MERS on the March: Why the Mortgage Electronic Registration System Threatens the Property Rights of Bankrupt Mortgagees*

INTRODUCTION

With more than sixty-five percent of new mortgages and deeds of trust[1] being registered in the Mortgage Electronic Registration System (the "MERS" system[2]), MERSCORP Holdings, Inc. ("MERS") is a titan in the mortgage industry.[3] MERS was founded nearly twenty years ago with an eye towards facilitating mortgage securitization.[4] In a typical mortgage securitization transaction, an

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1. Throughout this paper "mortgage" and "deed of trust" will be used interchangeably as the distinctions between the two are not relevant to the topic at hand.

2. Despite the fact that it is redundant, this paper will refer to the electronic system as "the MERS system." This avoids confusion with the corporation, MERS, Inc., and its parent company, MERSCORP Holdings, Inc., which will be referred to together as "MERS." *See generally An Introduction to the MERS® System, MERSCORP Holdings, Inc., and Mortgage Electronic Registration Systems, Inc.*, MERS® (May 2015), https://www.mersinc.org/media-room-docman/1026-quick-facts/file [http://perma.cc/F7WJ-NYJ9] (explaining what the MERS system is).

3. *See Take 5: Focused on the Future*, MREPORT, May 2014, at 12, http://www.mersinc.org/media-room-docman/53-mers-take-5-handout-final/file [http://perma.cc/84W2-4kHR] ("MERS products have become an integral part of the origination process in today's housing market.").

4. John Patrick Hunt, Richard Stanton & Nancy Wallace, *All in One Basket: The Bankruptcy Risk of a National Agent-Based Recording System*, 46 U.C. DAVIS L. REV. 1, 8 (2012).

investment bank purchases and bundles a large number of mortgages from different lenders, transfers the bundled mortgages to a Special Purpose Entity ("SPE") specifically created to hold them, and then sells ownership interests or bonds secured by the mortgages to a variety of investors.[5] Before MERS, this process was problematic due to the fact that each individual mortgage transfer needed to be recorded with the county recording office.[6] Due to the high volume of mortgage transfers required for a single securitization transaction, the recording process was time-consuming and expensive, and it reduced the overall profitability of the transaction.[7] MERS replaces the traditional recording process by placing its own name in the county records as mortgagee and tracking changes in the beneficial ownership of the mortgage in the MERS system.[8] This allows the mortgage to be transferred between the original mortgagee, the investment bank, and the SPEs without making any changes in the county records. The manner in which MERS facilitates the transfer of mortgages between beneficial owners can be analogized to the way stock brokers hold legal title to stock for the benefit of the actual stockholders and execute transfers on their behalf.[9]

While the MERS system greatly reduces the cost and complexity of executing mortgage-backed securitization transactions, it can create some confusion as to who technically owns the mortgage. In certain scenarios this can be problematic, such as those in which the beneficial owner files bankruptcy before MERS is able to assign the mortgage back to it. At the moment a bankruptcy petition is filed, the debtor's estate is cut off, meaning that all of its assets are placed in a bankruptcy estate for the benefit of its creditors.[10] In most cases, the

5. *Id.* at 8–9.

6. *Id.* at 10–11.

7. *See infra* notes 21, 38 and accompanying text.

8. Hunt, Stanton & Wallace, *supra* note 4, at 11; *see also Myths vs. Facts: The MERS® System, MERSCORP Holdings, Inc., and Mortgage Electronic Registration Systems, Inc.*, MERS® (May 2015), https://www.mersinc.org/media-room-docman/1024-myth-v-fact/file [http://perma.cc/8UAS-UZ2P] ("At closing, the lender and borrower agree to appoint Mortgage Electronic Registration Systems, Inc. (MERS) as the mortgagee on the mortgage or deed of trust. This means that when a MERS® System member sells the loan to another MERS® System member, legal title to the mortgage remains with MERS and the need for an assignment is eliminated.").

9. *See How Safe Are Stock Broker Nominee Accounts?*, INT'L INV., https://the-international-investor.com/investment-faq/stock-broker-account-safety [http://perma.cc/3WDH-LF94].

10. 11 U.S.C. § 544(a)(3) (2012). The provision that authorizes this, section 544 of the Bankruptcy Code, is often referred to as the "strong arm provision," because it allows the bankruptcy trustee to marshal every true asset of the debtor for the repayment of creditors. *Id.*

mortgage would add value to the estate because it can be sold or foreclosed on; however, if MERS has not assigned the mortgage back to its owner prior to the filing, it is unclear who is entitled to the rights that accompany the mortgage at the moment of bankruptcy. Because all property that rightfully belongs to the debtor is immediately made property of the debtor's bankruptcy estate (the pot of money from which creditors can be paid), the first question in the bankruptcy is always "what does the debtor own?"[11] The form of assignment to and from the MERS system has complicated this question somewhat, because, arguably, MERS owns at least some interest in the mortgages registered in its name.[12] For this reason, when the beneficial owner of a MERS-registered mortgage files bankruptcy, the debtor may find that MERS has an interest in the mortgages that the debtor may have previously believed it owned in full. This interest allows MERS to remove mortgages from the bankruptcy estate of the debtor, which will significantly diminish the value of the assets that the debtor can use to reorganize or pay off its creditors.

This paper analyzes the issue of what MERS actually owns in three parts. Part I discusses the structure of MERS and how note holders use the system. In particular, Part I examines the language of a typical deed of trust listing MERS as the mortgagee. Part II examines what MERS actually owns and the potential value of those rights. This Part will also pay special attention to what exactly servicers and loan originators agree to when they utilize MERS as the nominee on their mortgages and deeds of trust, and what effect this agreement may have on the mortgagee's interest in the note that evidences the debt. Finally, Part III examines the effects of that ownership on a troubled servicer's bankruptcy estate. Part III posits that MERS is the true owner of nearly all of the originator's property rights and that those rights are owned in such a way that the trustee or the debtor in possession will be entirely unable to recover them.

I. HOW MERS HAS BEEN USED BY MORTGAGEES

As briefly discussed above, the MERS system functions as a way for mortgagees to transfer the debt connected to a mortgage without having to transfer the mortgage itself. The service that MERS provides is simple in theory: the original mortgagee records the mortgage with MERS as the beneficiary "in nominee" for the real

11. *See id.* (providing that the trustee must answer this question "as of the commencement of the case").

12. For a discussion of how this is possible, see *infra* Part II.

mortgagee.[13] This means that the mortgagee is still the intended beneficiary of the mortgage, but MERS may take any action that it is authorized to take on behalf of the mortgagee.[14] Essentially, MERS acts like a bookmark on title, and the information about the note is entered into the MERS system to be bought and sold.[15] From there, mortgagees can easily transfer their interest electronically to other investors through the MERS system.[16] New assignments of the mortgage do not need to be drafted and recorded, because the party who has the authority to either enforce or assign the current mortgage, MERS, is already the record owner of the mortgage.[17] This simplistic procedure allows for quick transfers of the promissory notes that back the mortgage, and it preserves profits from market fluctuations and recording fees.[18]

Note sales are not a new idea, but mortgage securitization requires an unusual amount of volume to be successful. Instead of merely transferring a single mortgage from one entity to another, loans can be pooled at varying levels of risk, which provides for a diversified portfolio and, theoretically, a significant hedge against risk.[19] The model also allows for mezzanine financing that would not be available in low-dollar, single-property transactions, as the securitization model is set up with an SPE that can sell or finance ownership interests in itself in order to raise capital to purchase the note pools.[20] In order to accomplish this transaction, the notes are usually transferred several times before they are able to enter the SPE; at the very least, they will need to be transferred from the

13. MERS®, MERS® SYSTEM RULES OF MEMBERSHIP, at ii (2015) http://www.mersinc.org/join-mers-docman/979-mers-system-rules-final-1/file [http://perma.cc/YL38-3XFR].

14. *Id.* at 66.

15. *See FAQ*, MERS®, http://www.mersinc.org/information-for-homeowners/faq [http://perma.cc/AZ9M-FPFH].

16. *Id.*

17. Christopher Peterson, *Foreclosure, Subprime Mortgage Lending, and the Mortgage Electronic Registration System*, 78 U. CIN. L. REV. 1359, 1372 (2010).

18. *See* Kevin Hudspeth, *Clarifying Murky MERS: Does Mortgage Electronic Registration Systems, Inc., Have Authority to Assign the Mortgage Note in a Standard Illinois Foreclosure Action?*, 31 N. ILL. U. L. REV. 1, 9 (2010).

19. *See generally* STANDARD & POORS, NEVER UNDERESTIMATE CREDIT RISK IN MORTGAGE COVERED BONDS (Sept. 12, 2011), http://www.standardandpoors.com/spf/upload/Ratings_EMEA/NeverUnderestimateCreditRiskInMortgageCoveredBonds_12Sep2011.pdf [http://perma.cc/3FHS-FA9R] (explaining the risk-rating process for mortgage-backed securities).

20. BOND MKT. ASS'N, AN INVESTOR'S GUIDE TO PASS-THROUGH AND COLLATERALIZED MORTGAGE SECURITIES 1 (2002) [hereinafter AN INVESTOR'S GUIDE], http://www.freddiemac.com/mbs/docs/about_MBS.pdf [http://perma.cc/FMJ4-343M].

originator to the investment bank that collects the mortgages for the pool, and then again to the SPE that will be the beneficial owner.[21] Without a system like MERS that allows for transfer without recording, each transaction would require thousands of mortgage transfers in a short enough time period and at a cheap enough cost to preserve the profits.[22] Because the real estate market can be very volatile, investors may prefer to move quickly in order to reinvest the money and maximize return. The MERS system allows for quick transfers of mortgage rights in a form that would have taken days to draft and record in the past. Because of the time delays and recording fees associated with traditional mortgage assignments, it was a regular practice to leave assignments of mortgages unrecorded.[23]

The recording system can be cumbersome, involving the drafting and signing of grant deeds, usually the filing of physical copies of the deeds with a recorder, the payment of transfer taxes, and of course the possibility for error that comes with repeated transfers.[24] Because there are several crucial documents involved in a mortgage transaction, human error can lead to the loss or destruction of key documents before the recordation can even take effect.[25] There is little evidence that recordation is as fraught with error as detractors claim, but the potential clearly exists, particularly following the foreclosure crisis in the current world of heightened regulation.[26]

However, recording provides many attractive benefits, such as a complete chain of title for purposes of foreclosure and resale.[27] This, coupled with a string of cases that raised the question of whether an unrecorded mortgage could be avoided in bankruptcy, meant that lenders needed to take action to secure their investments.[28] In those cases, the failure of mortgagees to record their interest led to avoidance in bankruptcy and failures to prevail against good-faith purchasers who had been unable to locate the mortgage or its subsequent assignments in the underlying property's chain of title.[29]

21. Hunt, Stanton & Wallace, *supra* note 4, at 9.

22. *Id.*

23. Dale A. Whitman, *A Proposal for a National Mortgage Registry: MERS Done Right*, 78 MO. L. REV. 1, 23 (2013).

24. *See* Peterson, *supra* note 17, at 1365–68 (explaining the traditional property recording system that MERS was created to avoid).

25. Whitman, *supra* note 23, at 52–53.

26. *Id.*

27. *See generally id.* (outlining the benefits for a nationalized recording system).

28. *See generally id.* (collecting cases and statutes denying foreclosures where the mortgage transfer was unrecorded).

29. Peterson, *supra* note 17, at 1394.

In response to these cases and other serious issues that had plagued the industry, several stakeholders in the mortgage industry released a white paper suggesting that an electronic system of tracking mortgages would be preferable to the piecemeal system of requiring each mortgagee to undertake county-by-county recording, including drafting documents that were subject to human error and paying the associated transfer taxes.[30] This white paper made a case for the national electronic property registration system that would later become MERS.[31]

MERS presents itself as the natural solution to the problems of old book-and-paper recording: it is chain of title management 2.0, theoretically offering mortgagees the ability to transfer individual mortgages or large pools of mortgages and their associated notes with just a few clicks of the mouse. In order to avoid the requirement of recording each transfer separately, however, MERS must be the mortgagee listed on the title. In an attempt to accomplish this goal without actually taking title to the underlying property, MERS calls itself the nominee for the true beneficiary of the mortgage.[32] The true beneficiary may or may not appear on the face of the mortgage documents.[33] This allows MERS to be listed as the holder of the mortgage in the chain of title, preventing the necessity of repeated transfers.[34] Once the name of the mortgagee is set as MERS, Inc., the promissory note that accompanies the mortgage can be bundled into the SPE and the debt can be traded through the securitization process without the necessity of recording every transfer.[35]

In basic terms, the transaction with MERS functions as follows: the borrower signs with the originator, and the originator records the mortgage in MERS's name.[36] The originator is then free to transfer the note.[37] The originator can easily transfer it next to the entity that will pool the mortgage with other mortgages of similar or varying risk, and the pool can then be sold to the SPE that is the vehicle for

30. *Id.* at 1368.

31. *Id.*

32. *See* FANNIE MAE/FREDDIE MAC, NORTH CAROLINA–SINGLE FAMILY UNIFORM INSTRUMENT, at 3 (2015) [hereinafter NORTH CAROLINA–SINGLE FAMILY UNIFORM INSTRUMENT], http://www.freddiemac.com/uniform/mers/doc/MERS3034NC.doc [http://perma.cc/FJ37-UHNG].

33. *See An Introduction to the MERS® System*, *supra* note 2 (explaining that MERS can be listed as original mortgagee if agreed to by the parties at the closing of the loan).

34. *See id.*

35. *See* Hunt, Stanton & Wallace, *supra* note 4, at 11–12.

36. Peterson, *supra* note 17, at 1370 n.64 (citing R.K. Arnold, *Yes, There is Life on MERS*, PROB. & PROP., July/Aug. 1997, at 32, 34).

37. *Id.*

securitization.[38] The SPE is funded by investors who purchase either an equity interest in the entity or debt issued by the entity.[39] All of these transfers, including transfers to other SPEs or companies that trade debt, are not registered in the county records (unless the transferee is not a MERS member[40]), but are tracked exclusively online through the MERS system.[41] Instead of having each transfer recorded at the cost of county recording, they can be recorded quickly and electronically through MERS at a rate that recent studies show may be as much as forty dollars less over the life of the loan.[42]

If homeowners miss payments, the consequences are serious—namely, the foreclosure of homeowners' right of redemption and equity in the property. While this is not a remedy that is uniquely provided by MERS, in the event of a foreclosure, MERS is able to foreclose in its own name.[43] This provides the SPEs, which may not have the liquid capital available to fund employees to engage in direct foreclosure management, and which also want to protect the privacy of their investor parties, the opportunity to collect the underlying collateral without the necessity of directly foreclosing on it.[44] In the past, MERS has apparently offered this service to its customer base, and the customers have taken advantage of the anonymity provided.[45] Now, however, a recent revision to MERS's internal policy calls for an assignment to the current note holder so that the note holder can foreclose in its own name.[46] Nevertheless, there is nothing in the agreements between MERS and its clients that states that the membership rules are binding on MERS itself.[47] Even a 2011 consent order entered into between MERS and several federal financial watchdog agencies does not detail how this promise will be enforced.[48] The fact that MERS can foreclose in its own name is

38. *Id.* at 1367.

39. AN INVESTOR'S GUIDE, *supra* note 20, at 1–2 (explaining the types of mortgage securities available).

40. *See* MERS® SYSTEM RULES OF MEMBERSHIP, *supra* note 13, at 8.

41. Hunt, Stanton & Wallace, *supra* note 4, at 9–11.

42. *See* Peterson, *supra* note 17, at 1371 n.67.

43. Hunt, Stanton & Wallace, *supra* note 4, at 11.

44. Peterson, *supra* note 17, at 1362–63.

45. *Id.*

46. *See* MERS® SYSTEM RULES OF MEMBERSHIP, *supra* note 13, at 34–36.

47. *See* MERS®, MERS® SYSTEM RESIDENTIAL MEMBERSHIP APPLICATION FOR LITE, GENERAL OR PATRON CATEGORIES, (2015) [hereinafter MERS® SYSTEM RESIDENTIAL MEMBERSHIP APPLICATION], https://www.mersinc.org/join-mers-docman/1037-mers-system-marketing-brochure [https://perma.cc/V529-5TGZ].

48. *See generally In re* MERSCORP, Inc., OCC No. AA-EC-11-20 (Apr. 13, 2011) (consent order). This absence is interesting, given the consent order's vehement condemnation of MERS's failure to exercise oversight in its foreclosure practice. *Id.* at 5.

considered key to the securitization practice because of the anonymity and detachment from the proceedings that it provides to the SPEs that hold the pools of notes.[49] MERS's ability to foreclose in its own name keeps the SPE's name out of court dockets, removing the SPEs and their beneficial owners from the negative publicity associated with home foreclosures.[50]

The securitization model is "based on the premise that buyers of mortgage-backed securities are entitled to the flow of funds from the underlying secured notes . . . ."[51] The securitization, therefore, takes place in a manner that is intended to be bankruptcy remote; that is, if anyone in the securitization chain (e.g., the loan originator or the entity that pooled the loans) declares bankruptcy, the investors' interests in the securities backed by the loans should not be affected.[52] However, in any bankruptcy, even to the extent that the entity undergoing the restructuring is intended to be bankruptcy remote, the first question that must be asked remains: what does the debtor own? As the rest of this paper will examine, the answer may not be so simple. MERS, by allowing itself to be recorded in the chain of title in place of the true mortgagee, has allowed itself to take on several key property rights including, as this section has explained, the right to foreclose in its own name and the right to assign the mortgage at any time. Indeed, even after a bankrupt servicer had the bankruptcy court terminate its contract with MERS, MERS assigned mortgages away from the servicer and into other entities.[53]

The securitization process is set up to generate funds for investors in one of two ways. First, an investor may purchase an interest in the SPE that owns the mortgage.[54] This allows the investor to reap the profits that come into the entity from the borrower's timely payments, or, if the borrower defaults and is foreclosed on, from the value of the underlying property.[55] Alternatively, and second, if the investors would prefer a lump-sum payment or are looking to wind down the SPE, the entity may sell its entire portfolio

49. Peterson, *supra* note 17, at 1362–63.

50. *See id.* at 1363 ("Throughout history, executioners have always worn masks. In the American mortgage lending industry, MERS has become the veiled man wielding the home foreclosure axe.").

51. Hunt, Stanton & Wallace, *supra* note 4, at 15.

52. *Id.* at 15–17.

53. *In re* Marron, 462 B.R. 364, 372 (Bankr. D. Mass. 2012), *aff'd*, 499 B.R. 1 (D. Mass. 2013).

54. *See* Peterson, *supra* note 17, at 1372.

55. *See id.*

of mortgages as a "pool."[56] The pools are freely bought and sold among the SPEs.[57] The benefit to these SPEs, aside from the fact that it streamlines the process of title transfer, is that it allows the entity to avoid paying widely variable recording fees, which reduce profits in the volatile real estate industry.[58] Instead, MERS allows promissory notes to be generated and resold quickly and cheaply.[59]

The mortgage securitization process has been widely criticized as significantly contributing to the economic collapse and foreclosure crisis of 2008.[60] At least partly in response to this criticism, MERS changed its foreclosure policy.[61] Before the housing crisis, it was MERS's regular practice to undertake foreclosures as the mortgagee.[62] However, MERS was warned as part of a settlement agreement with several federal regulators that this practice was contributing to wrongful foreclosures, and this course of action was later abandoned.[63] MERS's practice of foreclosing in its own name was problematic because it often sped up foreclosures without the oversight necessary to ensure that the foreclosures were not wrongful.[64] As a result of MERS abandoning this practice, the SPEs now have to assume the expense of providing foreclosure supervision and management themselves.

In summation, MERS exists primarily as a device to transfer mortgage interests in real property without having to go through the

56. *See generally* AN INVESTOR'S GUIDE, *supra* note 20 (explaining the system of mortgage-backed securities and how returns are distributed).

57. *Id.* at 13 (discussing the liquidity of the market).

58. *See* Peterson, *supra* note 17, at 1362; Michael Powell & Gretchen Morgenson, *MERS? It May Have Swallowed Your Loan*, N.Y. TIMES (Mar. 5, 2011), http://www.nytimes.com/2011/03/06/business/06mers.html?pagewanted=all&_r=0 [http://perma.cc/7SHH-J2GL].

59. *See* Peterson, *supra* note 17, at 1362, 1371.

60. Powell & Morgenson, *supra* note 58; *see also* Hunt, Stanton & Wallace, *supra* note 4, at 3–4. This collapse decimated black and Latino wealth in the United States, erasing more than half of each group's assets in the span of only a few years. *See* THOMAS SHAPIRO, TATJANA MESCHEDE & SAM OSORO, INST. ON ASSETS & SOC. POLICY, THE ROOTS OF THE WIDENING RACIAL WEALTH GAP: EXPLAINING THE BLACK-WHITE ECONOMIC DIVIDE 4 (Feb. 2013), http://iasp.brandeis.edu/pdfs/Author/shapiro-thomas-m/racialwealthgapbrief.pdf) [http://perma.cc/9R3Y-AT67].

61. *Compare* Peterson, *supra* note 17, at 1362 ("MERS also frequently attempts to bring home foreclosure proceedings in its own name . . . . "), *with* MERS® SYSTEM RULES OF MEMBERSHIP, *supra* note 13, at 34–36 (mandating transfers back to the beneficial holder of the note and mortgage).

62. Peterson, *supra* note 17, at 1362.

63. *In re* MERSCORP, Inc., OCC No. AA-EC-11-20, at 5 (Apr. 13, 2011) (consent order).

64. *See id.* (finding that MERS lacked sufficient governance to adequately examine foreclosure transactions).

process of repeatedly recording title transfers. It allows for mortgages to be transferred several times in rapid succession as needed for securitization deals that must be bankruptcy remote. The system also serves as an important tool for individual lenders who may want to purchase blocks of notes for investment or servicing. MERS allows a quicker and easier transfer of property rights by taking at least some of those rights "in nominee," a status which allows it to exercise certain rights on behalf of the ultimate beneficiary of the related promissory note. However, recent cases have indicated that MERS may not only be taking these rights "in nominee." Instead, MERS may be the constructive owner of many of the mortgages in its system.

II. WHAT DOES MERS ACTUALLY OWN?

Despite the new internal rule that ostensibly prohibits MERS from foreclosing in its own name, there is nothing in the mortgage or note that requires this result. A sample deed of trust containing the provisions that government-backed loan purchaser and reseller Freddie Mac requires mortgage originators to use in North Carolina[65] when MERS is listed as the original mortgagee emphasizes that MERS is the sole beneficiary of the instrument.[66] While the document is unequivocal that MERS is only the nominee for the lender, it also states that the company "has the right: to exercise any or all of those interests, including, but not limited to, the right to foreclose and sell the Property; and to take any action required of Lender including, but not limited to, releasing and canceling this Security Instrument."[67]

As a result of these rights, MERS possesses all legal interest in the property subject to the mortgage, albeit in nominee for the originating lender or current note holder. MERS has the right to foreclose, the right to assign, and the right to cancel a mortgage; functionally, MERS has all the rights traditionally associated with mortgagees.[68] Practice shows this same result: MERS has repeatedly

65. The North Carolina version was selected because the MERS-compliant language contained therein does not differ materially from any other state's, and it will hopefully be the state of keenest interest to practitioners reading this paper.

66. *See* NORTH CAROLINA–SINGLE FAMILY UNIFORM INSTRUMENT, *supra* note 32, at 3; *FAQ*, MERS®, http://mersinc.org/join-mers/faq#momlanguage [http://perma.cc/7975-6HC5] (stating that when listing MERS as original mortgagee, a strategy the company recommends, the language *must* match the Fannie Mae and Freddie Mac versions for each individual state).

67. NORTH CAROLINA–SINGLE FAMILY UNIFORM INSTRUMENT, *supra* note 32, at 3.

68. MERS has the right to foreclose, Peterson, *supra* note 17, at 1385–86, the right to assign, MERS® SYSTEM RULES OF MEMBERSHIP, *supra* note 13, at 12–13, and the right to cancel, NORTH CAROLINA–SINGLE FAMILY UNIFORM INSTRUMENT, *supra* note 32, at 3.

taken the position that it is able to foreclose in its own name.[69] In these instances, it is common for MERS to rely on the language discussed above—specifically, that it is entitled to all rights of the lender in order to assert its standing to foreclose without assigning the note.[70] However, after being charged by multiple financial agencies with improperly initiating foreclosures,[71] the policy shifted to the current policy of assigning the mortgage before foreclosure.[72] This policy theoretically forces the beneficial owner of the mortgage to take responsibility for the foreclosure action and provide the management and governance necessary to preserve its own rights under the deed of trust.[73]

Despite its notable and lofty goals, the new policy is not likely to be binding in the event that MERS does not assign the mortgage prior to a foreclosure. It is clear from the language of the deeds of trust and mortgages that MERS has exactly the same powers as a true mortgagee.[74] Furthermore, nothing in MERS's membership rules prohibits the company from selling or assigning mortgages without the consent of the mortgagee.[75] Although a mortgagee may allege breach of contract, the actual contract that entities sign with MERS expressly states that its rules may be amended at any time, without input from the mortgagees.[76] Without any apparent binding obligation on MERS, MERS has little incentive, aside from the threat of negative publicity, to abide by the expectations of its clients to protect their interests in the mortgage. The fact that assignments have apparently been mishandled before with no penalty to MERS indicates that this lack of commitment to protecting its clients' interests represents a significant risk to lenders, servicers, originators, and the SPEs that hold pools of mortgage notes.[77] While the empirical evidence has not yet developed to show the number of mortgages that may have been affected by MERS's potential claims of ownership, recent cases have arisen that cast doubt on the supposition that

69. *See* Hunt, Stanton & Wallace, *supra* note 4, at 38.

70. *See id.*

71. *In re* MERSCORP, Inc., OCC No. AA-EC-11-20, at 5 (Apr. 13, 2011) (consent order).

72. *See* Hunt, Stanton & Wallace, *supra* note 4, at 38.

73. *See* Peterson, *supra* note 17, at 1362–63 (explaining that the trusts have few employees and prefer not to foreclose in their own names).

74. *See* Hunt, Stanton & Wallace, *supra* note 4, at 38–39.

75. *See id.*

76. MERS® SYSTEM RESIDENTIAL MEMBERSHIP APPLICATION, *supra* note 47.

77. *See* Chase Plaza Condo. Ass'n v. JPMorgan Chase Bank, N.A., 98 A.3d 166, 171 (D.C. 2014) (discussing the fallout from wrongful MERS assignments to improper subsidiaries of a bankrupted servicer and upholding those transactions).

MERS has no interest in the mortgages that it contains.[78] This troubling evidence has led scholars to question the effects of a potential MERS bankruptcy.[79] However, as of yet, scholars have not seriously considered the risk posed to the bankruptcy estates of MERS-using mortgagees. In order to assess that risk, however, one must consider how the transfer of mortgages to and from MERS is accomplished and how the rights of the various parties involved may be affected.

A. Does the Mortgage Follow the Note? Or Is It the Other Way Around?

A transfer of an interest in a mortgage has traditionally been accompanied by a transfer of an interest in the promissory note secured by the mortgage.[80] In many states, the axiom that "the deed of trust follows the note" means that whoever holds the note has the automatic and exclusive right to foreclose.[81] The right to foreclose is one of the ultimate rights that a mortgagee has in a property: it has the right to almost completely wipe out the borrower's interest and then sell the property at a judicially mandated sale, where it is allowed to bid up to the entire amount that it is owed.[82] The mortgage must follow the note, if only out of a sense of fairness, because the party that is owed the money should be the party that is allowed to foreclose. It follows that the party that is allowed to foreclose should also be able to exercise the other rights traditionally granted to mortgagees, such as the right to assign the mortgage to any party.

For instance, a recent Washington State federal district court case found that MERS, because it was listed as the nominee beneficiary under the deed of trust but lacked possession of the note,

78. *See infra* notes 133–39 and accompanying text (discussing the split that is evolving over MERS's ability to assign notes that were previously believed to be the assets of a bankrupt mortgagee).

79. *See generally* Hunt, Stanton & Wallace, *supra* note 4 (challenging the assumption that MERS-registered mortgages would not be available to MERS's creditors if MERS declared bankruptcy).

80. *See* Peterson, *supra* note 17, at 1379 ("Mortgages are inseparable from promissory notes because of the 'dependent and incidental relation' that a mortgage has with the obligation that it secures." (quoting Carpenter v. Longan, 83 U.S. 271, 275 (1872))).

81. *See, e.g.*, Scheider v. Deutsche Bank Nat'l Tr. Co., 572 F. App'x 185, 190 (4th Cir. 2014) (explaining that Virginia and South Carolina both follow the rule that the holder of the note also holds the mortgage, and the two cannot be split).

82. *See e.g.*, Basil H. Mattingly, *The Shift from Power to Process: A Functional Approach to Foreclosure Law*, 80 MARQ. L. REV. 78–80 (outlining the foreclosure process, including the process by which mortgagees may bid at the foreclosure sale, also known as "credit bidding").

was not permitted by the statute governing deeds of trust to be the actual beneficiary of the agreement with standing to foreclose.[83] Courts tend to be anxious about the separation of the note and the mortgage, often going out of their way to prevent such a result[84] because the unity of the mortgage and the underlying obligation is what generally creates the ability to foreclose.[85] In fact, in many states, "it is legally impossible to separate the mortgage from the note, even by means of a contrary agreement."[86] If the note becomes separated from the mortgage, the note holder is typically allowed to bring an equitable suit to force an assignment.[87]

Despite having the weight of the Supreme Court behind it, the rule that "the mortgage follows the note" is not applied in all foreclosure cases.[88] In many states, the logic is extended in the opposite direction, allowing the mortgagee to assign the note.[89] In these states, MERS's ability to assign the mortgage also provides it with the ability to assign the note because, as the "nominee" beneficiary, it is able to exercise all of the powers of a true mortgagee.[90] This is bolstered by the language of the deed of trust or mortgage, which grants MERS any and all of the rights of the lender.[91] These rights, of course, include the right to act upon the underlying indebtedness in the event of a default and the free transfer of that ability, just as if MERS were the holder in due course of the promissory note.

Even in states where the mortgage is said to follow the note, many jurisdictions have adopted additional respect for the freedom of contract of the parties and allowed them to contract around the basic

83. Knecht v. Fid. Nat'l Title Ins. Co., 2014 U.S. Dist. LEXIS 113131, at *7 (W.D. Wash. Aug. 14, 2014).

84. Whitman, *supra* note 23, at 4–5.

85. Christopher Peterson, *Two Faces: Demystifying the Mortgage Electronic Registration System's Land Title Theory*, 53 WM. & MARY L. REV. 111, 199 (2011).

86. Carpenter v. Longan, 83 U.S. 271, 274 (1872) ("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."); *see also* Whitman, *supra* note 23, at 6–7 (collecting more authorities). *But see, e.g.*, *In re* Mortg. Elec. Registration Sys., Inc., 754 F.3d 772, 784 (9th Cir. 2013) (stating that the rule of *Carpenter* is arguably not reflected in Arizona, California, and Nevada state law, though ultimately avoiding the issue).

87. Whitman, *supra* note 23, at 7–8.

88. *See* John Patrick Hunt, *Should the Mortgage Follow the Note?*, 75 OHIO ST. L.J. 155, 168 (2014).

89. *See* Hunt, Stanton & Wallace, *supra* note 4, at 41 (collecting cases).

90. *Id.* at 40–41.

91. *See* NORTH CAROLINA–SINGLE FAMILY UNIFORM INSTRUMENT, *supra* note 32.

rule.[92] In these states, the fact that the deed of trust and mortgage agreements name MERS as the original mortgagee and give MERS all of the rights of a mortgagee allows for the splitting of the note and mortgage.[93] For instance, Massachusetts recently upheld the ability of MERS to assign a mortgage to a party other than the note holder, due to the lack of language in the mortgage documents restricting transfer.[94] In such a case, MERS would gain the ability to transfer the mortgage to another mortgagee without giving the original lender recourse to any party but MERS itself.[95]

In states such as Massachusetts, where the right to foreclose exists independent of an interest in the underlying indebtedness,[96] MERS could have immediate access to the property regardless of the underlying note simply by virtue of holding the mortgage.[97] The holder of the note would be forced to go after MERS to recover its security interest. Meanwhile, if the holder of the note wanted to retrieve the collateral, it would need to simultaneously pursue a debtor who might be countersuing for wrongful foreclosure based on the note holder's lack of mortgage. Given that MERS is apparently within its rights to foreclose and deprive the note holder of its interest in the collateral, there is a huge problem for note holders in using the MERS system. However, it is unlikely that MERS would take advantage of this opportunity to the detriment of its clients. In fact, the issue only seems to arise as a result of bankruptcies, when the mortgages happen to be inadvertently mis-assigned.[98]

While these theories take different routes, they all arrive at the same destination: MERS is a party with the same rights as the mortgagee, and it is able to give and take title to the property at its option. The skeptical reader may now wonder whether courts would in fact uphold such a result. However, each of these avenues has been tried in foreclosures and motions to remove property from a bankruptcy estate so that it can be foreclosed on, and, in each case, MERS was trying the case in its own name.[99] In many cases, MERS was successful even at transferring notes by the transfer of the

92. Hunt, Stanton & Wallace, *supra* note 4, at 50–51.

93. *Id.*

94. Shea v. Fed. Nat'l Mortg. Ass'n, 87 Mass. App. Ct. 901, 903 (2015).

95. *See id.*

96. *In re* Marron, 462 B.R. 364, 376–77 (Bankr. D. Mass. 2012), *aff'd*, 499 B.R. 1 (D. Mass. 2013).

97. *Id.* at 374.

98. *See* Chase Plaza Condo. Ass'n v. JPMorgan Chase Bank, N.A., 98 A.3d 166, 171 (D.C. 2014).

99. *See* Hunt, Stanton & Wallace, *supra* note 4, at 49–54.

mortgage.[100] Sometimes MERS was rebuffed,[101] but these cases are the exception rather than the rule.[102] Originators, servicers, and MERS often try to avoid unpalatable results—such as making the mortgage avoidable or losing priority against future recorded transfers—by listing the promissory note in MERS's name as well to ensure that continuity will exist regardless of future intra-system transfers.[103] This represents a significant transfer of the interests in the mortgage and note to MERS, giving it the right to assign, foreclose, and take any other action with respect to both mortgage and note.

Because of the risk that an improper transfer will be upheld by courts, there is no guarantee that a lender would win any suit to recover property that MERS has assigned, even though this author could find no instance of the issue coming before a court.[104] The parties clearly contracted for the result that MERS possesses for itself all of the powers of the original lender.[105] A court that gives value to the freedom of contract may force the parties to be bound by the result that they ostensibly bargained for, which is MERS's complete ownership of the mortgage and the rights attendant thereto. Some courts have reasoned that when parties sign documents granting

100. *Id.*

101. *See, e.g.*, *In re* Agard, 444 B.R. 231, 250 (Bankr. S.D.N.Y. 2011) (citing cases holding that simple "nominee" status was not sufficient to allow MERS the right to assign a mortgage to be enforced by the assignee, but also collecting cases holding that the nominee status combined with mortgage documents or some other proof was sufficient).

102. *See* Hunt, Stanton & Wallace, *supra* note 4, at 41 n.175 (collecting cases from a variety of states upholding the ability to transfer the promissory notes associated with mortgages).

103. *See, e.g.*, Motion for Relief from Automatic Stay Under Section 362 of the Bankruptcy Code with Respect to Real Property Located at 7665 Golden Lantern Ct, Las Vegas, NV 89139, *In re* New Century TRS Holdings, 1:07-bk-10416 (Bankr. D. Del. June 4, 2008), ECF No. 6937 [hereinafter Motion for Relief from Automatic Stay]; Order Terminating Automatic Stay Under Section 362 of the Bankruptcy Code with Respect to Real Property Located at 7665 Golden Lantern Ct, Las Vegas, NV 89139, *In re* New Century TRS Holdings, 1:07-bk-10416 (Bankr. D. Del. June 4, 2008), ECF No. 7787 [hereinafter Order Terminating Automatic Stay] (granting relief from the automatic stay for a residential property mortgage that was part of the estate in a servicer bankruptcy, based on the fact that MERS was the beneficiary of both the note and mortgage of the senior lien).

104. There are cases where MERS was allowed to take into its own assets mortgages and notes that had been transferred to it, presumably in nominee status, and remove them from the control of the originator. *See* Motion for Relief from Automatic Stay, *supra* note 103. However, because there was no response from the debtor in that case and the matter was presumably handled at a hearing, it is impossible to know whether debtors contested the removal of the assets from the estate or not.

105. *See* NORTH CAROLINA–SINGLE FAMILY UNIFORM INSTRUMENT, *supra* note 32.

MERS "any and all rights of the lender" the parties can and should be held to that result.[106]

Furthermore, principles of estoppel may prevent a loan originator from arguing after the fact that MERS lacks the ability to assign mortgages or even notes.[107] To the extent that a loan originator has held MERS out to be the true owner of the mortgage or the note, principles of estoppel will apply.[108] The lender will thereafter be prevented from arguing that it alone has title to the property without a serious change in circumstances.[109] Though this possibility has previously been examined in the context of a potential MERS bankruptcy,[110] the same charges have worrying implications for lenders who have had MERS foreclose or take some action in its own name instead of in the lender's name. Once the beneficial owner has held out MERS as the party with the power to enforce the mortgage and the note, the owner's rights will be seriously damaged.[111]

The end result of this examination seems to be that MERS owns far more than its users and supporters seem to believe.[112] The large market share that MERS enjoys is clear evidence that originators and servicers either are willing to accept these serious loss risks or do not suspect MERS's broad contract rights to be applied to them. The inconsistent application of MERS's contract rights as both an agent of the beneficiary and the outright owner seems to create an odd result where MERS could potentially own nearly every mortgage currently registered with it. Despite assertions by activists that MERS's "robosigning" practices could lead to an avoidance of foreclosures,[113] courts have not always agreed.[114] MERS's practice of assigning mortgages without note holder consent has already created severe

106. *See* Hunt, Stanton & Wallace, *supra* note 4, at 39 n.165 (collecting cases where courts have relied on the "any or all" language in MERS's standardized deeds of trust and mortgages to grant MERS the ability to assign and foreclose mortgages in the system); *see also id.* at 41–42 (explaining that MERS has the same rights as a true owner, per the terms of its agreement).

107. Hunt, Stanton & Wallace, *supra* note 4, at 47.

108. *Id.*

109. *Id.*

110. *Id.*

111. *See id.*

112. *See, e.g.*, Kerri Ann Panchuk, *MERS Remains a "Lawful Beneficiary" After All These Years*, HOUSINGWIRE (Jan. 8, 2014), http://www.housingwire.com/articles/print/28511-mers-remains-a-lawful-beneficiary-after-all-these-years [http://perma.cc/P4F5-6U2T] (discussing the success of MERS's claims to being a beneficiary of a mortgage).

113. STRIKE DEBT, THE DEBT RESISTER'S OPERATIONS MANUAL 81–96 (2014), http://strikedebt.org/drom/chapter-five/ [http://perma.cc/7KU2-RPXZ].

114. *See* Peterson, *supra* note 17, at 1362.

problems when homeowners and other parties try to figure out exactly where property interests lie.[115]

III. EFFECT ON THE BANKRUPTCY ESTATE OF A MERS-COMPLIANT ENTITY

As discussed in the beginning of this piece,[116] the first question that must be answered in a bankruptcy is "what does the debtor own?" From there, the bankruptcy court will issue an automatic stay, preventing any voluntary or involuntary transfers from the debtor's total property (the "property of the estate").[117] Although the automatic stay is a powerful and vital debtor protection, it can only protect interests that the debtor actually owns at the moment of the filing.[118] Given that the ownership rights of MERS are so broad, one wonders what rights actually remain for the debtor that ostensibly owns mortgages listed in the MERS system. Despite the fact that mortgagees have gone bankrupt since the economic crash of 2007 and 2008,[119] the issue of what exactly such an entity can preserve for the benefit of creditors in its estate has not yet been litigated.[120] This Part attempts to answer this looming question by demonstrating that the MERS-using entity will be able to recover little, if any, of its investment from MERS through bankruptcy because it inadvertently signs away those rights at the moment it lists MERS as the beneficiary on its mortgage or deed of trust.

A. Rejecting the MERS Contract Does Not Prevent Postbankruptcy Assignments of Mortgages

The first question that a mortgagee must answer when it files for bankruptcy is whether it will accept or reject its executory contract with MERS. Under section 365(d)(2) of the Bankruptcy Code, a debtor in possession in a Chapter 11 reorganization has the choice to

115. *See* Chase Plaza Condo. Ass'n v. JPMorgan Chase Bank, N.A., 98 A.3d 166, 171 (D.C. 2014).

116. *See supra* Introduction.

117. 11 U.S.C. § 362(a)(2) (2012).

118. *See id.* § 44.

119. *See, e.g.*, *In re* New Century TRS Holdings, 465 B.R. 38, 42 (Bankr. D. Del. 2012); *In re* Washington Mutual, 442 B.R. 314, 322 (Bankr. D. Del. 2011).

120. As will be discussed *infra* at notes 128–32 and accompanying text, MERS has been able to remove some assets from the bankruptcy estate of New Century TRS Holdings, Inc. However, the removal of these assets does not appear to have been contested by the debtor and instead had to be contested by the homeowners who were later foreclosed on with mixed success.

accept or reject contracts deemed "executory."[121] In the world of bankruptcy, an executory contract is one in which there are substantial unperformed obligations on both sides.[122] The nature of these obligations is such that, if one side fails to perform, there will be a material breach that would excuse the performance of the other.[123] A rejection represents a repudiation of the debtor's obligations under the contract and, effectively, a cancelation of the contract.[124] Such a rejection is treated as a breach and is used to excuse the party whose contract is being rejected from continuing to perform.[125]

MERS itself has argued that the contract is executory and has sought to force a debtor in possession to either accept or reject the use of the service and the commensurate fees.[126] Once the debtor rejected the service, MERS was able to have the unpaid fees paid at administrative priority—that is, paid before all other expenses and creditors in the settlement of the bankruptcy estate.[127] If it is true that the contract with MERS is executory, then the question becomes: what happens when the debtor rejects the MERS contract?

Recently, in the contentious mortgage-servicer bankruptcy, *In re New Century TRS Holdings, Inc.*,[128] the debtor, who had already filed for bankruptcy, had been using the MERS system to transfer the mortgages that it owned that were held in the system during its liquidation efforts without paying MERS's transaction fees.[129] This

121. 11 U.S.C. § 365(d)(2).

122. Vern Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 MINN. L. REV. 439, 460 (1973).

123. *Id.*

124. *See* 11 U.S.C. § 365(h)(1)(A).

125. *See id.* § 365(g).

126. *See* Motion of Mortgage Electronic Registration Systems, Inc. and Merscorp, Inc. for Entry of an Order (I) Compelling Assumption or Rejection of Executory Contract, or Modifying the Automatic Stay; and (II) Compelling Payment of Administrative Expense, *In re* New Century TRS Holdings, 1:07-bk-10416 (Bankr. D. Del. Feb. 26, 2008), ECF No. 5050.

127. Order Granting Motion of Mortgage Electronic Registration Systems, Inc. and Merscorp, Inc. for Entry of an Order (I) Compelling Assumption or Rejection of Executory Contract, or Modifying the Automatic Stay; and (II) Compelling Payment of Administrative Expense, *In re* New Century TRS Holdings, 1:07-bk-10416 (Bankr. D. Del. Apr. 9, 2008), ECF No. 5763.

128. *See generally id.* (granting the motion by MERS to compel the opposing party to accept or reject the executory contract).

129. *See* Certification of Counsel Regarding Motion of Mortgage Electronic Registration Systems, Inc. and Merscorp, Inc. for Entry of an Order (I) Compelling Assumption or Rejection of Executory Contract, or Modifying the Automatic Stay; and (II) Compelling Payment of Administrative Expense, *In re* New Century TRS Holdings, 1:07-bk-10416 (Bankr. D. Del. Apr. 8, 2008), ECF No. 5754 [hereinafter Certification of Counsel Regarding Motion for Entry of an Order].

use of the system without either accepting or rejecting the executory contract and without paying the required fees brought MERS into the litigation against the debtor.[130] MERS ultimately won the right to require the debtor to either accept or reject the contract, and the debtor chose to reject the contract.[131] Despite the rejection of the contract and the ostensible protection of an automatic stay over the debtor's property, MERS proceeded to assign several mortgages out to other servicers.[132]

Something of a split seems to be evolving over what happens next. In Texas, two recent cases held that these assignments were valid.[133] However, the Supreme Court of Rhode Island recently held that assignments completed in spite of the servicer bankruptcy were invalid.[134] The reason for the tension seems to be competing rules about the nature of assignments made without agency, which MERS lacked at the time because the debtor had repudiated its contract with MERS[135] and was consequently unable to use the MERS system. In Texas, the rule is that such assignments are merely voidable and only voidable by the company who was defrauded by the assignment made without agency.[136] In this case, the company that was defrauded would seem to be the original owner of the mortgage, the bankrupt servicer. With that entity no longer around to protest such treatment, Texas courts upheld the assignments.[137] In Rhode Island, however, the rule is that an assignment without authority is automatically void as against all parties whose rights would be affected by a valid assignment.[138] The assignment was, therefore, automatically invalid and the plaintiff whose house had been foreclosed on was able to proceed with her challenge to the assignment and thereby to the assignee's ability to foreclose.[139]

130. *Id.*

131. Newton v. New Century Mortg. Corp., 2014 WL 7016133, at *1 (W.D. Tex. Dec. 11, 2014).

132. *See, e.g.*, *id.*; Applin v. Deutsche Bank Nat'l Tr., 2014 WL 1024006, at *5 (S.D. Tex. Mar. 17, 2014). *But see* DiLibero v. Mortg. Elec. Registration Sys., Inc., 108 A.3d 1013, 1017 (R.I. 2015) ("A void contract is void as to everybody whose rights would be affected by it if it were valid." (quoting 17A AM. JUR. 2D *Contracts* § 10 (2004))).

133. *Newton*, 2014 WL 7016133, at *5; *Applin*, 2014 WL 1024006, at *8.

134. *DiLibero*, 108 A.3d at 1017.

135. *See id.*

136. *Applin*, 2014 WL 1024006, at *8.

137. *Id.*; *Newton*, 2014 WL 7016133, at *1.

138. *DiLibero*, 108 A.3d at 1017.

139. *Id.* The plaintiff's ability to challenge the foreclosure on the basis of a faulty assignment appears to be a tenet of Rhode Island law, but that is not true for many other states.

Regardless of the theory applied, these cases illustrate a special danger of non-bankruptcy-remote servicers utilizing MERS: MERS is clearly able to assign the mortgages without the debtor's assent, despite the protections that bankruptcy offers to a debtor, including the prohibition on involuntary transfers that are not authorized by the bankruptcy court. Whether those assigned mortgages may be enforced is a state-by-state question. Although Texas has at least provided clarity and held the assigned mortgage to be enforceable,[140] most states have yet to reach the issue of whether MERS's violation of the automatic stay by assigning properties out of debtors' bankruptcy estates causes a defect which removes the note holder's right to foreclose. The next portion of this piece examines the specific risks created by MERS's ability to assign mortgages in contravention of the established norms of bankruptcy.

B. The Mortgages Assigned to MERS Will Not Necessarily Be Part of the Bankruptcy Estate

The provision of the Bankruptcy Code generally referred to as the "strong arm provision," section 544, allows the bankruptcy trustee (or the debtor in possession in a reorganization) to exercise all of the rights of the debtor that would be available to either a judgment lien creditor or a good-faith purchaser in bankruptcy.[141] As has just been shown, however, the rights of a MERS-using mortgagee may not be as transferrable as initially thought when the MERS system was created. Or, more to the point, they may end up transferrable only by MERS itself.[142]

MERS owns significantly more than the original deal between the loan originator and MERS seems to have contemplated. As examined above, MERS possesses the right to foreclose in its own name and to easily assign the mortgage and note out of its system without the consent of the original mortgagee.[143] In practice, MERS has been quick to remove assets that were assigned to it from the bankrupt mortgagee's protected estate.[144] In the case of one property

140. *Applin*, 2014 WL 1024006, at *8.

141. 11 U.S.C. § 544 (2012).

142. *Applin*, 2014 WL 1024006, at *9 ("The bankruptcy court's order does not divest MERS of interests it previously acquired with regard to properties on which [the bankrupt servicer] made loans as to which MERS was nominee prior to [the servicer's] bankruptcy." (quoting Khan v. Wells Fargo, N.A., 2014 WL 200492, at *8 (S.D. Tex. 2014))).

143. *See supra* Part II.

144. *See, e.g.*, Motion for Relief from Automatic Stay, *supra* note 103, at 4. In fact, the *In re New Century* bankruptcy docket has more than a dozen motions by MERS to

contested in the bankruptcy of servicer and mortgagee New Century, the company originated a mortgage in its own name to secure repayment of a debt used to purchase a residential property.[145] New Century transferred both the note and the mortgage to MERS at some point prior to New Century's bankruptcy, and both remained in MERS's possession.[146]

In support of its motion to remove New Century's interest in the property that had previously been under the protection of the automatic stay, MERS argued that the transfer to MERS to enter the mortgage into the system represented a transfer of the entire first mortgage to MERS.[147] Therefore, MERS argued, because New Century's only remaining interest in the property was in a completely underwater second mortgage, New Century lacked equity in the property.[148] Lack of equity, or ownership value, in a property is a key factor bearing on the ability to remove an asset from the protection of the bankruptcy estate.[149] MERS's motion, asking the court to allow it to foreclose on the property and reap the benefits, despite the fact that it was put into the system by a now-bankrupt originator, was granted using the suggested order provided by MERS itself.[150] This result should be troubling to MERS's defenders who claim that its only role is to speed along the process and that it no longer forecloses in its own name.[151] If these claims were true, then why is MERS fighting so hard to remove mortgages, and the value attendant in the underlying properties, from its constituents' bankruptcy estates?

These results—and the fact that MERS clearly has more than a nominal interest in the mortgages that it is assigned[152]—demonstrate that MERS, at the very least, takes a clearly actionable form of legal

remove the automatic stay for certain parcels of residential property. *In re* New Century TRS Holdings, 1:07-bk-10416 (Bankr. D. Del. Apr. 2, 2007).

145. Motion for Relief from Automatic Stay, *supra* note 103, at 1–2.

146. *Id.* at 2.

147. *Id.*

148. *Id.*

149. 11 U.S.C. § 62(d) (2012) ("On request of a party in interest and after notice and a hearing, the court shall grant relief from the [automatic stay] . . . such as by terminating, annulling, modifying, or conditioning such stay . . . [if] (A) the debtor does not have an equity in such property; and (B) such property is not necessary to an effective reorganization.").

150. *See generally* Motion for Relief from Automatic Stay, *supra* note 103 (suggesting language for MERS's requested order for relief); Order Terminating Automatic Stay, *supra* note 103 (adopting the proposed language from MERS's motion).

151. HousingWire Staff, *MERS to Members: Don't Foreclose in Our Name*, HOUSINGWIRE (Feb. 17, 2011, 11:05 AM), http://www.housingwire.com/articles/11701-mers-members-don%E2%80%99t-foreclose-our-name [http://perma.cc/K9DG-4DSY].

152. *See supra* Part II.

title to the mortgages that are assigned to it, provided that the mortgages use the standard MERS language.[153] The cases also demonstrate that the title that MERS takes is sufficient to foreclose in its own name,[154] to assign the mortgage outside of the mortgagee's bankruptcy,[155] and even to assign mortgages that are supposedly protected by the automatic stay over the property of the estate.[156]

Given that the mortgages are all listed in MERS's name, it remains to be seen how the trustee or the debtor in possession would even be able to recover the relevant mortgages without MERS's consent.[157] As previously examined, MERS makes no promises in its contract with the servicers.[158] In the case of a bankruptcy, MERS can and does use its assignment powers to avoid having the mortgages preserved in the debtor's estate.[159] Furthermore, it seems to be successful in at least some of these claims, especially those that are supported by the theory that the property right was transferred at the creation of the mortgage.[160]

In such cases, it would seem impossible for trustees and debtors in possession in the case of MERS-compliant mortgage trading and servicing entities to recover their mortgage interest at all. It is very likely that recovery of damages would also be difficult, if not impossible, particularly given that MERS is clearly intended to be the mortgagee of record. What court would not want to hold two sophisticated parties to the clear terms of their contract? The notes are not likely to easily be disregarded entirely by courts, but it is undeniable that the current set up of the MERS system poses significant risk to transferee mortgagees' ability to foreclose.[161]

If it is possible for MERS to assign mortgages out of the bankruptcy estate at will, and it certainly seems that this is the case, the bankrupt mortgagee could conceivably lose its entire investment

153. *See* Hunt, Stanton & Wallace, *supra* note 4, at 37–38; *supra* Part II.

154. Hunt, Stanton & Wallace, *supra* note 4, at 37–38.

155. *Id.* at 38.

156. *See* Hunt, Stanton & Wallace, *supra* note 4, at 37–38; *supra* Part II.

157. *See* Hunt, Stanton & Wallace, *supra* note 4, at 37–38 (stating that MERS has the right to exercise all of the rights to take any action required of the lender).

158. MERS® SYSTEM RESIDENTIAL MEMBERSHIP APPLICATION, *supra* note 47.

159. *See* DiLibero v. Mortg. Elec. Registration Sys., Inc., 108 A.3d 1013, 1017 (R.I. 2015); Newton v. New Century Mortg. Corp., 2014 WL 7016133, at *1 (W.D. Tex. Dec. 11, 2014); Applin v. Deutsche Bank Nat'l Tr., 2014 WL 1024006, at *8 (S.D. Tex. Mar. 17, 2014).

160. *See, e.g.*, *Applin*, 2014 WL 1024006, at *5.

161. *See* Hunt, Stanton & Wallace, *supra* note 4, at 41; *see also supra* notes 46–49 and accompanying text (explaining this theory of automatic note transfer following an assignment of the mortgage).

on the logic that the investment as a whole had been assigned to MERS at its creation. Though this is as yet a speculative result, past experience shows that the possibility exists through MERS's ability to remove assets from the bankruptcy estate of mortgagees and preserve the later buyer's ability to foreclose.[162] While the mortgagee may argue that it received nothing in exchange for the assignment, such an assignment is a key requirement of receiving the manifold benefits of the MERS system, including significant savings in transaction costs.[163] This likely outcome is extremely dangerous to a mortgagee attempting to restructure its business, as well as to the other creditors of the estate because of the automatic depletion of estate property that it engenders. A mortgagee in this position must rely on the assets that it possessed at the time of the bankruptcy to begin the restructuring process, and if the conflicting interests of the MERS system damage those assets, the value of a mortgagee's loan portfolio will decrease significantly. Without sufficient estate assets, a debtor can neither repay creditors nor provide additional collateral to attract new post-bankruptcy investment. In other words, if the mortgagee does not have the full value of the loans that it believed it had, liquidation that maximizes creditor returns will be almost prohibitively difficult, let alone reorganization into a functioning business. In this way, a vehicle designed to swell the mortgage industry to new heights could actually end up as its poison pill, ruining any chance at reorganization for mortgagees who have been decimated by recession.

Even if MERS deigns to assign the mortgage back into the bankruptcy estate following a rejection of the executory contract, there is also significant danger that the assignment could go irreparably astray. Without any check on MERS's ability to assign, there is a significant chance that the mortgage could be assigned to an incorrect subsidiary or entity in the bankruptcy. This recently became an issue in the District of Columbia Court of Appeals, when some of Washington Mutual's mortgages were improperly assigned, leading to significant litigation about what was contained in JPMorgan's purchase of many of Washington Mutual's assets.[164] In that case JPMorgan possessed a note indorsed in blank, which meant that it was payable to whomever was in possession at the time.[165] Without

162. *See supra* notes 128–32.

163. *See* Peterson, *supra* note 17, at 1371.

164. *See* Chase Plaza Condo. Ass'n v. JPMorgan Chase Bank, N.A., 98 A.3d 166, 171 (D.C. 2014).

165. *See id.* at 169.

any challenge from MERS, JPMorgan was unopposed in its action in equity to enforce the note against the underlying collateral.[166] Nevertheless, the possibility that a mortgage could be mistakenly assigned into the wrong bankruptcy estate is a cause for concern.

If the mortgage were to be mis-assigned, it would fall to the trustee or the debtor in possession, under section 544, to repair that loss of value for the purpose of growing the estate for the creditors.[167] However, if the automatic stay covers every subsidiary, there is a potential that a transfer after the mortgage has been assigned into a subsidiary may violate the automatic stay.[168] Furthermore, a bankrupt servicer may no longer be allowed to utilize the MERS system without both accepting the executory contract and paying the company's transaction fees as a first-priority administrative expense, like other critical vendors in a typical bankruptcy.[169] As we have seen in the New Century case, MERS is perfectly willing and able to not only extract fees from bankrupt servicers, but it is also happy to remove from automatic protection the servicer's assets that were assigned to MERS at their origination and to prepare those assets for foreclosure.[170]

CONCLUSION

The problems with MERS have loomed large in the national and academic discourse on mortgage lending since the financial crash brought greater scrutiny to this previously unexamined behemoth.[171] There is no question that MERS has, in the past, been involved in "the kind of case that no prospective homeowner wants to read about."[172]

Unfortunately, it seems that stakeholders in the mortgage industry have worked themselves into a situation where they cannot forego the use of the system. However, there are some critical issues

166. *See id.* at 169–70.

167. *See* 11 U.S.C. § 544(a) (2012).

168. *Chase Plaza Condo. Ass'n*, 98 A.3d at 171 (indicating that, had there been proof that the mortgage in question was transferred to the wrong entity, it would have been a violation of the automatic stay for JPMorgan to foreclose on the mortgage).

169. *See* Certification of Counsel Regarding Motion for Entry of an Order, *supra* note 124, at 1–2.

170. *See generally* Order Terminating Automatic Stay, *supra* note 103 (allowing MERS to remove assets from a bankrupt servicer's estate).

171. Powell & Morgenson, *supra* note 58.

172. Lancaster v. Fox, 72 F. Supp. 3d 319, 321 (D.D.C. 2014). The *Lancaster* case is a truly terrifying maze of byzantine frauds in which MERS was (unsurprisingly) the named beneficiary for multiple suspect deeds. *Id.* at 324.

apparent in the operation of the system that may become more apparent if another financial crash takes more note holders with it. Specifically, mortgages are simply not safe in the hands of MERS. Even with the stringent protections afforded to debtors in bankruptcy, MERS clearly has substantial rights to the underlying mortgage and property, which, when exercised, significantly reduce the value of the mortgagee's assets as it may lose the opportunity to foreclose on the underlying collateral.[173] MERS has not been shy about exercising its rights in the past.[174]

This paper has argued that the legal footing of MERS is such that it is the rightful owner of every mortgage on which it is listed as the so-called "nominee" of the lender. While the danger that MERS will suddenly decide that it would like to completely crash its own business model and adversely possess every single mortgage in its system is so slight as to be risible, the danger of a trustee in bankruptcy being unable to recover mortgages from a potentially unauthorized MERS assignment and therefore preventing a fully effective reorganization of the debtor mortgagee is very real. While this may not cause another foreclosure crisis, it is yet another reason to heavily scrutinize MERS's operations, especially on behalf of homeowners whose foreclosures may be invalid due to unauthorized assignments by MERS.

If current legal trends continue, MERS's operations will become an even bigger issue as jilted homeowners continue to press novel theories against the mortgage industry titan. The invalid assignments by MERS that were a side effect of the collapse of Washington Mutual and New Century have shown that these problems are all too real and institutions that were once thought to be untouchable could be next on the chopping block at any time. With mortgagees facing new regulations, fines, and destabilizations that may put them closer to bankruptcy,[175] the risk to clear title posed by MERS's ability to meddle in servicer and originator bankruptcies is all too real. All stakeholders in the mortgage industry need to be apprised of the risk of allowing this "too big to fail" institution to continue its free reign

173. *See generally* Order Terminating Automatic Stay, *supra* note 103 (finding that MERS rather than the mortgagee was entitled to foreclose on the property).

174. *See generally* Hunt, Stanton & Wallace, *supra* note 4 (collecting examples of all of MERS's varied legal theories allowing them to exercise property rights in their own name).

175. Ben Lane, *Things at Ocwen Just Went from Bad to Much, Much Worse*, HOUSINGWIRE (Feb. 27, 2015), http://www.housingwire.com/articles/33102-things-at-ocwen-just-went-from-bad-to-much-much-worse [http://perma.cc/CJB6-ZA6G].

unabated. This paper has attempted to be one drop in the river of scholarship to awaken this awareness.

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