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First Circuit Rules MERS Can Assign Mortgages and Borrowers Can Challenge Standing

In a decision that has sparked a great deal of discussion, the U.S. Court of Appeals for the First Circuit recently decided a borrower has standing to raise certain challenges to the assignment of his or her mortgage from Mortgage Electronic Registration Systems, Inc. (MERS) to a lender. At the same time, the court affirmed the legal validity of the MERS system, putting to rest any questions about the propriety of a MERS loan under Massachusetts law. *Culhane v. Aurora Loan Servs. of Neb.*, No. 12-1285, 2013 U.S. App. LEXIS 3313 (1st Cir. Feb. 15, 2013).

In a matter of first impression, the court held that, under Massachusetts law, a borrower has standing to challenge the assignment of his or her mortgage, even though he or she was not a party, nor a third-party beneficiary, of the assignment. Previously, federal district courts in Massachusetts had ruled borrowers lacked standing to challenge mortgage assignments because a "litigant should not normally be permitted to assert the rights and interests of a third party." *Id.* at *13 (collecting cases). Evaluating those decisions, the First Circuit opined that the district court decisions denying standing painted "with too broad a brush." *Id.* at *14. Although the court agreed with the general principle that a nonparty that does not benefit from a contract lacks standing to assert rights under the contract, it disagreed with the conclusion reached by other courts and found, instead, that borrowers in Massachusetts have such standing, partly because of the "unusual" position they are in when their mortgages contain a power of sale provision. *Id.*

The court explained that, under Massachusetts law, a borrower has the right to challenge an assignment because (i) the borrower has a statutory right to ensure that a foreclosure on his or her home is conducted lawfully, and (ii) the lender is permitted to foreclose without prior judicial authorization. Under these circumstances, to ensure that the statutory right to a lawful foreclosure has been met, the borrower must have an opportunity to challenge the lender's right to foreclose.

The court cautioned this is a narrow holding and a borrower only "has standing to challenge a mortgage assignment as invalid, ineffective, or void (if, say, the assignor had nothing to assign or had no authority to make an assignment to a particular assignee)." *Id.* at *16. A borrower may not, however, challenge an assignment that is "effective to pass legal title," even if the assignment is voidable by a party to the agreement. *Id.*

While providing borrowers with the right to contest the standing of a lender to foreclose, the decision also laid to rest questions about the validity of the MERS system. As the court stated, the "MERS framework is faithful to the age-old tenets of mortgage law." *Id.* at *3. In so ruling, the court rejected the borrower's claim that MERS did not legitimately hold the mortgage at the time of assignment because "MERS never owned the 'beneficial half' of the 'legal interest' in the mortgage." *Id.* at *18. Upholding the MERS system, the court held "there is no reason to doubt the legitimacy of the common arrangement whereby MERS holds bare legal title as mortgagee of record and the noteholder alone enjoys the beneficial interest in the loan." *Id.* The court, therefore, found MERS had legal title to the property when it made the assignment and MERS derived authority to properly assign the mortgage "both from MERS's status as equitable trustee and from the terms of the mortgage contract." *Id.* at 22.

Notably, the court also rejected the borrower's claim that the assignment was invalid because MERS appointed an individual employed by the servicer to certify as to the validity of the assignment as an officer of MERS. Affirming the MERS framework, the court rejected the borrower's argument, finding it was "little more than wishful thinking," *Id.* at *25, because the "Massachusetts statute neither places restrictions on who may be elected as an officer of the assignor nor imposes special requirements (say, regular employment) on who may serve as a vice president of an assignor corporation." *Id.* at *19.

This is a narrow holding that is limited to Massachusetts foreclosures. Nonetheless, banks and loan servicers should expect an increase in challenges by borrowers to a lender's right to foreclose, if only to delay the proceedings. On the positive side for lenders, the greater impact of the holding may be to put to rest, at least under Massachusetts law, challenges to the validity of the MERS system.