Bloomberg Law Reports® Banking & Finance

New York Federal and State Courts Question MERS Assignments

Joy Harmon Sperling and Michael A. Weiss, Day Pitney LLP

Introduction

Two recent decisions in a bankruptcy court and a New York appellate court could have a wide-reaching impact on lenders in New York and, perhaps, throughout the nation. In the first case, although the court permitted the foreclosure to proceed, the bankruptcy court wrote in dicta that the system operated by Mortgage Electronic Registration Systems, Inc. (MERS), a private mortgage registration company involved with up to 50 percent of American home mortgages,[1] cannot serve as an agent to assign mortgages. The court further advised that the MERS system cannot provide standing for a mortgage owner that obtained its mortgage assignment through the MERS system. In the second case, the New York appellate court dismissed a foreclosure action that had been brought by an assignee of a mortgage executed in favor of MERS, opining that MERS could not assign the right to foreclose upon a mortgage if it did not also own the promissory note.

***Agard* and *Silverberg* in Brief**

On February 10, 2011, in *In re Agard*,[2] the United States Bankruptcy Court for the Eastern District of New York granted a motion filed for relief from the automatic stay. The mortgage at issue in that case had been assigned through the MERS system. The court granted the mortgage servicer permission to foreclose, finding that because the servicer had already obtained a foreclosure judgment from the state court, the bankruptcy court could not undo that judgment under the *Rooker-Feldman* doctrine and the doctrine of *res judicata*. Nonetheless, the court decided to analyze the role of the MERS system "in the ownership and transfer of real property notes and mortgages," in light of the many cases in which the issue of the validity of a MERS assignment is a significant factor in the litigation.[3] In so doing, the court essentially rendered an advisory opinion that, if followed by other courts, could have a dramatic effect on the mortgage industry.

On June 7, 2011, in *Bank of New York v. Silverberg*,[4] the Appellate Division of the Supreme Court of the State of New York for the Second Department dismissed a foreclosure suit brought by Bank of New York, which had obtained ownership of two notes (originally made in favor of Countrywide Home Loans (Countrywide)) and was assigned the corresponding mortgages (which had been made in favor of MERS as Countrywide's nominee). The court held that “because MERS was never the lawful holder or assignee of the notes described and identified” in the loan documents, “MERS was without authority to assign the power to foreclose to the plaintiff.”[5] In making such a ruling, the court essentially nullified all foreclosure proceedings (at least within its jurisdiction) that have been brought by a plaintiff that is an assignee of a MERS

mortgage, where MERS is not also the owner of the promissory note.

The MERS System

As indicated on its website, "MERS is an innovative process that simplifies the way mortgage ownership and servicing rights are originated, sold and tracked. Created in the mid-1990's by the real estate finance industry, MERS eliminates the need to prepare and record assignments when trading residential and commercial mortgage loans."[6] MERS' participants include leading financial institutions such as Bank of America, CitiMortgage, Fannie Mae, Freddie Mac, HSBC, and Wells Fargo.[7]

In a typical MERS mortgage transaction, MERS itself is named as the beneficiary of a mortgage or deed of trust as "nominee" for the lender. The purpose of this structure is to avoid generating a new paper assignment for recording every time the ownership of the loan changes. Consequently, the mortgage remains in the name of MERS, and MERS itself tracks the change of ownership among its members. MERS maintains a private database that tracks changes in ownership of the loan, which is accessible only by MERS members. In the event of a borrower's default, MERS typically assigns its interest in the mortgage to the lender that is the current holder of the loan. That entity then initiates the foreclosure action against the borrower, usually after a written assignment of mortgage has been recorded in the land records.

As compared to the mortgage, the note executed by the borrower in favor of the lender is solely in the lender's name. MERS is not named as a nominee and has no interest in the note. Therefore, at the time the lender seeks to foreclose on the mortgage, there is nothing for MERS to assign back to the lender.

In creating the MERS system, the financial industry sought to facilitate the transfer of mortgage loans from one owner to another and to enable lenders to avoid the cumbersome and expensive process of recording each individual transfer of a mortgage's ownership in the local land records.[8]

***Agard* Analyzes the MERS System**

MERS (an intervenor in the *Agard* lawsuit) argued that because "the provisions of the Mortgage grant to MERS the right to assign the Mortgage as 'nominee,' or agent, on behalf of the [original] lender," it had the proper authority to assign the Mortgage to the lender.[9] Specifically, MERS's Memorandum of Law stressed that the mortgage agreement designated it as the nominee and mortgagee of record for the lender and its successors and assigns. MERS also pointed out that the debtor expressly agreed to MERS acting on behalf of the lender to foreclose or enforce other rights a nominee my exercise.[10]

Further, MERS argued that its own membership rules provide it with the authority to assign mortgages and directed the court to language in the MERS membership agreement appointing MERS as each members' authorized agent with authority to hold legal title to mortgages.[11] MERS argued that because the original lender had appointed it as an agent to hold the Mortgage on behalf of it and its successors and assigns through the MERS membership agreement, each subsequent holder taking ownership of the loan within the MERS system was "deemed to have appointed MERS to act as its agent to hold the Mortgage as nominee."[12]

However, the *Agard* court held that neither MERS membership rules nor the terms of the mortgage created an agency relationship.[13] The court noted that MERS did not receive any particular power or authority from its membership rules, which simply require that it "at all times comply with the instructions of the holder of mortgage loan promissory notes." The court further opined that the MERS membership rules did not include any "explicit reference to the creation of an agency or nominee relationship."[14] The court declined to

"cobble together" the MERS membership rules with the mortgage itself in order to read an agency meaning into the term "nominee."[15]

The *Agard* court further found that "the fact that MERS is named 'nominee' in the Mortgage is not dispositive of the existence of an agency relationship and does not, in and of itself, give MERS any 'authority to act.'"[16] The court noted that an agency relationship between MERS and a lender must be committed to writing pursuant to the statute of frauds, and that, under New York law, a grant of such authority could only arise "from a direct manifestation of consent from the principal to the agent."[17] In ruling that the naming of MERS as the mortgagee was insufficient to evidence a grant of authority for MERS to act for the lender's benefit "and subject to [its] control," the court relied upon various New York state cases "hold[ing] that MERS may not validly assign a mortgage based on its nominee status, absent some evidence of specific authority to assign the mortgage."[18] The court found that a nominee's legal status depends on the relationship between the nominee and its principal. The court concluded that MERS could not show any evidence of its authority to assign the mortgage by way of, for instance, "a power of attorney or some other document executed by the original lender."[19]

As a result of its opinion, the *Agard* court called into question the efficacy of the MERS system and the ability of MERS to effectuate assignments.

Silverberg Analyzes the MERS System

The *Silverberg* court went further than the *Agard* court by dismissing a foreclosure suit based on lack of standing.

In *Silverberg*, two promissory notes made in favor of Countrywide and two mortgages made in favor of MERS as nominee for Countrywide were consolidated into a single loan obligation. The resulting obligation was transferred by MERS to the foreclosure plaintiff prior to the commencement of the foreclosure action. The borrowers in *Silverberg* argued that "the mortgages were never properly assigned to the [foreclosure] plaintiff because MERS, as nominee for Countrywide, did not have the authority to effectuate an assignment of the mortgages."[20] MERS did not intervene in the *Silverberg* suit.

In response to the borrowers' arguments, the plaintiff contended that "case law supports its position that MERS has the power to foreclose, where, as here, MERS is identified in a mortgage as nominee and mortgagee for the purpose of recording."[21] The plaintiff cited in particular the same court's ruling in *Mortg. Elec. Registration Sys., Inc. v. Coakley*[22] in which the court held that MERS had standing to foreclose a mortgage.[23]

The court cited precedent that "a transfer of the mortgage without the debt is a nullity, and no interest is acquired by it."[24] The court then concluded that "the foreclosure of a mortgage cannot be pursued by one who has no demonstrated right to the debt."[25] The court explained that in *Coakley* "the lender had transferred and tendered the promissory note to MERS before the commencement of the foreclosure action," and the terms of the mortgage instrument included an unequivocal agreement by the mortgagor that MERS had the right to foreclose if the mortgagor defaulted.[26] The court noted that neither factor was present in the *Silverberg* case.[27]

As a result of its opinion, the *Silverberg* court ruled that a foreclosure suit cannot be successfully brought anywhere in the Second Department (which encompasses most of New York City and its surrounding suburbs[28]) if MERS was a former or present beneficiary of the mortgage, but did not own the corresponding note.

Limitations of the *Agard* and *Silverberg* Rulings

Although potentially far-reaching, it is important to note that the *Agard* court's ruling regarding the MERS system was merely dicta. The issue of the validity of the MERS system was not presented to the *Agard* court. Indeed, the only issue before the court was the right of the mortgagee to obtain relief from the automatic stay, and such relief was granted. Moreover, the issue of agency was not raised by those parties who would have standing to do so—MERS and the mortgagee.[29] Instead, the court decided to address a question that, arguably, was outside the scope of the issues before it. Nonetheless, the *Agard* decision was cited in the *Silverberg* case for the principle that because the mortgage "did not specifically give MERS the right to assign the underlying notes . . . the assignment of the notes was thus beyond MERS's authority as nominee or agent of the lender."[30]

The *Silverberg* case's ruling on MERS, while not dicta, is limited to the Second Department and is subject to a potential decision by the Court of Appeals of New York. Nevertheless, it presents a troubling challenge for lenders with loans in that jurisdiction and could affect the ability to foreclose on a large share of the approximately 74,000 foreclosures pending in New York.[31]

Nationwide Consideration of MERS-Assisted Foreclosure

Importantly, the *Agard* and *Silverberg* rulings are at odds with decisions rendered by other courts throughout the nation, including federal bankruptcy courts in Massachusetts[32] and Kansas,[33] which have found that a MERS assignment suffices to provide a mortgage lender with standing to pursue a foreclosure.[34] In those cases, the bankruptcy courts found that a MERS assignment to the foreclosing entity was sufficient to grant that entity the power to foreclose, and that MERS had sufficient agency power to assign the subject mortgage.

Non-judicial Remedies Available to Courts and Lenders Seeking Solutions

One legal argument that lenders could use against following the *Agard* and *Silverberg* rulings—which was not addressed in *either* decision—is the theory of unjust enrichment. All mortgage loans are supported by consideration in the form of funds the borrowers received from the lenders. Because the borrowers received the benefit of these loans, the borrowers would be unjustly enriched if the *Agard* dicta and/or *Silverberg* decision was followed. Under the theory of an equitable assignment, the equities would compel enforcement of the mortgages. If a court is concerned about future claims of enforceability by other entities that may believe that they had an interest in the loan, it has the authority to provide such relief as it deems appropriate. For instance, the court may require lenders seeking foreclosure on a MERS-generated assignment to indemnify the borrower against claims by other entities. Furthermore, the *Silverberg* court explicitly recognized the possibility that a lender could cure its standing deficiency by keeping ownership of the mortgage in MERS' name, and transferring ownership of the promissory note to MERS prior to the commencement of the foreclosure suit.[35]

Ramifications of the *Agard* and *Silverberg* Decisions

The dicta of the *Agard* court and the ruling of the *Silverberg* court may not remain limited to New York's Second Department. Courts in other jurisdictions where a state court has not ruled directly on the validity of the MERS assignment system may choose to adopt the reasoning of the *Agard* and *Silverberg* courts as a basis for their decisions. In a jurisdiction where either of these rulings is or may be followed, lenders may find themselves unable to foreclose on delinquent loans, causing the lenders and their investors to incur substantial losses and resulting in windfalls to delinquent borrowers. Even worse, the decision

may encourage borrowers with MERS loans to cease paying their mortgages secure in the knowledge that the lender may not have the authority to foreclose in the short term.

Conclusion

Courts across the nation continue to issue rulings both accepting and rejecting the validity of MERS assignments.[36] The *Agard* and *Silverberg* rulings are examples of courts rejecting the MERS system in New York. Public outrage regarding shoddy foreclosure practices and concern that mortgage lenders will commence foreclosure actions without sufficient proof of their ownership of mortgage loans may increase the likelihood that courts will carefully scrutinize the effectiveness of MERS assignments.

In short, the *Agard* and *Silverberg* courts have issued significant rulings which, if followed, could slow down or even block lenders' enforcement of millions of home mortgage loans. One would expect MERS and any lenders affected by courts that may follow the *Agard* dicta and *Silverberg* decision to seek such relief as is needed to have such decisions given as limited effect as possible in order to protect the MERS system.[37] The ultimate issue of the validity of MERS assignments will likely be decided in the state supreme courts. In the alternative, and as suggested by the *Agard* court, Congress or the state legislatures could explicitly validate MERS assignments by law. An act of Congress, however, could pose questions of federal power in regulating mortgage assignments, which have traditionally been the subject of state authority. Until either Congress speaks or there is some consensus from a larger number of state supreme courts, MERS and its members will face more challenges to their foreclosure practices.

Joy Harmon Sperling is a partner at Day Pitney LLP. Her practice involves representing consumer lending institutions in connection with the defense of claims by borrowers, as well as the prosecution of actions against borrowers, originators of loans and mortgage brokers. She also handles cases covering the defense and prosecution of mortgage fraud claims. She can be reached at jsperling@daypitney.com. Michael Weiss is an associate at the firm, who represents banks and financial institutions in disputes with borrowers and other parties. He can be reached at mweiss@daypitney.com.

---

1 *Agard*, 2011 BL 34342 at * 4 (Bankr. E.D.N.Y. Feb. 10, 2011).

2 *Id*.

3 *Id.* at *18 – 19.

4 *Silverberg*, 2011 BL 153781 (App. Div. 2d Dep't June 7, 2011).

5 *Id.* at *5.

6 *See* http://www.mersinc.org/index.aspx.

7 *See* http://www.mersinc.org/about/shareholders.aspx.

8 *Agard*, at *14; Austin Kilgore, *Foreclosure Crisis Throws Mers on The Defensive*, American Banker, Oct. 15, 2010, at 8.

9 *Agard*, at *7.

10 *Id.* at *9-10.

11 *Id.* at *10.

12 *Id.* at *11.

13 *Id.* at *20.

14 *Id.* at *32-33.

15 *Id.* at *34.

16 *Id. at *34.*

17 *Id.* at *33.

18 *Id.* at *29, *33. The court cited, *inter alia*, *Bank of New York v. Mulligan*, 2010 BL 197224, at *8-9 (N.Y. Sup. Ct. Aug. 25, 2010); *One West Bank, F.S.B. v. Drayton*, 910 N.Y.S.2d 857, 871 (N.Y. Sup. Ct. 2010); *Bank of New York v. Alderazi*, 900 N.Y.S.2d 821, 824 (N.Y. Sup. Ct. 2010) (the "party who claims to be the agent of another bears the burden of proving the agency relationship by a preponderance of the evidence"); and *LaSalle Bank N.A. v. Lamy*, 824 N.Y.S.2d 769 at *2 (N.Y. Sup. Ct. Aug. 7, 2006) ("A nominee of the owner of a note and mortgage may not effectively assign the note and mortgage to another for want of an ownership interest in said note and mortgage by the nominee.").

19 *Agard*, at *30-31.

20 *Silverberg*, at *2.

21 *Id.* at *5.

22 *Coakley*, 838 N.Y.S. 2d 622, 623 (N.Y. App. Div. 2d Dep't 2007).

23 *Silverberg*, at *5.

24 *Id.* at *4. The court cites these New York cases in support of its decision: *Merritt v. Bantholick*, 36 N.Y. 44, 45 (N.Y. 1867); *Carpenter v. Longan*, 83 U.S. 271, 274 (1873) (an assignment of the mortgage without the note is a nullity); *U.S. Bank N.A. v. Madero*, 80 A.D.3d 751, 752 (N.Y. App. Div. 2011); *U.S. Bank, N.A. v. Collymore*, 68 A.D.3d at 754 (N.Y. App. Div. 2009); *Kluge v. Fugazy*, 145 A.D.2d 537, 538 (N.Y. App. Div. 1988) (plaintiff, the assignee of a mortgage without the underlying note, could not bring a foreclosure action); *Flyer v. Sullivan*, 284 App. Div. 697, 698 (N.Y. App. Div. 1954) (mortgagee's assignment of the mortgage lien, without assignment of the debt, is a nullity); *Beak v. Walts*, 266 App. Div. 900 (N.Y. App. Div.1943).

25 *Silverberg*, at *4.

26 *Id.* at *5.

27 *Id.*

28 N.Y Appellate Div., Second Judicial Dep't, *An Overview of the Appellate Division*, *available at* http://www.courts.state.ny.us/courts/ad2/aboutthecourt.shtml.

29 MERS submitted "extensive briefing and oral argument" in support of its argument that the MERS membership agreement and New York law gave MERS "the authority to assign the mortgage." *Agard*, at *2.

30 *Id.* at *4.

31 Jon Prior, *New York Foreclosure Backlog: 'A Totally Different World*, HousingWire, (May 16, 2011), *available at* http://www.housingwire.com/2011/05/16/new-york-foreclosure-backlog-a-totally-different-world.

32 *In re Lopez,* 2011 BL 32862, at *3, *9 (Bankr. D. Mass Feb. 9, 2011) (where the "Mortgage specifically identified MERS as the mortgagee under the instrument and granted it and its 'successors and assigns' a power of sale," the court found that the current mortgage holder had established proper standing, and that "even though MERS never had possession of the Note, it was legally holding the Mortgage in trust for the Note holder.").

33 *Martinez v. Mortg. Elec. Registration Sys., Inc.*, 2011 BL 35727, at *20 (Bankr. D. Kan. Feb. 11, 2011) (holding that the loan owner's "interest is secured and it has the right to enforce the Note and Mortgage through its agent, MERS, or on its own (by directing its agent to assign the mortgage to it")).

34 On the other hand, state appellate courts in Oklahoma, Kansas, Arkansas, Missouri and Maine "have refused to allow MERS or its assignee to assert rights against the mortgagor because it did not hold the note secured by the mortgage." *BAC Home Loans Servicing, L.P. v. White*, 2011 OK CIV APP 35 (Okla. Civ. App. Dec. 3, 2010).

35 *Silverberg*, at *5.

36 *See, e.g., Martinez*, 2011 BL 35727 at *20 (Bankr. D. Kan. 2011); *Lopez*, 2011 BL 32862 (Bankr. D. Mass. 2011); *Crum v. LaSalle Bank*, N.A., 2009 BL 200796 (Ala. Civ. App. 2010); *Blau v. America's Servicing Company,* 2009 BL 207964 (D. Ariz. Sept. 28, 2009); *MERS v. Saunders*, 2 A.3d 289 (Me. 2010); *Landmark Nat'l Bank v. Kesler*, 216 P.3d 158 (Kan. 2009).

37 For instance, in jurisdictions where courts have refused to permit a foreclosure action brought under the MERS name, lenders have worked with third-party vendors providing assignment and lien-release services to remove the loan from the MERS system and remove MERS's registration as the mortgagee of record. Austin Kilgore, *Court Upholds Use of MERS*, American Banker, Mar. 16, 2011, at 10. Similarly, in April of 2010, Fannie Mae instructed mortgage servicers of MERS loans to file foreclosures in their own name or the name of the trust that owns the loan, and not in the name of MERS. Kate Berry, *Litigation-Wary Lenders Turn Cool Toward MERS*, American Banker, Oct. 29, 2010, at 1.