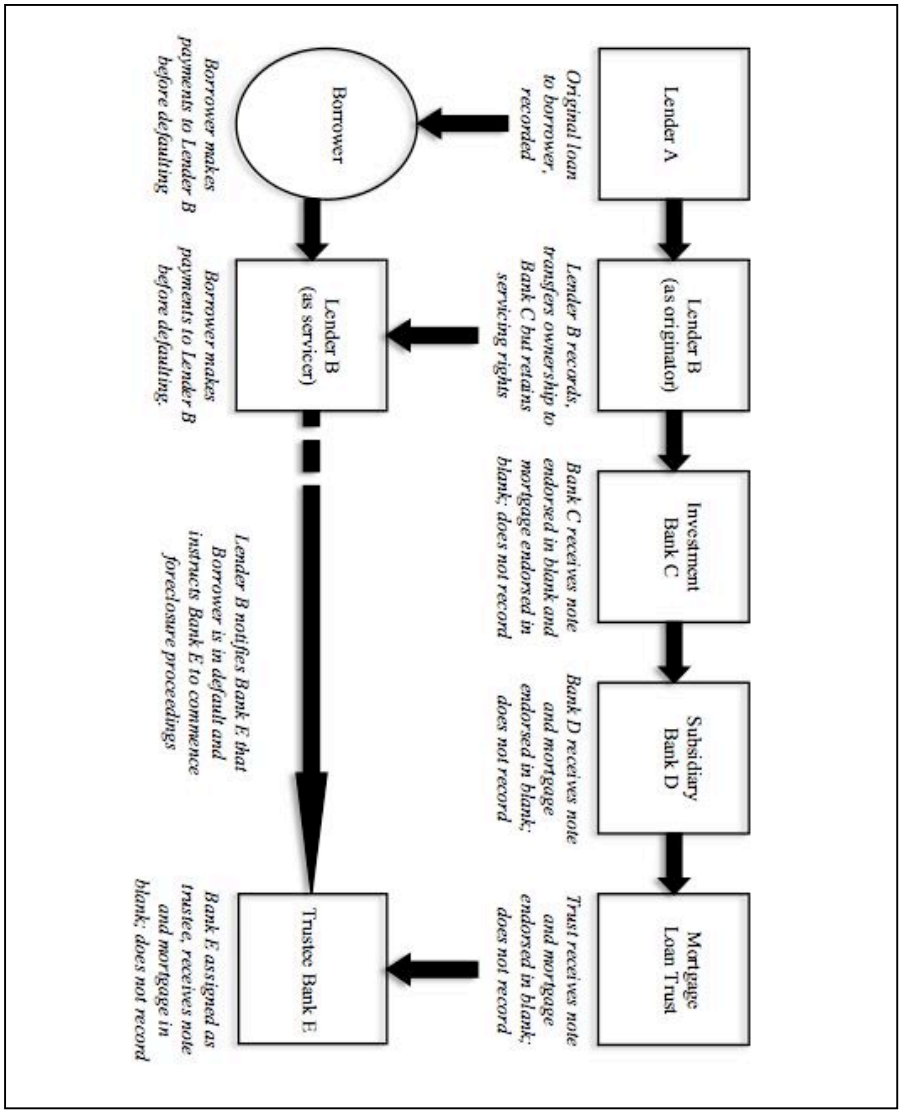
47 Lehman Brothers sold the Ibanez loan to Structured Asset Securities Corporation, its fully owned subsidiary. Option One was the "originator" for Lehman Brothers, who was the "sponsor" or "seller." Structured Asset Securities Corporation was the "depositor." *Id*.

48 In *Ibanez*, Structured Asset Securities Corporation transferred the loan to the Structured Asset Securities Corporation Mortgage Loan Trust 2006-Z, with U.S. Bank named as trustee ("Bank *E*"). *Id.*

49 *Id*.

50 The Structured Asset Securities Corporation Mortgage Loan Trust 2006-Z issued two senior and eight subordinate classes of certificates with varying rates of return, "ranked in order of their payout priority in the event of shortfalls. Lehman purchased the certificates (presumably as the underwriter of the offering) and sold them in an offering to qualified investors." *Id.*

Figure A


Lender A
Original loan to borrower, recorded
Borrower
Borrower makes payments to Lender B before defaulting
Lender B (as originator)
Lender B records, transfers ownership to Bank C but retains servicing rights
Lender B (as servicer)
Borrower makes payments to Lender B before defaulting
Investment Bank C
Bank C receives note endorsed in blank and mortgage endorsed in blank; does not record
Subsidiary Bank D
Bank D receives note and mortgage endorsed in blank; does not record
Mortgage Loan Trust
Trust receives note and mortgage endorsed in blank; does not record
Trustee Bank E
Lender B notifies Bank E that Borrower is in default and instructs Bank E to commence foreclosure proceedings
Bank E assigned as trustee, receives note and mortgage in blank; does not record

Lender *B* is assigned to service Borrower's loan (i.e., receive payments).[51] At this point, Lender *B* is playing two roles—that of "originator" and that of "servicer."

At some point, Borrower defaults on the loan. Lender *B* (as "servicer" of the loan) sends an email to Bank *E* (as trustee of Mortgage Loan Trust), instructing it to initiate foreclosure proceedings against Borrower in Bank *E*'s name.[52] Note that Lender *B* (in its capacity as "originator," not as "servicer") is still the recorded mortgagee, while Bank *E* holds the promissory note, endorsed in blank, and an unrecorded assignment of the mortgage, also endorsed in blank. Bank *E* initiates foreclosure proceedings, meeting the statutory notice requirements for non-judicial foreclosure by advertisement.[53] At the foreclosure sale, Bank *E* purchases the property to satisfy the debt owed on the note.

In Massachusetts, Bank *E* does not have legal standing to foreclose in this scenario. In *U.S. Bank National Association v. Ibanez*,[54] the Massachusetts Land Court held, based upon these facts, that two foreclosures initiated by trustees in the position of Bank *E* were void because the foreclosing party did not hold a recordable assignment of the mortgage.[55] The court's decision—which was recently affirmed by the Massachusetts Supreme Court[56]—is discussed further in Part II.B.

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51 "The loans in the *Ibanez* pool were administered by five 'Servicers,' one of which was Option One (now acting in a different capacity than Originator). Option One is alleged to be the Servicer for the *Ibanez* loan. These Servicers were supervised by Aurora Loan Services LLC (a wholly-owned Lehman subsidiary) (the 'Master Servicer'). The loan documents themselves were kept by 'Custodians'—Deutsche Bank, Wells Fargo, or U.S. Bank." *Id.* (footnotes omitted).

52 The facts in *Ibanez* are slightly more complicated. After Ibanez defaulted on the loan, a new entity called Fidelity National Foreclosure and Bankruptcy Solutions became involved. Fidelity, purporting to act on behalf of Option One (as "servicer") sent an email to counsel for Option One "with instructions to bring a foreclosure action against Mr. Ibanez and his property 'in the name of U.S. Bank National Association, as Trustee for the Structured Asset Securities Corporation Mortgage Pass-Through Certificates, Series 2006-Z.'" *Id.* at *8.

53 Non-judicial foreclosure is available in approximately sixty percent of states, as an alternative to foreclosure by judicial proceeding. Grant S. Nelson & Dale A. Whitman, *Reforming Foreclosure: The Uniform Nonjudicial Foreclosure Act*, 53 DUKE L.J. 1399, 1403 (2004). Non-judicial foreclosure is generally a quicker and less cumbersome process than judicial foreclosure. *Id.* The primary statutory requirement for a foreclosing lender is to provide adequate notice to the borrower prior to the foreclosure sale. *Id.*; *see infra* Part II.A. In *Ibanez*, the court held that the statutory requirement of providing adequate notice was met. 2009 WL 3297551, at *2.

54 No. 08 Misc. 384283 (KCL), 2009 WL 3297551 (Mass. Land Ct. Oct. 14, 2009).

55 *Id.* The court's holding came as a surprise to U.S. Bank, as it was the plaintiff in the case, seeking quiet title based on concerns over the legal sufficiency of the advertisement of the foreclosure sale. *Id.* at *2. The court held that the advertising method used met statutory requirements, but found that U.S. Bank's lack of a recordable assignment was fatal to its foreclosure action. *Id.*

56 U.S. Bank Nat'l Ass'n v. Ibanez, 941 N.E.2d 40 (Mass. 2011).

C. *How MERS Works*

MERS was created to avoid outcomes like *Ibanez* without having to actually record assignments. By 2007, over fifty million loans were recorded in the MERS System.[57] By becoming MERS members, lenders are able to electronically transfer mortgage rights to other members, ostensibly without the burden of recording the assignments in the official land records.[58] MERS estimates that their members save approximately $30 per loan, as well as substantial amounts of time and energy in preparing, executing, and recording paper assignments.[59] In exchange for these benefits, members pay between $264 and $7500 in annual membership fees, and nominal transaction fees.[60] By 2008, MERS had over 4593 member lenders and loan servicers, including the nation's best-known financial institutions.[61]

MERS defines the relationship between itself and its members in a forty-three page document entitled the "Merscorp, Inc. Rules of Membership."[62] According to the rules, before being admitted as a member, an individual or institutional lender must demonstrate that it has adequate personnel to register transactions on the MERS System, and that it is willing to complete a computer-based training program.[63] Membership is denied to any person or lender whom MERS has reason to believe has engaged in fraudulent activity, has breached a fiduciary duty, or has been convicted of a mortgage-related crime.[64] Qualified members become registered users of the MERS System, and they are responsible for registering loan transactions, including any transfers of the beneficial interest or servicing rights to a loan, and the initiation of

57 Press Release, MERS, 50 Millionth Loan Registered on the MERS® System (May 24, 2007), *available at* http://www.mersinc.org/newsroom/press_details.aspx?id=194.

58 T. Mary McDonald, *MERs and the Recorder's Office: The Impact of Electronic Record-Keeping on the Recording Function*, *in* TITLE INSURANCE 2008: CRITICAL ISSUES FACING BUYERS, SELLERS, & LENDERS 11, 15 (PLI Real Estate Law & Practice, Course Handbook Ser. No. 13949, 2008).

59 *MERS Frequently Asked Questions*, *supra* note 15.

60 *MERS Online Pricing*, MERS, http://www.mersinc.org/MersProducts/pricing.aspx?mpid=1 (last visited Mar. 25, 2011). The $264 fee applies to "Lite Membership," designed for lenders "who originate and sell loan servicing rights on a flow basis within 30 days." The $7500 fee applies to lenders who annually originate loans worth $10 billion or more, or lenders who service a loan portfolio worth $50 billion or more. *Id.*

61 *See* Mortg. Elec. Registration Sys., Inc. v. Brosnan, No. C 09-3600 (SBA), 2009 WL 3647125, at *5 (N.D. Cal. Sept. 4, 2009). MERS's members include American Land Title Association, Bank of America, Chase Home Mortgage Corporation of the Southeast, CitiMortgage, Inc., Fannie Mae, Freddie Mac, HSBC Finance Corporation, Merrill Lynch Credit Corporation, Washington Mutual Bank, and Wells Fargo Bank, N.A. *MERS Shareholders*, MERS, http://www.mersinc.org/about/shareholders.aspx (last visited Mar. 25, 2011).

62 MERS RULES, *supra* note 7.

63 *Id.* at 2.

64 *Id.* at 3.

foreclosure proceedings.[65] Loans enter the MERS System either when a MERS member originates the loan or when the loan is assigned from a non-MERS member to a MERS member after origination. In either case, MERS members are required to record their mortgages, at the member's expense, with the appropriate county clerk's office with "Mortgage Electronic Registration Systems, Inc." appearing as the mortgagee of record.[66] The standard MERS entry in the public land records identifies MERS as mortgagee "solely as nominee" for the original lender and the original lender's "successors and assigns."[67] When a loan is satisfied, the member holding the beneficial interest in the loan must register the satisfaction in the MERS System and record it with the county clerk, at the member's expense. MERS then notifies any other member with a beneficial interest in the loan, as identified by the MERS System.[68]

MERS members can also have one or more officers of the member's company appointed as a "certifying officer" of MERS. This allows the lender's officers to act in MERS's name for various purposes, including the initiation of foreclosure proceedings.[69] A lender may have several reasons to foreclose on a mortgage in MERS's name rather than its own. First and foremost, by doing so the lender avoids

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65 *Id.* at 8-9.

66 *Id.* at 11. Mortgage Electronic Registration Systems, Inc. is a fully owned subsidiary of Merscorp, Inc. Mortgage Electronic Registration Systems, Inc. is the entity relevant to this Note. The subsidiary was presumably created to protect Merscorp, Inc.'s shareholders from potential liability. The United States District Court in Delaware held that MERS's corporate structure is legally permissible in *Trevino v. Merscorp, Inc.*, 583 F. Supp. 2d 521, 525 (D. Del. 2008) (rejecting allegations that "MERS was created and established by [Merscorp, Inc.'s shareholders] for the purpose of facilitating their business interests and limiting their liability . . . and that, based on its 'diminutive size and meager asset base, MERS is grossly undercapitalized to cover the potential liability stemming directly from its role as primary mortgagee on tens of millions of Mortgage Notes.'" (citation omitted)). The court found no sufficient basis to pierce the corporate veil of MERS and hold Merscorp, Inc.'s shareholders liable to plaintiffs. *Id.* at 531.

67 *See*, *e.g.*, *In re* Vargas, 396 B.R. 511, 514-15 (Bankr. C.D. Cal. 2008).

68 MERS RULES, *supra* note 7, at 13-14.

69 *Id.* at 15-16. Rule 3, § 3(a) reads in pertinent part:

> Upon request from the Member, Mortgage Electronic Registration Systems, Inc. shall promptly furnish to the Member, in accordance with the Procedures, a corporate resolution designating one or more officers of such Member, selected by such Member, as 'certifying officers' of Mortgage Electronic Registration Systems, Inc. to permit such Member . . . (iii) to foreclose upon the property securing any mortgage loan registered on the MERS® System to such Member, (iv) to take any and all actions necessary to protect the interest of the Member or the beneficial owner of a mortgage loan in any bankruptcy proceeding regarding a loan registered on the MERS® System that is shown to be registered to the Member . . . . In instances where Mortgage Electronic Registration Systems, Inc. designates an officer of a Member as a certifying officer of MERS for the limited purposes described above, such Member shall indemnify MERS and any of its employees, directors, officers, agents or affiliates against all loss, liability and expenses which they may sustain as a result of any and all actions taken by such certifying officer.

Id.

the cost of recording an assignment of the mortgage if the lender is not the party who originated the loan. Second, in non-judicial foreclosure states,[70] a MERS member may not need to be in physical possession of the promissory note to initiate foreclosure proceedings (for example, if the original note is lost).[71]

E. *The Benefits of MERS*

MERS's popularity among its members is not surprising, given that over ninety-five percent of residential mortgages are securitized.[72] Mortgage industry leaders are quick to point out the system's benefits to both lenders and borrowers.[73] As noted above, before MERS was created, the process of assigning a mortgage was burdensome and costly, as each assignment had to be individually drafted and recorded in the proper county clerk's office.[74] Lenders incurred substantial transactional costs, which they passed on to their customers.[75] By one account, these expenses added an extra thirty dollars to the price of the average residential mortgage transaction, and even more if mistakes were made.[76] In response to these problems, government-sponsored

70 Non-judicial foreclosure states allow mortgagees to foreclose without bringing judicial proceedings (e.g., foreclosure by advertisement). *See supra* note 53; *infra* notes 87-90 and accompanying text.

71 *See infra* notes 127-30 and accompanying text.

72 *See* Patrick A. Randolph, Jr., *Florida Trial Court Rules That MERS Lacks Status to Foreclose as Representative of Lender Even When MERS Holds the Note*, DIRT (Sept. 16, 2005), http://dirt.umkc.edu/SEP2005/DD_09-16-05.htm ("Use of MERS has become the standard for residential mortgages, over 95% of which are securitized, and for securitized commercial mortgage as well.").

73 Brief For American Land Title Association as Amici Curiae Supporting Appellants *4, Landmark Nat'l Bank v. Kesler, 216 P.3d 158 (Kan. 2009) (No. 07-98489-A), 2009 WL 1347072 ("The MERS® System Greatly Benefits Real Estate Buyers and Sellers."); *see also* Korngold, *supra* note 13, at 742 ("[The MERS System facilitates . . . the flow of global capital, bringing investment funds into areas without local mortgage financing. Potential homeowners, as well as those seeking the most favorable rates, can benefit from MERS.").

74 Brief for American Land Title Association, *supra* note 73, at *5. One commentator described the pre-MERS mortgage recording system as "a terribly cumbersome, paper-intensive, error-prone, and therefore costly . . . process . . . derived from seventeenth century real property law [that] is not at all suited to late twentieth century mortgage finance transactions." Phyllis K. Slesinger & Daniel McLaughlin, *Mortgage Electronic Registration System*, 31 IDAHO L. REV. 805, 808 (1995).

75 Brief for American Land Title Association, *supra* note 73, at *5 (arguing that this process created "needless expense in terms of transaction costs, lawyers' fees, and filing fees" and that "[s]imple economics dictated that these costs were ultimately passed to the consumers").

76 Steve Cocheo, *Moving from Paper to Blips,* 88 A.B.A. BANKING J. 48 (1996); s*ee also* Phillips, *supra* note 5, at 263 ("There can be little doubt that MERS saves consumers, investors, and the mortgage industry millions of dollars each year in recording fees and related costs. For example, recording costs for each assignment typically begin at $15-$30 for the first page and accrue at $2-$3 for each additional page. Multiplying this by a large volume of mortgage transactions (including assignments and securitizations), the economic benefits of MERS are

enterprises like Freddie Mac, Ginnie Mae, the Federal Housing Authority, and the Department of Veterans Affairs, joined with private lenders to create MERS. Many of these governmental entities serve on MERS's Steering Committee.[77]

II. ANALYSIS

A. *Granting Standing to MERS in Foreclosure Actions Threatens to Undermine the Protections for Homeowners Traditionally Provided by Foreclosure Law*

In *Mortgage Electronic Registration Systems, Inc. v. Revoredo*,[78] the Florida District Court of Appeals articulated the predicament confronting judges and lawyers in determining whether MERS should have standing to foreclose. According to the court, the difficulty of the question stems from the fact that MERS is a modern innovation. In stark contrast, the law of mortgages and foreclosure is deeply rooted in medieval English property law.[79] The court conceded that applying traditional principles of foreclosure law might lead to the conclusion that MERS lacks standing. Yet, the court noted, this conclusion should not be reached if homeowners are not harmed by the MERS system—if the system amounts merely to a "commercially effective means of business."[80] Indeed, if the MERS system is simply an effective and harmless innovation, there would be little reason to question MERS's right to foreclose. But this is not the case. To the contrary, allowing MERS to foreclose on behalf of its members without the execution of recordable assignments has serious ramifications.

Among the main purposes of foreclosure law is to ensure (1) that a borrower can locate the entity that holds the equitable interest in her

clear and significant." (footnote omitted)).

77 Slesinger & McLaughlin, *supra* note 74, at 807.

78 955 So. 2d 33 (Fla. Dist. Ct. App. 2007). Interestingly, despite a favorable ruling in this case, the MERS Rules of Membership prohibit lenders from foreclosing in MERS's name in Florida. The rules specifically bar foreclosure in MERS's name only in the state of Florida. *See* MERS RULES, *supra* note 7, at Rule 8, § 1(c).

79 "To the extent that courts have encountered difficulties with the question, and have even ruled to the contrary of our conclusion," the court opined, "the problem arises from the difficulty of attempting to shoehorn a modern innovative instrument of commerce into nomenclature and legal categories which stem essentially from the medieval English land law." *Revoredo*, 955 So. 2d at 34.

80 *Id.* (suggesting that a formalistic application of foreclosure law might lead to the conclusion that MERS lacks standing to foreclose in some circumstances, but "no substantive rights, obligations or defenses are affected by the use of the MERS device, [so] there is no reason why mere form should overcome the salutary substance of permitting the use of this commercially effective means of business").

note; and (2) that the borrower will not lose her property if she is able to pay her debt. Modern foreclosure law developed as a response to the traditionally harsh consequences borrowers faced if they failed to pay their loans on time.[81] In fourteenth and fifteenth century England, a borrower who failed to repay his mortgage loan on the exact due date—known as "law day"—lost all interest in his property.[82] This occurred even if the borrower could not physically locate the lender.[83] English courts of equity began to sympathize with borrowers who wanted a reasonable amount of time to pay their debts without losing all rights to their property.[84] The courts began prohibiting lenders from taking possession of mortgaged property until the borrowers had a "reasonable time" to repay the loans. In response to lenders' uncertainty concerning the exact meaning of a "reasonable time," the equity courts created the remedy of foreclosure. Upon petition by the lender, the court would establish a reasonable time frame for the borrower to pay, after which all equitable rights of the borrower to reclaim his property were extinguished.[85]

These principles still apply today.[86] In about forty percent of states, judicial action is the sole method of foreclosure.[87] A typical judicial foreclosure requires, inter alia, the filing of a foreclosure complaint, the service of process on all interested parties, a hearing before a judge, the entry of a judgment, and a public foreclosure sale

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81 RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 3.1 cmt. a (2010).

82 *Id.* In the fourteenth and fifteenth centuries, the English common-law mortgage took the form of a fee-simple conveyance subject to a condition subsequent. As the RESTATEMENT (THIRD) OF PROPERTY explains:

> Suppose a lender loaned $10,000 to borrower to be repaid in three years, the loan to be secured by Blackacre, real estate owned by borrower. The borrower (as grantor) would convey Blackacre to lender and his heirs, but subject to the condition that if on the due date (called the 'law day') borrower repaid the $10,000, borrower would have the right to reenter and terminate the lender's estate.

Id.

83 *Id.*

84 *Id.* For a discussion of the evolution of the equitable right to redemption, see generally Jeffrey L. Licht, *The Clog on the Equity of Redemption and its Effect on Modern Real Estate Finance*, 60 ST. JOHN'S L. REV. 452 (1986); C. C. Williams, Jr., *Clogging the Equity of Redemption*, 40 W. VA. L.Q. 31, 33 (1933).

85 RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 3.1 cmt. a. Subsequently, lenders attempted to craft language into mortgages providing that the borrower relinquished any right to foreclosure, but the courts invalidated these clauses out of a judicial desire to protect "impecunious landowners." *Id.*

86 For a general summary of foreclosure laws throughout the United States, including their underlying legal principles, see Debra Pogrund Stark, *Foreclosing on the American Dream: An Evaluation of State and Federal Foreclosure Laws*, 51 OKLA. L. REV. 229 (1998).

87 Nelson & Whitman, *supra* note 53, at 1403. Non-judicial foreclosure is also called power of sale foreclosure. POWELL ON REAL PROPERTY DESK EDITION, *supra* note 4, § 37.42. ("Judicial foreclosure is available everywhere, but wherever power of sale foreclosure is permitted this non-judicial alternative is generally the most widely used. An exception is New York, where judicial foreclosure remains the more prevalent procedure.").

that is usually conducted by a sheriff.[88] The remaining states permit non-judicial foreclosure processes that are less complicated and costly than judicial proceedings. After providing sufficient notice—the form and degree of which varies from state to state—the mortgaged property is sold at a public sale by a third party (i.e., a sheriff or trustee), or by the mortgagee.[89] Under most state foreclosure statutes, the foreclosing party must also submit proof of ownership of the note and mortgage before initiating proceedings.[90]

Like the fifteenth century borrower discussed above, a homeowner confronting a MERS foreclosure may have difficulty identifying the party holding the equitable interest in her loan, which can have serious consequences.[91] For a homeowner facing foreclosure and wishing to assert a defense relating to predatory lending practices,[92] the MERS system may make it difficult for the homeowner to produce the necessary documentation tying the current owner of the mortgage to the party that engaged in predatory practices.[93] One problem is that MERS is often ill-prepared to respond to discovery requests relating to predatory lending defenses.[94] This is because any evidence of predatory

88 Nelson & Whitman, *supra* note 53, at 1403.

89 *Id.* at 1403-04.

90 *See infra* notes 140-42 and accompanying text.

91 The same characteristics that make non-judicial foreclosure attractive to lenders can make borrowers more vulnerable when facing foreclosure by MERS. Most challenges to MERS standing arise in the judicial context because a court is overseeing the foreclosure process, and can assist a homeowner who is unable to identify the party with whom she can negotiate. A colorful example of this occurred in Florida, where a judge presiding over several foreclosure actions initiated by MERS received numerous phone calls from frustrated borrowers wanting to contact the party with whom they could negotiate their loan. The deluge of calls prompted the judge to remind MERS's attorney that "[i]t's really not a very welcome thing for us judges to be getting calls . . . saying we're under foreclosure, we want to talk to somebody, nobody will return our call." Mortg. Elec. Registration Sys. v. Azize, No. 05-001295CI-11, at 13 (Fla. Cir. Ct. Aug. 18, 2005), *available at* www.msfraud.org/law/lounge/OrderDismissingMERS.pdf (dismissing complaint for lack of standing to foreclose on behalf of others).

92 Predatory lending statutes prohibit certain types of loans and loan terms that are harmful to borrowers. Examples include fraud, non-transparency, loans requiring the waiver of legal redress, discriminatory lending, balloon payments, and prepayment penalties. *See* James Carlson, *To Assign, or Not to Assign: Rethinking Assignee Liability as a Solution to the Subprime Mortgage Crisis*, 2008 COLUM. BUS. L. REV. 1021, 1028-29 (2008). For examples of state predatory lending statutes, see CAL. FIN. CODE §§ 4973, 4979 (West, Westlaw through 2011 Reg. Sess. c. 1 urgency legis.), and TEX. FIN. CODE ANN. §§ 343.201-205 (West, Westlaw through 2009 Reg. and 1st called Sess. 81st Leg.).

93

> When a trust takes control of a securitized pool, it typically registers with MERS and therefore MERS is the only name that appears in the county register. When foreclosures occur, MERS brings the foreclosure in its name. Thus, even determining who to sue is not easy, raising transaction costs for precisely the type of clients and attorneys already particularly sensitive to them.

Carlson, *supra* note 92, at 1047 (footnote omitted).

94 *See, e.g.*, Christopher L. Peterson, *Predatory Structured Finance*, 28 CARDOZO L. REV. 2185, 2266 (2007) ("[A]ll across the country, MERS now brings foreclosure proceedings in its own name . . . . This is problematic because MERS is not prepared for or equipped to provide

lending is likely not in MERS's possession, but in the possession of the entity that owns the borrower's loan. In this situation, a homeowner must identify the entity that owns her loan—a difficult task, as discussed below—and join that party in the foreclosure action in order to uncover evidence of predatory lending.[95] This may be too costly a task even for homeowners who know such evidence exists.[96] At a minimum, this predicament raises transaction costs for those who are already particularly sensitive to them.[97]

A MERS foreclosure may also make it impossible for a homeowner to negotiate with her lender. In response to the skyrocketing number of foreclosure proceedings in recent years, the Obama administration has identified loan negotiation and modification as key tools for borrowers facing foreclosure, pressing lenders to negotiate loan terms with distressed borrowers rather than initiating foreclosure proceedings.[98] While still in their infancy, data suggests that programs requiring lenders to negotiate with borrowers to avoid foreclosure are already yielding positive results.[99] But a homeowner facing foreclosure initiated by MERS cannot identify the equitable owner of her mortgage by consulting the local land records.[100] If the borrower asks MERS to identify her lender, MERS's policy is to refuse to disclose the owner of the note, and instead direct the homeowner to contact her loan servicer.[101] If the servicer is unable or unwilling to

responses to consumers' discovery requests with respect to predatory lending claims and defenses. In effect, the securitization conduit attempts to use a faceless and seemingly innocent proxy with no knowledge of predatory origination or servicing behavior to do the dirty work of seizing the consumer's home.").

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> While up against the wall of foreclosure, consumers that try to assert predatory lending defenses are often forced to join the party—usually an investment trust—that actually will benefit from the foreclosure. As a simple matter of logistics this can be difficult, since the investment trust is even more faceless and seemingly innocent than MERS itself. . . . The prospect of waging a protracted discovery battle with all of these well funded parties in hopes of uncovering evidence of predatory lending can be too daunting even for those victims who know such evidence exists.

Id.

96 *Id.*

97 *See* Carlson, *supra* note 92, at 1047.

98 *See, e.g.*, Sheryl Gay Stolberg & Edmund L. Andrews, *$275 Billion Plan Seeks to Address Crisis in Housing*, N.Y. TIMES, Feb. 19, 2009, at A1 (discussing the Obama administration's plan "to help as many as nine million American homeowners refinance their mortgages or avert foreclosure").

99 *See, e.g.*, Peter S. Goodman, *Philadelphia Gives Struggling Homeowners a Chance to Stay Put*, N.Y. TIMES, Nov. 18, 2009, at A1 (discussing a program in Philadelphia that has enabled hundreds of troubled borrowers to retain their homes through loan negotiation and modification).

100 A MERS mortgage names only MERS and the original lender in the local land records. *See supra* note 8 and accompanying text.

101 *See, e.g.*, Mortg. Elec. Registration Sys. v. Azize, No. 05-001295CI-11, at 13-14 (Fla. Cir. Ct. Aug. 18, 2005), *available at* www.msfraud.org/law/lounge/OrderDismissingMERS.pdf (reviewing MERS's attorney's explanation that when borrowers inquire with MERS as to the identity of their lender, MERS will instruct them to contact their servicer).

disclose the requested information, the frustrated borrower is left with no way of identifying the equitable owner of her loan. While MERS asserts that the electronic tracking of mortgage assignments in the MERS System is necessary to overcome inefficiencies resulting from an outdated recording system,[102] a homeowner facing foreclosure by MERS may find herself similarly situated to a fifteenth century mortgagor who cannot find her lender on "law day."[103] Indeed, the same concerns that led English courts of equity to initially develop the foreclosure process reemerge if MERS is not required to abide by the legal process.

B. *MERS, When Operating Pursuant to its Rules of Membership, Does Not Have Legal Standing to Foreclose in its Own Name*

This Subpart argues that MERS does not have legal standing to foreclose on a mortgage when: (1) MERS is the recorded mortgagee "solely as nominee for the lender and lender's successors and assigns"; (2) MERS holds the promissory note endorsed in blank; and (3) the original lender has sold, assigned, or otherwise transferred its interest in the mortgage to another entity who is also a MERS member. To illustrate this reasoning, this Subpart will begin by describing the role MERS would play in a foreclosure scenario based on *U.S. Bank National Association v. Ibanez*, discussed in Part I.B.

In *Ibanez*, the court held that a non-judicial foreclosure was void because the foreclosing party did not have a recorded interest in the mortgage. The note and mortgage in question were passed between various entities several times before the borrower defaulted. When it was time to foreclose, the equitable owner of the note was not the owner of record of the mortgage, although it held the promissory note with a blank endorsement and an unrecorded mortgage assignment. The court rejected plaintiff's claim that, for statutory purposes, it should be considered the present holder of the mortgage because it possessed the note and a blank mortgage assignment.[104] The court noted that in Massachusetts, a mortgage is a conveyance of land, subject to statutory requirements that must be met before a conveyance is valid. In *Ibanez*, the unrecorded agreements between the various parties did not create

102 *See supra* notes 81-85 and accompanying text.

103 *But see* Phillips, *supra* note 5, at 269 (arguing that while a MERS foreclosure may impede a borrower's ability to negotiate her loan, this is the acceptable "price" for the efficiency the MERS system brings to mortgage transactions, which ultimately benefits borrowers).

104 U.S. Bank Nat'l Ass'n v. Ibanez, No. 08 Misc. 384283 (KCL), 2009 WL 3297551, at *10 (Mass. Land Ct. Oct. 14, 2009).

valid conveyances of the mortgage.[105] Significantly, the court held the foreclosure sale to be void rather than merely voidable.[106] An inherent feature of a voidable sale is that all rights to set aside the sale are cut off if the land passes to a bona fide purchaser for value.[107] When this happens, the purchaser receives clear title and the only remedy against the foreclosing mortgagee by an aggrieved party is an action for damages. In contrast, a void foreclosure sale is subject to the risk of being set aside even when there is a bona fide purchaser.[108]

The foreclosing party in *Ibanez* argued that a ruling against it should apply only prospectively because lenders had relied on the assumption that this foreclosure process was legal.[109] The court rejected this argument, noting that the "Private Placement Memorandum" provided to purchasers of the certificates assured investors that a recordable assignment would be held by a custodian of the trustee,[110]

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> [A] mortgage is a conveyance of land. Nothing is conveyed unless and until it is *validly* conveyed. The various agreements between the securitization entities stating that each had a right to an assignment of the mortgage are *not themselves* an assignment and they are certainly not in recordable form. At best, the agreements gave those entities a right to bring an action to *get* an assignment. But actually *holding* something and having only the *right* to be its holder are two very different things. To obtain a mortgage assignment you do not actually possess presumes, at the least, that you have a demonstrable right to get it, that you will be able to *determine* the entity that validly holds the mortgage you need assigned (not always easy when all previous assignments have not been recorded at the Registry), that that entity will still be *operational*, that it will be able to *find* the relevant paperwork, that it will have someone with authority to *execute* the relevant paperwork, and that it will be able to do so in a *timely fashion*. These presumptions are not always accurate.

Id. at *11 (footnotes omitted).

106 Generally, a sale is void when the mortgagee lacks a substantive right to foreclose. Examples of fatal defects include a forged mortgage, the foreclosing party not owning the note, or a trustee not having the noteholder's authorization. Procedural defects can also lead to a void foreclosure. Such defects include omitting a portion of the mortgaged real estate from the notice of sale or failing to send written notice per statutory requirement. *See* Nelson & Whitman, *supra* note 53, at 1499-1501.4

107 A "bona fide purchaser" means "any person who acquires an interest in property for a valuable consideration and without notice of any outstanding claims held against the property by third parties." POWELL ON REAL PROPERTY DESK EDITION, *supra*, note 4, § 82.01(2)(b). Accordingly, if a sale is voidable, and there is a subsequent purchaser without notice of the circumstances that made the sale voidable, than any right to set aside the sale is extinguished.

108 Nelson & Whitman, *supra* note 53, at 1501-02. As discussed *infra*, the mere possibility that a foreclosure will be voided has serious consequences, including difficulties for the purchaser in obtaining title insurance and the existence of clouds on title to property purchased at MERS foreclosure sales. *See infra* Part II.D.

109 *Ibanez*, 2009 WL 3297551, at *11.

110 The Private Placement Memorandum stated:

> The Mortgage Loans will be assigned by the Depositor [Structured Asset Securities Corporation] to the Trustee [U.S. Bank], together with all principal and interest received with respect to such Mortgage Loans on and after the Cut-off Date [December 1, 2006] (other than Scheduled Payments due on that date) . . . . Each Mortgage Loan will be identified in a schedule appearing as an exhibit to the Trust Agreement which will specify with respect to each Mortgage Loan, among other things, the original

presumably in anticipation of a foreclosure action. Interestingly, the Memorandum included an exception to the recordable assignment requirement aimed directly at MERS.[111] Specifically, no recordable assignments needed to be kept if the mortgages were recorded in MERS's name, as nominee for the original lender and its successors and assigns.[112]

If MERS is involved in a fact pattern like that of *Ibanez*, and all MERS members act in accordance with the MERS Rules of Membership,[113] the foreclosure action would arise as follows (see Figure B):

> principal balance and the Scheduled Principal Balance as of the close of business on the Cut-off Date, the Mortgage Rate, the Scheduled Payment, the maturity date, the related Servicer and the Custodian of the mortgage file, whether the Mortgage Loan is covered by a primary mortgage insurance policy and the applicable Prepayment Premium provisions, if any.

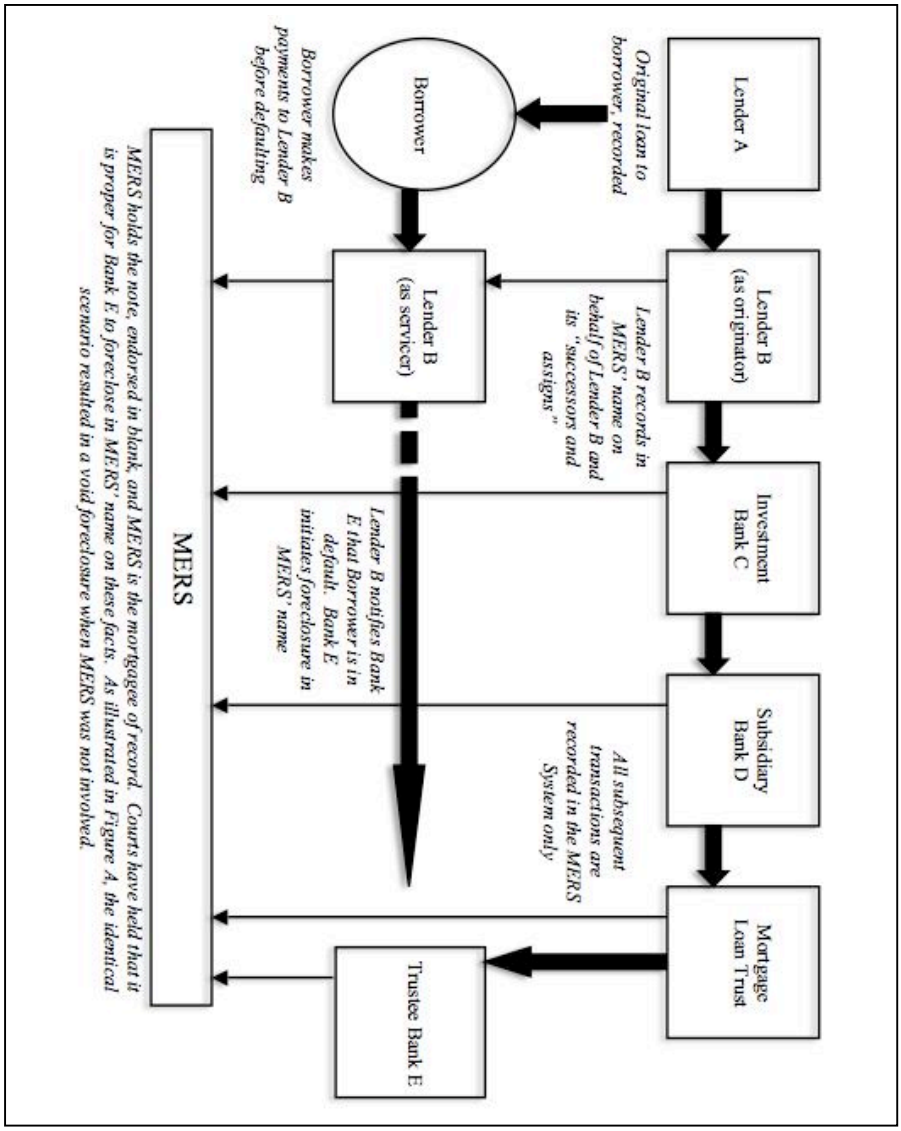
Id. at *7.

111 *Id.* at *7 n.34 ("[The exception applies when] the mortgages or assignments of mortgage [had] been recorded in the name of an agent [*e.g.,* Mortgage Electronic Registration Services ("MERS")] on behalf of the holder of the related mortgage note." (internal quotation marks omitted)).

112 *Id.* Essentially, the Memorandum assures investors that the trust will record mortgage assignments pursuant to the recording act as discussed above, unless MERS is the mortgagee, in which case recorded assignments are unnecessary. Part II.B of this Note argues that this policy is misguided. As *Ibanez* demonstrates, failing to secure recordable assignments each time a mortgage is transferred means a loan trustee will not have standing to foreclose on the mortgage. Introducing MERS into the same scenario, solely as an agent for the various lenders involved in this transaction, should not change that outcome. *See infra* Part II.B.

113 *See supra* Part I.D.

Figure B


Lender A
Original loan to borrower recorded
Lender B (as originator)
Lender B records in MERS' name on behalf of Lender B and its "successors and assigns"
Investment Bank C
All subsequent transactions are recorded in the MERS System only
Subsidiary Bank D
Mortgage Loan Trust
Trustee Bank E
Borrower
Borrower makes payments to Lender B before defaulting
Lender B (as servicer)
Lender B notifies Bank E that Borrower is in default. Bank E initiates foreclosure in MERS' name
MERS
MERS holds the note, endorsed in blank, and MERS is the mortgagee of record. Courts have held that it is proper for Bank E to foreclose in MERS' name on these facts. As illustrated in Figure A, the identical scenario resulted in a void foreclosure when MERS was not involved.

Lender *A* originates the loan, and then transfers it to Lender *B*. Lender *B* (now a MERS member) records the mortgage in MERS's name, "solely as nominee for Lender *B* and Lender *B*'s successors and assigns."[114] Lender *B* also endorses the promissory note in blank, and the note is held by MERS.[115] The loan is immediately assigned a unique number within MERS's electronic database. Each time the equitable interest in the loan is transferred, the change in ownership is tracked in the MERS System, but no assignments of the loan or the mortgage are executed or recorded in the official land records: in this example, the mortgage is transferred from Lender *B* to Investment Bank *C*, from Investment Bank *C* to Bank *D*, and from Bank *D* to Mortgage Loan Trust with Bank *E* as trustee.[116] When Borrower defaults, Lender *B* (as servicer) informs Bank *E* (as trustee for the beneficial owners) that Bank *E* should initiate foreclosure proceedings. MERS claims to have standing to foreclose as Bank *E*'s agent, even though Bank *E* does not hold a recordable assignment of the mortgage. Most courts have agreed that MERS has such standing.[117]

Despite MERS's success in the courtroom, however, the reasoning set forth in *Ibanez*[118] coupled with basic principles of agency support the claim that MERS should not, in fact, have legal standing to

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114 *See, e.g.*, *In re* Wilhelm, 407 B.R. 392, 397 (Bankr. D. Idaho 2009) ("[E]ach deed of trust names Mortgage Electronic Registration Systems, Inc. (MERS) as the beneficiary under the deed of trust, clarifying, however, that MERS is acting 'solely as a nominee for Lender and Lender's successors and assigns.' Each deed also states that MERS holds 'only legal title' to the deed of trust, but it may foreclose and sell the property, among other things, 'if necessary to comply with law or custom.'").

115 Rule 8, section 2 of the MERS Rules of Membership provides that: "If a Member chooses to conduct foreclosures in the name of Mortgage Electronic Registration Systems, Inc., the note must be endorsed in blank and in possession of one of the Member's MERS certifying officers. If the investor so allows, then MERS can be designated as the note-holder." *See* MERS RULES, *supra* note 7, at Rule 8, § 2; *supra* Part I.D.

116 Rule 2, section 3 of the MERS Rules of Membership requires a member to promptly record in the MERS System several types of transactions, including an assignment of the beneficial interest in a mortgage. *See* MERS RULES, *supra* note 7, at Rule 2, § 3. According to MERS's website, tracking the transfer of loans on the MERS System "eliminates the need to prepare and record assignments when trading residential and commercial mortgage loans." MERS, http://www.mersinc.org (last visited Jan.11, 2011).

117 *See infra* notes 126-30 and accompanying text.

118 U.S. Bank Nat'l Ass'n v. Ibanez, No. 08 Misc. 384283 (KCL), 2009 WL 3297551 (Mass. Land Ct. Oct. 14, 2009). *Ibanez* held that a party lacks standing to foreclose when it holds a note endorsed in blank and an assignment of the mortgage endorsed in blank, but not a recordable assignment. Importantly, *Ibanez* noted the difference between an ordinary contract, such as a promissory note, and a mortgage, which is a conveyance of land. An "assignee" of a mortgage is not simply the holder of the promissory note that the mortgage secures. Instead, the legal requirements associated with a conveyance of land (i.e., that it be in writing and identifying the party to whom the land is assigned) must be met before the recipient is legally an "assignee." *See id.* at *8; *see also* POWELL ON REAL PROPERTY DESK EDITION, *supra* note 4, § 37.27 ("Because mortgages involve an interest in land, the usual formalities for transferring property interests must be met. . . . The local requirements of the statute of frauds as to signatures, seals, witnesses, acknowledgments, and delivery must be satisfied.").

foreclose in this scenario. First, *Ibanez* establishes that Bank *E* does not meet the statutory requirements to foreclose in Massachusetts because it does not hold a recordable assignment of the mortgage. Second, it is axiomatic that an agent cannot augment the power of its principal, nor can a principal grant rights to an agent that the principal does not itself possess. Third, MERS is merely an agent of the various lenders involved in these transactions, claiming no independent ownership interest in the note or the mortgage. Therefore, if Bank *E* lacks standing to foreclose, so must MERS.

In the *Ibanez* scenario, when MERS originally records the mortgage, it does so "solely as nominee for Lender *B* and Lender *B*'s successors and assigns."[119] According to *Ibanez*, a lender does not become the assignee of a mortgage unless it holds a recordable assignment of the mortgage, meaning that Bank *E* is not legally Lender *B*'s "successor" or "assign."[120] Bank *E* should not have additional legal rights solely because it has an agency relationship with MERS.[121] Nor can Lender *B* expand the legal rights of Bank *E* by giving MERS broad authorization to act on Lender *B*'s behalf. It is a well-settled legal principle that an agent cannot augment or reduce the legal rights of its principal.[122] Therefore, if Bank *E* does not have standing to foreclose in this scenario, it necessarily follows that Bank *E*'s agent does not have the power to do so either. The fact that MERS is also the agent of the entity that initially recorded the mortgage should be irrelevant.

A more difficult question is whether Lender *B*—as opposed to Bank *E*—has standing to foreclose in this scenario, and thus whether MERS can initiate foreclosure in its capacity as Lender *B*'s nominee. This question was not implicated in *Ibanez*, because in that case the entity playing the role of Lender *B* was no longer in business at the time of the foreclosure sale.[123] If Lender *B were* still in business—and the mortgage at issue was recorded in MERS's name as nominee for Lender *B*—then MERS might argue that it has standing to foreclose in its

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119 *See supra* note 8.

120 The term "successor" appears to be identical in meaning to "assign" in this context. The legal definition of a successor is a "person who succeeds to the office, rights, responsibilities, or place of another; one who replaces or follows a predecessor." BLACK'S LAW DICTIONARY 1569 (9th ed. 2009). As the court explained in *Ibanez*, a person succeeds to the rights of a mortgage holder when she receives an assignment of the mortgage.

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> The capacity to do a legally consequential act by means of an agent is coextensive with the principal's capacity to do the act in person. The dispositive question is whether, as to an agent's action, the principal's legal rights and obligations would have been affected had the action instead been done by the principal in person. Agency law reflects in this respect a principle of neutrality or transparency because an agent's legal capacity neither augments nor reduces the principal's capacity.

RESTATEMENT (THIRD) OF AGENCY § 3.04 cmt. b (2006).

122 *Id.*

123 *Ibanez*, 2009 WL 3297551, at *6.

capacity as nominee for the mortgagee of record, even though Lender *B* has assigned away its interest in the note. However, long-standing Supreme Court precedent cuts against this argument. In *Carpenter v. Longan*,[124] the Court held that a mortgage is merely incident to its accompanying note—meaning that an assignment of the note necessarily carries with it an assignment of the mortgage.[125] Applying this principle, Lender *B* assigned any interest it had in the mortgage when it assigned the note, and thus neither Lender *B* nor Lender *B*'s nominee ought to have standing to foreclose in this scenario. However, as the cases discussed below demonstrate, at least some courts are willing to deviate from this approach in cases involving MERS.

Standing issues aside, Lender *B* is unlikely to be the party seeking to initiate foreclosure proceedings for practical reasons, as illustrated in *Ibanez*. Bank *E* owns the note—and thus is the party entitled to the proceeds of a foreclosure sale—so Bank *E* will seek to foreclose. This is precisely why Bank *E* might attempt to foreclose in MERS's name, and precisely why it is unlawful for Bank *E* to do so. Because MERS is named as mortgagee in the land records (as nominee for Lender *B* and Lender *B*'s successors and assigns), Bank *E*'s claim that it has standing to foreclose in MERS's name relies on the illusion that the mortgage and note are held by the same entity: MERS. In fact, this is not the case—Lender *B*'s agent is the named mortgagee, and Lender *E*'s agent holds the note. The fact that both agents are the same entity (MERS) is confusing, but irrelevant. Allowing MERS to foreclose in this scenario would require treating MERS as the actual mortgagee, not as Lender *B*'s nominee. But from a legal standpoint, MERS cannot simultaneous be both principal *and* agent.

The reasoning set forth in *Ibanez* and discussed above has not yet been applied in cases involving challenges to MERS's standing to foreclose. Instead, courts that have examined MERS's standing have focused on note ownership rather than on the mortgage. For example, in *Jackson v. Mortgage Electronic Registration System, Inc.*,[126] the Minnesota Supreme Court held that MERS's failure to record mortgage assignments prior to foreclosure does not violate Minnesota foreclosure law,[127] which requires that, prior to foreclosure, "the mortgage has been

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124 83 U.S. 271 (1872).

125 *Id.* at 274 ("The note and mortgage are inseparable; the former as essential, the latter as an incident. An assignment of the note carries the mortgage with it, while an assignment of the latter alone is a nullity.").

126 770 N.W.2d 487 (Minn. 2009).

127 *Id.* In *Jackson,* the Minnesota Supreme Court answered a certified question from the United States District Court for the District of Minnesota. The reformulated question (which the court answered in the negative) was as follows:

> Where an entity, such as defendant [Mortgage Electronic Registration Systems, Inc.], serves as mortgagee of 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

recorded and, if it has been assigned, that all assignments thereof have been recorded."[128] The court reasoned that the statute only applies to assignments of the mortgage, not to assignments of the note.[129] The court concluded that a MERS foreclosure does not violate the statute because the mortgage itself is never assigned; the mortgagee of record is MERS, "solely as nominee for lender and lender's successors and assigns," when the loan is originated, and continues to be MERS throughout the life of the loan, no matter how many times the equitable interest in the note is transferred.[130]

The court in *Jackson* acknowledged that the MERS system potentially conflicts with traditional principles of real property law, particularly the concept that a mortgage is incident to the debt it secures, so that an assignment of the debt is also an assignment of the mortgage.[131] But after surveying the relevant Minnesota case law, the court held that a party can, in fact, hold legal title to a mortgage without holding any interest in the underlying debt. Therefore, if a lender assigns only the promissory note, then no assignment of legal title has been made, and thus no recorded assignment is required under the foreclosure statute.[132]

The court's reasoning, however, suggests that MERS, acting solely as an agent, somehow broadens the legal rights of its principal. Furthermore, the court erroneously treats MERS as the actual mortgagee of record, when in fact it is merely an agent of the original lender. For example, if Lender *A* originates a mortgage and then sells that mortgage to Lender *B*, the Minnesota foreclosure statute precludes Lender *B* from foreclosing on the mortgage absent a recorded

> 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 under Minnesota Statutes chapter 580?

Id. at 489.

128 MINN. STAT. ANN. § 580.02 (West, Westlaw through 2011 Reg. Sess. ch. 2). Section 580.02 places the following requirements on a party seeking to foreclose:

> (1) that some default in a condition of such mortgage has occurred, by which the power to sell has become operative;
>
> (2) that no action or proceeding has been instituted at law to recover the debt then remaining secured by such mortgage . . .
>
> (3) *that the mortgage has been recorded and, if it has been assigned, that all assignments thereof have been recorded* . . . .

Id. (emphasis added).

129 *Jackson*, 770 N.W.2d at 500-01.

130 *Id.* at 492.

131 *Id.* at 494; *see also* RICHARD R. POWELL, 4-37 POWELL ON REAL PROPERTY § 37.27 (Michael Allan Wolf ed., 2010) ("As a mortgage is but an incident to the debt which it is intended to secure, the logical conclusion is, that a transfer of the mortgage without the debt is a nullity, and no interest is acquired by it. The security cannot be separated from the debt and exist independently of it." (internal quotations omitted)).

132 *Jackson*, 770 N.W.2d at 500-01.

assignment from Lender *A* to Lender *B*.[133] The holding in *Jackson*, however, suggests that this same foreclosure can occur without a recorded assignment if Lender *A* and Lender *B* utilize the same agent (MERS). This conclusion can only by reached by treating MERS as the actual mortgagee—and not merely as Lender *A*'s agent—which it is not. To the contrary, MERS's standard mortgages explicitly indicate that MERS acts solely in a nominal capacity.[134] Therefore, if Lender *A* does not execute and record a valid assignment to Lender *B*, MERS necessarily lacks the legal authority to foreclose as Lender *B*'s agent, because Lender *B itself* lacks the authority to foreclose.[135]

An important sidebar to the *Jackson* decision is a relevant amendment to the state recording act passed by the Minnesota legislature in 2004.[136] The statute, frequently referred to as "the MERS statute," was passed in response to questions raised regarding the legality of the MERS system in other jurisdictions.[137] The *Jackson* court was careful to note that the MERS statute affected only the recording act and not the foreclosure statutes, and thus was not dispositive in the case at bar. However, the court noted that the statute demonstrates a tacit approval of the MERS System by the Minnesota legislature,[138] and this fact may have played a role in the court's decision.

Another common foreclosure scenario illustrates the logical and practical shortcomings of the reasoning set forth in *Jackson*, and other decisions like it. Often, foreclosure proceedings are initiated by the servicer of the loan, as attorney-in-fact[139] for the trustee overseeing the

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133 *See supra* note 118-22 and accompanying text.

134 *See supra* note 8 and accompanying text.

135 *See supra* note 122 and accompanying text. While MERS would be named on the mortgage as Mortgagee for Lender *A* and Lender *A*'s assigns, MERS would be foreclosing as Lender *B*'s agent, not as Lender *A*'s agent. Since there was no assignment of the mortgage executed from Lender *A* to Lender *B*, Lender *B* is not among Lender *A*'s assigns.

136 MINN. STAT. ANN. § 507.413(a) (West, Westlaw through 2011 Reg. Sess. ch. 2). The statute provides:

> An assignment, satisfaction, release, or power of attorney to foreclose is entitled to be recorded . . . and is sufficient to assign, satisfy, release, or authorize the foreclosure of a mortgage if: (1) a mortgage is granted to a mortgagee as nominee or agent for a third party identified in the mortgage, and the third party's successors and assigns; (2) a subsequent assignment, satisfaction, release of the mortgage, or power of attorney to foreclose the mortgage, is executed by the mortgagee or the third party, its successors or assigns; and (3) the assignment, satisfaction, release, or power of attorney to foreclose is in recordable form.

Id.

137 *See* 770 N.W.2d at 491.

138 *Id.* at 494 ("By passing the MERS statute, the legislature appears to have given approval to MERS' operating system for purposes of recording. Nonetheless, the MERS statute is a recording statute, and we conclude that it does not change the requirements of the foreclosure by advertisement statute.").

139 "Attorney-in-fact" is defined as, "[s]trictly, one who is designated to transact business for another; a legal agent." BLACK'S LAW DICTIONARY 147 (9th ed. 2009) (in entry for "attorney").

mortgage for the investors who own the note. (In Figures A and B, this means Lender *B* is foreclosing as attorney-in-fact for Bank *E*). In this case—when MERS is not involved—the servicer is required to prove that the trust is, in fact, the owner of the applicable mortgage, and to produce "a valid, duly executed, and enforceable power of attorney establishing the servicer's authority to prosecute the foreclosure action."[140] In some jurisdictions, courts also require a copy of the pooling and servicing agreement.[141] The servicer may be required to produce the original note in order to establish the trust's ownership of the note,[142] and doing so can be difficult because the original note is typically kept in a vault with thousands of other loans held by the trust.[143] It can also be difficult for a servicer or trust to prove ownership of a mortgage by showing a chain of assignments from the original lender because the loans in a securitized trust are usually transferred several times before being contributed to the applicable trust.[144]

For a servicer wanting to foreclose, a gap in the chain of title or an improper execution or recordation of an assignment can stymie the servicers' efforts to establish the trust's ownership of the loan.[145] While eliminating these obstacles would certainly make the servicer's job easier, the requirements are often strictly enforced in order to protect a borrower from an unlawful foreclosure initiated by an entity without a legal interest in the borrower's loan.[146] But applying the holding in *Jackson*, that same servicer can bypass these consumer protection measures by becoming a MERS member, as long as the loan trust is also a member.[147] If this were the case, the servicer could simply

140 Robert T. Mowrey, Robert Grady & Nicholas H. Mancuso, *Issues Arising in Connection With the Foreclosure or Other Enforcement of the Securitized Loan*, *in* MORTGAGE AND ASSET BACKED SECURITIES LITIGATION HANDBOOK § 5:114 (Talcott J. Franklin & Thomas F. Nealon III eds., 2010).

141 *Id.*

142 *Id.*

143 *Id.*

144 *Ibanez* offers a good example of loans being transferred several times before landing in a securitized trust, and a discussion of the commonality of this process. U.S. Bank Nat'l Ass'n v. Ibanez, No. 08 Misc. 384283 (KCL), 2009 WL 3297551 (Mass. Land Ct. Oct. 14, 2009), *aff'd*, 941 N.E.2d 40 (Mass. 2011).

145 *Id.*

146 *See, e.g.*, *In re* Foreclosure Actions, Nos. 1:07cv1007, et al., 2007 WL 4034554, at *1 (N.D. Ohio Nov. 14, 2007) ("To the extent a note and mortgage are no longer held or owned by the originating lender, a plaintiff must appropriately document the chain of ownership to demonstrate its legal status *vis-a-vis* the items at the time it files suit on those items. Appropriate 'documentation' includes, but is not limited to, trust and/or assignment documents *executed before the action was commenced*, or both as circumstances may require."); *In re* Foreclosure Cases, Nos. 1:07CV2282, et al., 2007 WL 3232430, at *3 n.3 (N.D. Ohio Oct. 31, 2007) ("The [lending] institutions seem to adopt the attitude that since they have been doing this for so long, unchallenged, this practice equates with legal compliance. Finally put to the test, their weak legal arguments compel the Court to stop them at the gate.").

147 As discussed *supra* in the text accompanying notes 111-12, *Jackson* held that MERS has standing to foreclose without producing written assignments of a mortgage, as long as the

foreclose in MERS's name, and because MERS is the mortgagee of record—solely as nominee for the original lender and its successors and assigns—the servicer would not need to produce any proof of ownership other than a copy of the note, endorsed in blank. This result is logically flawed because it allows an agent to augment the rights of its principal, and it leads to the practical concerns discussed in Part II.A.

While the court in *Jackson* held that MERS has standing to foreclose because it can hold legal title to a mortgage when the equitable interest in the note has been transferred between MERS members, other state courts have disagreed. For example, in *LaSalle Bank National Association v. Lamy*,[148] a New York trial court held that MERS did not have standing to foreclose. The court relied on repeated precedent in Suffolk County and elsewhere, holding that an agent such as MERS cannot prosecute a foreclosure action in its own name because it does not own the note and the mortgage.[149] While the Minnesota Supreme Court opined that legal title in a mortgage can vest in MERS without MERS possessing an equitable interest in the note secured by the mortgage, the *Lamy* court held that the remedy of foreclosure is only available to the party owning both the note and the mortgage at the time the action is commenced.[150]

In some states, MERS regularly conducts non-judicial foreclosure proceedings without judicial challenge, even where the local foreclosure statutes suggest that MERS does not have the statutory authority to do so. In Michigan, for example, a foreclosing party must be "either the owner of the indebtedness or of an interest in the indebtedness secured by the mortgage or the servicing agent of the mortgage."[151] The statute further stipulates that, "if the party foreclosing the mortgage by advertisement is not the [original lender], a record chain of title . . . evidencing the assignment of the mortgage to the party foreclosing the mortgage" must exist before the date of the sale.[152]

mortgage is recorded by MERS "solely as nominee" for the original lender and the original lender's "successors and assignees." In explaining the benefits of MERS membership, MERS assures servicers that, "[w]hen MERS is the mortgagee of record, the foreclosure can be commenced in the name of MERS in place of the loan servicer." MYRON C. WEINSTEIN, 29 N.J. PRACTICE, LAW OF MORTGAGES § 11.1 (2d ed. 2010).

148 824 N.Y.S.2d 769 (N.Y. Sup. Ct. 2006) (unpublished table decision). Several other cases in Suffolk County have similarly denied MERS standing to foreclose. *See generally* Sam Weisberg, *MERS Foreclosures Continue to Face Challenges in Suffolk County Courts*, N.Y. L.J., May 30, 2006, at 20. *But see* U.S. Bank v. Flynn, 897 N.Y.S.2d 855, 858-59 (N.Y. Sup. Ct. 2010) (disagreeing with the conclusion reached in *Lamy* and declining to follow it).

149 *Lamy*, 824 N.Y.S.2d 769.

150 *Id.*; s*ee also* Kluge v. Fugazy, 536 N.Y.S.2d 92, 92 (N.Y. App. Div. 1988) ("[F]oreclosure of a mortgage may not be brought by one who has no title to it and absent transfer of the debt, the assignment of the mortgage is a nullity.").

151 MICH. COMP. LAWS ANN. § 600.3204(1)(d) (West, Westlaw through 2010 Act 257); *see also* MICHIGAN LAND TITLE STANDARDS § 16.13 (6th ed. 2007).

152 BAXTER DUNAWAY, 5 LAW OF DISTRESSED REAL ESTATE § 73:15 (2010) (quoting MICH.

MERS does not own any interest in the indebtedness of any mortgage, nor is it a mortgage servicer.[153] Nevertheless, MERS continues to conduct residential foreclosures in Michigan without disclosing the owner of the note, and some courts have even implicitly recognized that these foreclosures are proper.[154]

In Georgia, a foreclosing party must provide the borrower with written notice of the name, address, and telephone number of the entity having full authority to negotiate, amend, and modify the terms of the mortgage.[155] Lenders continue to foreclose in MERS's name in Georgia without disclosing the entity owning the mortgage debt. While Georgia courts have not yet considered whether this practice violates the statute, the Georgia Supreme Court has explicitly acknowledged that the question of whether MERS has standing to bring a foreclosure action is "worthy of inquiry."[156]

Amidst growing concern regarding MERS's legal ability to foreclose in its name, some loan servicers have chosen to no longer foreclose in MERS's name and instead obtain the necessary recordable assignments to foreclose in their own names.[157] In December 2006, Fannie Mae announced that, "MERS must not be named as a plaintiff in any judicial action filed to foreclose on a mortgage owned or securitized by Fannie Mae."[158] Instead, servicers are required to prepare a written, recordable assignment between MERS and the servicer, and foreclose in the servicer's name.[159] In jurisdictions where non-judicial foreclosure is

COMP. LAWS ANN. § 600.3204(3)).

153 MERS does not claim any interest in mortgage debt, only a legal interest in the security instrument as nominee for the original lender and its successors and assignees, if the original lender and its successors are MERS members. *See, e.g.*, Mortg. Elec. Registration Sys., Inc. v. Neb. Dep't of Banking and Fin., 704 N.W.2d 784, 787 (Neb. 2005) ("MERS does not take applications, underwrite loans, make decisions on whether to extend credit, collect mortgage payments, hold escrows for taxes and insurance, or provide any loan servicing functions whatsoever.").

154 *See, e.g.*, Ruby & Assocs., P.C. v. Shore Fin. Servs., 741 N.W.2d 72 (Mich. Ct. App. 2007) (denying quiet title claim by previous owner of property sold at MERS foreclosure sale, but not addressing MERS's standing to foreclose directly), *vacated in part on other grounds*, 745 N.W.2d 752 (Mich. 2008); Mortg. Elec. Registration Sys., Inc. v. Pickrell, 721 N.W.2d 276 (Mich. Ct. App. 2006) (holding that MERS met requirements of Michigan's Mobile Home Commission Act in conducting foreclosure of a mobile home, but not addressing MERS's standing generally).

155 GA. CODE ANN. § 44-14-162.2 (2010).

156 ALEXANDER, *supra* note 2, §5:4 (citing Taylor, Bean, & Whitaker Mortg. Corp. v. Brown, 583 S.E.2d 844, 848 (Ga. 2003)).

157 *Recent Court Cases Pose Issues for MERS and Securitized Loans,* MOODY'S RESILANDSCAPE (Moody's Investors Service), Oct. 29, 2009, at 7-8 [hereinafter MOODY'S RESILANDSCAPE].

158 Announcement 06-24, Fannie Mae, Process for Foreclosing on Mortgage Loans Reflecting Mortgage Electronic Registration Systems, Inc. as Mortgagee 1 (Dec. 7, 2006) [hereinafter Announcement 06-24, Fannie Mae], *available at* https://www.efanniemae.com/sf/guides/ssg/annltrs/pdf/2006/0624.pdf.

159 *Id.* Note that a foreclosing servicer must meet more statutory requirements than MERS,

available, however, Fannie Mae still allows foreclosures in MERS's name.[160] Fannie Mae did not articulate a reason for treating MERS foreclosures differently in the judicial versus non-judicial context, but favorable court cases in non-judicial states, like *Jackson*, might have something to do with it. Fannie Mae's stance is troubling because the same characteristics that make non-judicial foreclosure more efficient than judicial proceedings also makes borrowers more vulnerable when MERS initiates foreclosure. A lack of judicial oversight means that challenges to MERS's standing are less likely, and the likelihood that a borrower will be unable to locate the owner of her mortgage increases.[161]

C. *MERS and the Recording Acts*

Outside of the foreclosure context, MERS's practice of not publically recording assignments of mortgages between MERS members has raised the ire of at least one county clerk's office.[162] In 2001, the New York Attorney General's office issued an informal opinion concluding that recording a MERS instrument violates New York's recording statutes.[163] In response, the Suffolk County clerk stopped recording MERS instruments. MERS sought to compel the county clerk to record the instruments, and a New York trial court held that the clerk was obligated to record mortgages submitted in MERS's name, but not discharges or assignments.[164] The Appellate Division affirmed with respect to mortgages, but also held that the county clerk

including documenting its relationship with the owner of the note. *See supra* notes 119-24 and accompanying text.

160 Announcement 06-24, Fannie Mae, *supra* note 158, at 2.

161 *See* Nelson & Whitman, *supra* note 53, at 1433; *see also supra* note 91 and accompanying text.

162 *See* Merscorp, Inc. v. Romaine, 861 N.E.2d 81, 88-89 (N.Y. 2006). The Suffolk County Clerk's office claims to have lost over $1 million in revenue as a result of MERS. *Id.* at 89 (Kaye, C.J., dissenting in part).

163 N.Y. Att'y Gen., Informal Opinion 2001-2 (2001), *available at* http://www.oag.state.ny.us/bureaus/appeals_opinions/opinions/index_op.html#2001. Pursuant to New York's recording statute, a county clerk "shall" record any "conveyance of real property" upon the request of "any party," so long as that conveyance has been "duly acknowledged by the person executing the same." N.Y. REAL PROP. LAW § 291 (McKinney 2010). According to the Attorney General

> since MERS has no legal interest in the mortgages it seeks to file, designating MERS as the mortgagee in the mortgagor-mortgagee indices would not fully satisfy the intent of Real Property Law's recording provisions to inform the public about the existence of encumbrances, and to establish a public record containing identifying information as to those encumbrances.

N.Y. Att'y Gen., Informal Opinion 2001-2, at 3.

164 Merscorp, Inc. v. Romaine, 808 N.Y.S.2d 307, 309 (N.Y. App. Div. 2005).

must record discharges and assignments.[165] On appeal, a divided Court of Appeals ruled in favor of MERS, holding that mortgages, discharges, and assignments listing MERS as nominee on behalf of a lender satisfy the limited requirements of the recording statute.[166] In a dissenting opinion, Chief Judge Kaye expressed concern that the MERS System harms borrowers. Specifically, MERS's policy of providing borrowers with the name of their servicers, but not the name of their lenders, makes it more difficult for a borrower to negotiate her loan or assert her legal rights.[167] Judge Kaye also argued that the MERS System will render the public land records useless by depriving the public of valuable information, and might even insulate predatory lenders from liability.[168] Judge Kaye's concerns are particularly relevant in the context of foreclosure, where borrowers are most in need of the protections the law affords them.

D. *Uncertainty Surrounding MERS's Standing to Foreclosure Places a Cloud on the Title to Land Purchased at MERS Foreclosure Sales*

In addition to undermining the protections for homeowners that foreclosure law traditionally provides, the legal uncertainty surrounding MERS's standing to initiate foreclosure proceedings may place a cloud on title to property sold at MERS foreclosure sales.[169] As discussed above, when a court determines that a foreclosure is void, rather than merely voidable, the foreclosure sale is invalid *even if* there was a subsequent bona fide purchaser of the property. The *Ibanez* decision demonstrates that courts will void an otherwise valid foreclosure sale if the foreclosing party did not have legal standing to bring the action. In response to *Ibanez*, some Massachusetts title companies are no longer

165 *Id.* ("Contrary to the Supreme Court's determination, there is no valid distinction between MERS mortgages and MERS assignments or discharges for the purpose of recording and indexing.").

166 *Romaine*, 861 N.E.2d 81. Writing separately, one judge acknowledged the "plethora of policy arguments" against allowing MERS to record mortgages, including the difficulty a homeowner faces when trying to determine the actual holder of the mortgage. *Id.* at 85-86 (Ciparick, J., concurring). For a critique of the majority's holding, see McDonald, *supra* note 58, at 15-20.

167 *Romaine*, 861 N.E.2d at 88-89 (Kaye, C.J., dissenting).

168 *Id.* at 88 ("Not only will this information deficit detract from the amount of public data accessible for research and monitoring of industry trends, but it may also function, perhaps unintentionally, to insulate a noteholder from liability, mask lender error and hide predatory lending practices.").

169 *See, e.g.*, MOODY'S RESILANDSCAPE, *supra* note 157, at 7-8. A "cloud on title" refers to a "defect or potential defect in the owner's title to a piece of land arising from some claim or encumbrance, such as a lien, an easement, or a court order." BLACK'S LAW DICTIONARY 291 (9th ed. 2009).

issuing clean title insurance policies for properties purchased by lenders at MERS foreclosure sales.[170] Not only can this place a cloud on the title of land purchased at these foreclosure sales, it may also harm borrowers by discouraging potential bidders who could raise the sale price of the property at auction. A provision of the Uniform Nonjudicial Foreclosure Act, for example, requires foreclosing creditors to obtain and provide title evidence to prospective bidders.[171] Evidence may include an attorney's opinion based on an examination of the title, or other title evidence issued by an entity "willing to provide a policy of title insurance to a person that acquires title to the real property by virtue of the foreclosure."[172] The provision is designed to assure prospective bidders that they will be able to obtain title insurance if they buy the property. If title insurance is not available, a foreclosing party, such as MERS, could still satisfy the requirement by furnishing an attorney's opinion, but a prudent bidder would be unlikely to purchase the property without title insurance.

Despite the issues discussed above, MERS maintains that members can legally foreclose in MERS's name, and that there is no definitive case law to the contrary.[173] Nevertheless, as long as courts continue to question MERS's standing to foreclose—and as demonstrated above, courts have the legal rationale to do so—uncertainty will exist as to the legitimacy of title held by purchasers at MERS foreclosure sales, and borrowers facing foreclosure will be less likely to avert foreclosure by negotiating and modifying their loans.

CONCLUSION

Whether foreclosure law and the recording system should be reformed is a valid question. But it is one that should be answered by legislatures, not by the mortgage industry.[174] While the MERS system may be a "commercially effective means of business,"[175] it runs afoul of

170 MOODY'S RESILANDSCAPE, *supra* note 157, at 8.

171 *See* Nelson & Whitman, *supra* note 53, at 1433.

172 *Id.*

173 MOODY'S RESILANDSCAPE, *supra* note 157, at 8.

174 In dismissing twenty MERS-initiated foreclosure actions in Florida in 2005, Judge Walt Logan made the following observation: "The MERS situation seems to have resulted from the establishment of the corporation and agreements with lenders without the participation of the Florida Legislature or the Supreme Court in its rule making role. The fact that the market might find it easier to operate with the real party in interest somewhere in the background of a foreclosure lawsuit is not a compelling reason to modify the traditional requirements of a party to establish status to bring litigation." Mortg. Elec. Registration Sys., Inc. v. Azize, No. 05-001295CI-11 (Fla. Cir. Ct. Aug. 18, 2005).

175 Mortg. Elec. Registration Sys., Inc. v. Revoredo, 955 So. 2d 33, 34 (Fla. Dist. Ct. App. 2007).

established foreclosure law, and courts should rule accordingly. As one court put it, "[t]he [lending] institutions seem to adopt the attitude that since they have been doing this for so long, unchallenged, this practice equates with legal compliance. Finally put to the test, their weak legal arguments compel the Court to stop them at the gate."[176] But as the mortgagee of record for nearly two-thirds of newly originated residential mortgages in the United States, MERS has long since left the starting gate. The question now is whether they will be stopped before they cross the finish line.

176 *In re* Foreclosure Cases, Nos. 1:07CV2282 et al., 2007 WL 3232430, at *3 n.3 (N.D. Ohio Oct. 31, 2007).