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MERS – The Good, The Bad & The Ugly:

The Current Legal Atmosphere Surrounding the Mortgage Industry's Most Beloved "Nominee" Beneficiary/ Mortgagee

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There is little doubt that America is infatuated with convenience and efficiency. The assembly line, the microwave, the internet, speed dating and drive-thrus are just a few examples. Another example, not as publicly well-known or understood as the foregoing, is the MERS System of registering and tracking transfer of interests in Deeds of Trust. Incorporated in 1997, Mortgage Electronic Registration Systems, Inc. ("MERS") revolutionized mortgage banking. By acting as the designated "holder" of a loan's security instrument, albeit as a nominee for the holder of the loan, the MERS System circumvents the administrative hurdle of publicly recording documents that reflect each sale or transfer of a secured home loan. As a result, the common burdens, inefficiencies and expenses associated with selling or transferring secured home loans were greatly minimized.

Unfortunately, with convenience and efficiency, come negative side-effects. The assembly line, the microwave, the internet, speed dating and drive-thrus, arguably brought poor-quality, obesity and anti-social behavior. Similarly, with the ease of transfer of loans under the MERS System, some argue, came a substantial factor in the exploitation of the sub-prime lending market by unscrupulous lenders. In fact, many defaulted borrowers continue to allege that the MERS System permitted numerous lenders and investors to play "hot potato" with their sub-prime loans, which they naively believe caused the Nation's current housing crisis.

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Finding MERS' nominee relationship incomprehensible, many defaulted borrowers filing lawsuits today, in an attempt to thwart, or at least delay, foreclosure, allege that MERS' role as "nominee" illegally "splits" the loan from its security instrument, rendering the loan unsecured. Although it is true, with exception, that the law requires a loan and its security instrument to be owned by one entity, these defaulted borrowers attempt to stretch the law beyond its intent. Nevertheless, Courts across the country are having trouble reconciling MERS' relationship loans and its security instruments. Using a title from one of Clint Eastwood's best movies, here is the Good, the Bad and the Ugly of the recent MERS debate in the courts.

The Good...

The first recent noteworthy judicial decision favoring MERS is *Ramos v. Mortgage Electronic Registrations Systems, Inc.*[1] There, the Federal District Court of Nevada rejected plaintiffs' argument that MERS, as nominee beneficiary, "has no rights or powers to confer upon the [foreclosure] trustee the power to sell" in a deed of trust.[2] The *Ramos* Court held that since Nevada law permits a deed of trust's "beneficiary" to foreclose, and because the deed of trust expressly named MERS as its "beneficiary", MERS was legally "empowered" and contractually authorized by the borrower to foreclose and appoint a substitute foreclosure trustee.[3]

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Several months after *Ramos,* came the Supreme Court of Minnesota's decision in *Jackson v. Mortgage Electronic Registration Systems, Inc.*[4] In *Jackson*, the plaintiffs argued that MERS could not commence foreclosure proceedings because the numerous assignments of the underlying promissory note had not been publicly recorded, in violation of Minnesota law.[5] Although Minnesota *does* require the recording of all mortgage assignments before initiating foreclosure, the *Jackson* Court distinguished an assignment of the mortgage from an assignment of only the promissory note. The Court articulated that "…an assignment of only the promissory note, which carries with it an equitable assignment of the security instrument, is not an assignment of legal title that must be recorded…"[6] In rendering its decision, the Minnesota Supreme Court held that nominee mortgagees, like MERS, can "hold legal title of the security instrument without holding an interest in the promissory note" since the equitable beneficiary interest, or "real ownership", in the security is held by the note-holder, which keeps the note and mortgage intertwined.[7]

Bucci v. Lehman Bros. Bank, FSB,[8] from the Superior Court of Rhode Island, is another recent judicial decision in favor of MERS. Similar to *Ramos,* the *Bucci* Court held that MERS had both a contractual and statutory right to commence foreclosure proceedings. First, the *Bucci* Court recognized that the language in the mortgage expressly granted "MERS as nominee for Lender and Lender's successors and assigns" the "Statutory Power of Sale" and right to foreclose.[9] Second, the *Bucci* Court reasoned that even though MERS is acting as nominee and does not have a beneficial interest in the note, the express designation in the mortgage that MERS is the "mortgagee", permitted MERS to initiate foreclosure proceedings as a mortgagee pursuant to the Rhode Island law.[10]

A final notable decision in favor of MERS is *Cervantes v. Countrywide Home Loans, Inc.*[11] In *Cervantes*, the Federal District Court of Arizona dismissed MERS from the action, holding that: (1) MERS, by acting as a nominee beneficiary and never owning or acquiring a beneficial interest in the promissory note, is not a "sham" beneficiary, and (2) the MERS System of tracking assignments of promissory notes, as opposed to public recordings, is not fraudulent.[12]

While MERS was given a legal boost in 2009, MERS also received a few interesting defeats.

The Bad…

The "Bad" starts in the Mid-West with the Missouri Court of Appeals decision in *Bellistri v. Ocwen Loan Servicing, LLC.*[13] There, the Court of Appeals held that because "MERS never held the promissory note…its assignment of the deed of trust to [the assignee] separate from the note had no force", and thus, the assignee was without any legal interest in the deed of trust.[14] The *Bellistri* Court relied on the general legal premise that if the note and its deed of trust are separated and not held by the same person, then the note becomes unsecured.[15] However, the *Bellistri* decision may have relied more on counsel's failure to explain MERS' agency relationship with its principal note-holders, rather than a finding that the note and deed of trust were actually separated. In fact, the Court acknowledged that when the holder of the deed of trust is the agent for the holder of the note, a separation or "splitting" does not occur, leaving the deed of trust unaffected and valid.[16]

Relying, in part, on the holding of *Bellistri*, the Supreme Court of Kansas recently stunned the industry with its decision of *Landmark National Bank v. Kesler.*[17] In *Landmark*, MERS was acting as the nominee mortgagee for a second mortgage. When the first lienholder filed a petition to foreclose, neither MERS nor its principal note-holder were named parties or given notice of the litigation. As a result, the trial court entered a default judgment in favor of the first lienholder. MERS unsuccessfully challenged the ruling. The Supreme Court found that since MERS did not have any tangible interest in the mortgage (e.g., it was not a beneficiary, did not issue the loan, and was not entitled to collect on the debt), it was not entitled to notice.[18] Fortunately, the *Landmark* Court seemed to imply that it was merely deciding whether the lower trial court acted appropriately, not whether MERS was "technically" entitled to

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notice.[19] However, the case could be read both ways, and you can be sure which way the borrowers will read it; i.e., that if MERS does not have an interest in the mortgage to entitle it to notice, it does not have the right to foreclose.

Another recent negative MERS decision is *In Re Hawkins.*[20] In *Hawkins*, the United States Bankruptcy Court, for the District of Nevada, held that MERS did not produce sufficient evidence to demonstrate that it was entitled to lift a bankruptcy stay on foreclosure. The *Hawkins* Court did acknowledge that Nevada only permits enforcement of a note by its holder (i.e., the person whom the instrument is made payable) or a nonholder in possession with the rights of the holder, but the Court found MERS did not prove it was either.[21] Like *Bellistri*, the *Hawkins* Court recognized that a note cannot be "split" from its deed of trust, but it also noted the exception of when the holder of the deed of trust is the *agent* for the holder of the note.[22] As such, the *Hawkins* Court indicated that had MERS proven it was the actual agent for the holder of the note, then MERS would have likely been able to lift the bankruptcy stay, albeit, only in the name of its principal.[23]

The Ugly

While extremely limited in scope, the holdings of *Bellistri, Landmark* and *Hawkins* have opened the door for numerous class action lawsuits in Arizona, Nevada and California.[24] These class action plaintiffs claim that MERS' designation as

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"beneficiary" under their deeds of trust impermissibly "splits" the promissory note from its deed of trust, rendering the note unsecured. On this basis, the class action plaintiffs are seeking to enjoin *all* foreclosures in Arizona, Nevada and California. Fortunately, there have not been any broad injunctions issued as of yet. The cases are currently awaiting a decision from the Multi-District Litigation Panel on whether to centralize the cases before one judge. Co-author Robert Finlay had the privilege of sitting in on the MDL hearing last week (November 19, 2000) at Harvard Law School. Interestingly, half of the lender defendants argued for centralization; while Freddie Mac, Fannie Mae, other lenders and the plaintiffs argued to keep the cases in their respective courts. A ruling is expected by mid-December. Centralization could be a great result if we get the Judge who decided the Cervantes case discussed above. But, centralization with the wrong Judge could turn these class actions even uglier.

In addition to the troublesome class actions, numerous homeowners across the country are filing individual lawsuits also challenging MERS' role as nominee beneficiary/mortgagee. Not only do these lawsuits greatly delay pending foreclosures and require a substantial amount of money in litigation expenses, but, they also create more opportunities for the Courts to make decisions like *Bellistri, Landmark* and *Hawkins*. This will only cause further trouble for MERS and its principal note-holders.

Although *Bellistri, Landmark* and *Hawkins* provide fodder for the seemingly nationwide attack on MERS, these cases appear to supply the answer for MERS' plight: demonstrating, elaborating and explaining to the Court MERS' agency relationship with its note-holders. Both *Bellistri* and *Hawkins* recognized the exception to the rule that when the holder of the security instrument is an agent for the holder of the promissory note, the instruments are not "split". Unfortunately the Courts in *Bellistri* and *Hawkins* were provided insufficient explanations and evidence to demonstrate that MERS' agency relationship falls within the exception. Consequently, while such litigation will continue - for the short-run anyway - the net-result may be favorable for MERS with changes in the law that finally recognize and incorporate the utility of the MERS System.

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1 2:08-CV-1089-ECR-RJJ (D. Nev. March 4, 2009).
2 *Id.* at Docket No. 21, pg. 6:24-26.
3 *Id.* at pps. 6:26-27; 7:1-19.
4 770 N.W.2d 487 (Minn. 2009).
5 *Id.* at 492-493.
6 *Id.* at 500-501.
7 *Id.* at 500.
8 No. 09-3888 (Sup. Ct. R.I. August 25, 2009).
9 *Id.* at the Court's Decision pg. 7.
10 *Id.* at pps. 11-12; 22.
11 CV 09-517-PHX-JAT (D. Ariz. September 23, 2009).
12 *Id.* at Docket No. 222, pps. 14:25-28 to 16:1-18.
13 284 S.W.3d 619 (Mo. Ct. App. 2009).
14 *Id.* at 624.
15 *Id.* at 623.
16 *Id.*
17 216 P.3d 158 (Kan. 2009).
18 *Id.* at 166-168.
19 *Id.* at 168.
20 2009 WL 901766 (Bkrtcy. D. Nev. March 31, 2009).
21 *Id.* at *4.
22 *Id.* *4-6.
23 *Id.*
24 *Lopez v. Executive Trustee Services, LLC*, No. 3:09-cv-180-ECR-VPC (D. Nev.); *Goodwin v. Executive Trustee Services, LLC*, No. 3:09-cv-00306-ECR (D. Nev.); *Green v. Countrywide Home Loans, Inc.*, No. 3:09-cv-00374-BES (D. Nev.); *Dalton v. CitiMortgage, Inc.*, No. 3:09-cv-00534-RCJ (D. Nev.); *Cervantes v. Countrywide Home Loans, Inc.*, No. 09-cv-517-JAT (D. Ariz.); *Robinson v. GE Money Bank*, No. 4:09-cv-227 (D. Ariz.); *Vargas v. Countrywide Home Loans, Inc.*, No. 2:09-cv-2309-SJO (C.D. Cal.).

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