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Whither MERS?

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In the zeal to stall lenders' efforts to foreclose on woefully delinquent mortgages, the plaintiff bar has put forward a variety of theories. Some of the more interesting theories involve the relationship between the promissory note and the mortgage (or deed of trust) that secures the note. The lenders may have made these theories easier for borrowers' advocates to advance, when they created the MERS system for recordation.[1]

MERS was designed as a system to facilitate the secondary market in mortgage loans by permitting the mortgage document to be recorded just once, in the name of MERS, and then having transfers of the mortgage noted electronically on MERS' own records, with MERS acting as the title holder for all the successive owners of the note and the mortgage. This was a smart idea, since the lag time associated with recording assignments of the mortgage document created a huge tracking problem for custodians and secondary market participants. Nevertheless, with recordation in the name of MERS, rather than being in the name of the owner of the note, borrowers have found an opportunity to assert deficiencies in the foreclosure process entitling them to defend against foreclosures.

In the latest round of cases addressing this issue, a bankruptcy court in New York concluded that MERS does not have the power to foreclose the mortgage,[2] and another bankruptcy court in Kansas found that a foreclosure by MERS is perfectly fine.[3] There are factual differences between these cases that may explain the apparently diverging results. In the New York case, the court focused on the difference between a "nominee" and an "agent." Under the documents presented to the court, MERS had been appointed as "nominee" and "mortgagee of record" only. That court had no documents before it that constituted MERS as an agent for any functions other than holding bare legal title to the mortgage instrument. The court concluded that the role of nominee and mortgagee of record did not include the power to foreclose and take title to the real property in MERS' own name.

By contrast, the court in Kansas found that, based on the documents before it, the role of MERS as nominee included authorization to act as agent of the noteholder for purposes of foreclosing. The court quoted language from the mortgage itself saying that the powers of MERS as nominee included "the right to foreclose and sell the Property; and to take any action required of Lender."

In reaction to the case in New York, and other challenges to the MERS structure, MERS has issued a notice[4] recommending that its members foreclose in their own names, rather than in the name of MERS (even though the MERS procedural manual permits both approaches), to avoid these challenges until the case law becomes more settled. It was important for MERS to react quickly to these developments, as some commentators have questioned the viability of the MERS model altogether. What the cases reflect, however, is more subtle than that. The MERS model requires precise explanation and adherence to its supporting documentation. If the documentation for a particular loan provides that the nominee has only bare title, then MERS can only act as a holder of bare title. If the documentation lawfully causes MERS to be a duly appointed agent for other functions, then

MERS can act with those other functions. But the parties should not assume that a court will infer the existence of broad agency powers, unless they are proven.

In a sense this latest skirmish regarding MERS is part of the larger war, and is akin to the battle over so-called "robo-signers." In a variety of different settings, the courts are making it very clear that foreclosure is a drastic remedy, and hence must be seen as technically demanding. To use it, the lenders must conform to the precise technical requirements.

The latest court developments do not need to spell the demise of MERS. While it is true that the MERS platform and forms of documentation could, with hindsight, have been created with better transparency and clarity as to these issues, the MERS arrangements are not inherently unenforceable. As with all other aspects of the foreclosure process, what is called for is taking the time and attention to understand the loan-specific documentation, and to present to the court all of the pertinent documents. Notwithstanding, if the MERS model is continually attacked, major participants may wish to pull out, which could leave MERS without the credibility or the economies of scale to survive.

[1] MERS stands for Mortgage Electronic Registration Systems, which is operated by a membership organization of banks and other mortgage industry participants. MERS claims that it handles about half of the residential mortgages in the United States.

[2] *In re Ferrel L. Agard*, U.S. Bankruptcy Court, Eastern Dist. N.Y., Feb. 10, 2011 (Case No. 810-77338-reg).

[3] *In re David Michael Martinez and Michelle Christine Martinez*, U.S. Bankruptcy Court, Dist. Kan., Feb. 11, 2011 (Case No. 09-40886).

[4] MERS Announcement Number 2011-01, dated February 16, 2011, entitled "Re: Foreclosure Processing and CRMS Scheduling."