FORECLOSURE, SUBPRIME MORTGAGE LENDING, AND THE MORTGAGE ELECTRONIC REGISTRATION SYSTEM

Christopher L. Peterson[*]

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INTRODUCTION

In the past two years, subprime mortgage lending has forced the American economy to the brink of a depression and fundamentally undermined world faith in American consumer financial markets. [1] A host of dubiously underwritten mortgage loans helped inflate a bubble in residential real estate values.[2] As it has

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[*] Associate Dean of Academic Affairs and Professor of Law, University of Utah, S.J. Quinney College of Law. The author wishes to thank the following for helpful conversations, comments, encouragement, research assistance, and/or suggestions: April Charney, Prentis Cox, Ron Fuller, Michael Kent, Kathleen Keest, Tera Peterson, Diane Thompson, and Michael Wolf. I am also grateful for helpful comments and questions posed by faculty, students, and other participants attending presentations related to this project at Seton Hall University, the University of Houston Law Center, Ohio State University, and Harvard Law School.

[1] *Compare* Paul Krugman, *Crisis of Confidence*, N.Y. TIMES, April 14, 2008 *with* Robert J. Samuelson, *How this Crisis is Different*, WASH. POST., March 18, 2008.

[2] Kareem Fahim & Janet Roberts, *Foreclosures, With No End in Sight*, N.Y. TIMES, May 17, 2009, at NJ 1.

become clear that millions of Americans are not capable of repaying loans crafted for them by commission hungry brokers, the liquidity of securities drawn from those loans froze.[3] Currently about 25 percent of all subprime home mortgages are delinquent with millions more likely to follow.[4] One rating agency predicts that between 40% and 50% of all subprime mortgages originated since 2006 will eventually end in foreclosure.[5] As the volume of foreclosures increased, it put downward pressure home prices creating the first decline in the national median price for previously owned homes since the Great Depression of the 1930s.[6] According to one estimate over a quarter of all American households are currently have negative equity—they owe more on their home mortgage than their home is worth.[7] About half of all subprime borrowers are underwater on their loans.[8] Thousands of financial "foreclosure rescue" predators and con artists are openly stalking desperate families looking for a financial lifeline.[9] County and municipal governments in the Los Angeles area have begun campaigns to exterminate a scourge of mosquitoes breeding in the rotten water of swimming pools behind thousands of abandoned suburban homes.[10] In Cleveland, Ohio an estimated 15,000 of the area's 84,000 single-family homes are sitting vacant and deteriorating into urban blight with squatters and scavengers taking over entire neighborhoods.[11] America lost friends in places as far off as Norway and Australia when municipal pension funds bottomed out on investments in American subprime

[3] Joshua Boak, *IMF Puts Subprime Loss Near $1 Trillion: Economic Damage Equals $143 for Every Person on the Planet,* CHI. TRIB., April 9, 2008, C1.

[4] Paul Gores, *Trouble at Home Among the 50 States and District of Columbia*, MILWAUKEE JOURNAL SENTINEL, August 21, 2009, at 1; E. Scott Reckard, *State's Mortgage Woes forecast to Rise: Delinquencies on Loans will continue to Climb through 2009, TransUnion Projects*, L.A. TIMES, August 25, at 2.

[5] Grant Bailey, Vincent Barberio, & Glenn Costello, *Revised Loss Expectations for 2006 and 2007 Subprime Vintage Collateral,* www.fitchratings.com, March 25, 2008, at 2.

[6] *Banks Collect Houses Amid Subprime Fallout*, INT'L HERALD TRIB., July 3, 2007, 10.

[7] Jody Shenn, '*Underwater' Mortgages to Hit 48%, Deutsche Bank Says*, Bloomberg.com, August 5, 2009, available at: http://www.bloomberg.com/apps/news?pid=20601110&sid=ac9y1xr7yNhQ.

[8] Les Christie, *Underwater World*, CNNMoney.com, August 6, 2009

[9] Donna Leinwand, *Foreclosure Rescue Scams Multiply: States, FTC Tackle 'Fraud Virus' Hitting Some Homeowners*, USA TODAY, August 4, 2008, at 3A.

[10] Steve Chawkins, *A Magical Misery Tour in Stockton*, L.A. TIMES, December 13, 2007, A1; Devid Streitfeld, *Blight Moves in After Foreclosures: Untended Properties Become Eyesores; Then There are the Uninvited Guests: Mosquitoes, Vandals and Squatters*, L.A. TIMES, August 28, 2007, A1.

[11] Erik Eckholm, *Foreclosures Force Suburbs to Fight* Blight, N.Y. TIMES, March 3, 2007, A1 ("Many of the houses are filled with smelly trash and mattresses used by vagrants. They have been stripped of aluminum siding, appliances, pipes and anything else that scavengers can sell to scrap dealers."); Alex Kotlowitz, *All Boarded Up*, N.Y. TIMES, March 8, 2009 ("The city estimates that 10,000 houses, or 1 in 13, are vacant. The county treasurer says it's more likely 15,000. Most of the vacant houses are owned by lenders who foreclosed on the properties and by the wholesalers who are now sweeping in to pick up houses in bulk, as if they were trading in baseball cards."

mortgage securities.[12] The International Monetary Fund estimates subprime losses at nearly a trillion dollars; about $143 for every person on the planet.[13]

Reckless overleveraging on Wall Street combined with losses in mortgage securities to squeeze the investment banking establishment. Two of the nation's formerly most reputable investment houses, Bear Sterns and Lehman Brothers, collapsed when it became clear that its billions of dollars of their subprime mortgage assets were virtually worthless.[14] For its part, the Federal Reserve Board of Governors slashed interest rates on loans offered to member banks, keeping the economy afloat, but fueling concerns of a return to 1970s-style stagflation.[15] Teetering on the edge of financial abyss, the Fed opened up new credit lines to Wall Street investment firms, creating financial arrangements not unlike deposit insurance, but chillingly devoid of traditional deposit insurance regulatory oversight—without any explicit prior approval from Congress,[16] In addition to the crumpled Wall Street investment houses and hedge funds, smaller subprime mortgage loan originators folded up their tents like the Bedouin—over 100 different subprime mortgage origination companies systematically collapsed.[17] Currently over four hundred banks are on the FDIC's "problem list."[18]

With so many fundamental changes, opportunities for moral hazard, agency cost problems, consumer abuses, and impending lawsuits, perhaps the only group with plethora of opportunities are law professors looking for salient article topics. Indeed, the academy has responded with a new crop of scholarship exploring the role of investment bankers, rating agencies, hedge funds, mortgage brokers, mortgage originators, and loan servicers. It is, however, somewhat ironic that virtually no academic attention has been paid to the one particular company that has been a party in more subprime mortgage loans than any other. Mortgage Electronic Registration Systems, Inc., commonly known as "MERS", is a corporation registered in Delaware and headquartered in the Virginia suburbs of Washington, D.C.[19] MERS operates a computer database designed to track

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[12] Julia Werdigier, *Wall St.'s Pullback on Financing Creates Openings for Europe's Smaller Banks*, N.Y. TIMES, March 22, 2008, C3.
[13] Boak, *supra* note X, at C1.
[14] WILLIAM D. COHAN, HOUSE OF CARDS; A TALE OF HUBRIS AND WRETCHED EXCESS ON WALL STREET 4 (2009); Devin Leonard, *How Lehman got Its Real Estate Fix*, N.Y. TIMES, May 3, 2009, at BU 1.
[15] Tom Lauricella, *Quarterly Markets Review: Trying to Get Up Off the Mat --- Bernanke Offers a Hand, As Stocks Fall in Quarter; Where's the Turning Point?* WALL ST. J., April 1, 2008, C1.
[16] *Top Officials: Bear Rescue was not a Bailout; Senators are Told Possible Collapse was Threat to Global Financial System*, CHI. TRIB., April 4, 2008, C1.
[17] Steve Stecklow, *Subprime Lender's Failure Sparks Lawsuit Against Wall Street Banks: People Who Bought Its Notes Lost All; FBI Comes Calling*, WALL. ST. J., April 9, 2008, A1.
[18] Damian Paletta & David Enrich, *Banks on Sick List Top 400: Industry's Helath Slides as Bad Loans Pile Up; Deposit-Insurance Fund Shrinks*, WALL. ST. J., August 28, 2009.
[19] Carson Mullen, *MERS: Tracking Loans Electronically*, MORTGAGE BANKING, May 31, 2000, 62

servicing and ownership rights of mortgage loans anywhere in the United States.[20] Originators and secondary market players pay membership dues and per-transaction fees to MERS in exchange for the right to use and access MERS records.[21]

But, in addition to keeping track of ownership and servicing rights, MERS has attempted to take on a different, more aggressive, legal role. When closing on home mortgages, mortgage lenders now often list MERS as the "mortgagee of record" on the paper mortgage—rather than the lender that is the actual mortgagee.[22] The mortgage is then recorded with the county property recorder's office under MERS, Inc.'s name, rather than the lender's name—even though MERS does not solicit, fund, service, or ever actually own any mortgage loans. MERS then purports to remain the mortgagee for the life of a mortgage loan even after the original lender or a subsequent assignee transfers the loan into a pool of loans that are ultimately sold to investors—a process known as securitization. Although MERS is a young company, 60 million mortgage loans are registered on its system.[23] Indeed, today MERS is legally involved in the origination of approximately 60% of all mortgage loans in the United States.[24] In past generations, employees of county recording offices kept records of each individual company that recorded mortgage loans and mortgage loan assignments. But today, increasingly recording officials carry on something of a bizarre puppet show, dutifully filing away records of the name of one company repeated over, and over again: MERS.

MERS justifies its role in mortgage loan closings and securitization deals by explaining that it is acting as a "nominee" for the parties.[25] The mortgage lending industry obtains two principal benefits from attempting to use MERS as a "mortgagee of record in nominee capacity." First, under state secured credit laws, when a mortgage is assigned, the assignee must record the assignment with the county recording office, or risk losing priority vis-à-vis other creditors, buyers, or lienors. Most counties charge a fee, ranging from $25 to $50, to record the assignment, and use these fees to cover the cost of maintaining the real property records.[26] Some counties also use recording fees to fund their court systems, legal aid organizations, low income housing programs, or schools.[27] In this respect, MERS' role in acting as a mortgagee of record in nominee capacity is simply a tax

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[20] Howard Schneider, *MERS Aids Electronic Mortgage Program*, MORTGAGE BANKING, January 1, 1997.
[21] *Id.*
[22] *See infra* note X and accompanying text.
[23] Kate Berry, *Foreclosures Turn Up Heat on MERS*, AM. BANKER, July 10, 2007, at 1.
[24] *Id.*
[25] *See infra* note X and accompanying text.
[26] Andrew Lipton, *Mortgage Electronic Registration Systems, Inc. (MERS): Its Impact on the Credit Quality of First-Mortgage Jumbo MBS Transactions*, Moody's Investors Service Structure Finance Special, April 30, 1999, at 2.
[27] *See, e.g.*, Chelan County Auditor, Recording Fee Disbursement, http://www.co.chelan.wa.us/ad/adr_fees.htm, (viewed Sept. 2, 2009) (illustrating distribution of county recording fees in the State of Washington).

evasion tool.[28] By paying MERS a fee, the parties to a securitization lower their operating costs. The second advantage MERS offers its customers comes later when homeowners fall behind on their monthly payments. In addition to its document custodial role, and its role as a tax evasion broker, MERS also frequently attempts to bring home foreclosure proceedings in its own name, rather than the name of the actual owner of the loan, which is often a trust owned by investors.[29] This eliminates the need for the trust—a purely legal business entity with no employees, offices, or assets other than its loans—to foreclose in its own name, or to reassign the loan to a loan servicing company to bring the foreclosure.[30] Throughout history, executioners have always worn masks. In the American mortgage lending industry, MERS has become the veiled man wielding the home foreclosure axe.

This Article is the first academic piece that explores the legal and public policy foundations of the MERS system. Part I provides a brief explanation of the origins of the county real property recording systems and the law governing real property liens. Part II explains how MERS works, why mortgage bankers created the company, and what MERS has done to transform the underlying assumptions of state real property recording law. Part III explores three controversial legal issues confronting MERS and the companies that have relied on it. In particular, this Part queries whether MERS actually has standing to bring foreclosure actions; whether MERS should be considered a debt collector under the federal Fair Debt Collection Practices Act; and whether loans recorded in MERS' name should have priority in various collateral competitions under state law and the federal bankruptcy code. Next, Part IV explores whether MERS bears some responsibility for the current mortgage foreclosure crisis and what the long term effects of privatized land title records will have on our public information infrastructure. Part IV also considers the deeper question of whether the mortgage banking industry, in creating and embracing MERS, has subverted the democratic governance of the nation's real property recording system.

I. THE AMERICAN REAL PROPERTY RECORDING SYSTEM

Public land title records have been a fundamental feature of American law since before the founding of the Republic. Unlike feudal Europe, where most real property was tied up in successive generations of aristocratic families, most early colonists came to America seeking new opportunities.[31] Relatively wide availability and lack of ancestral estates facilitated more frequent transfers of real property among businesses and families.[32] Moreover, the American entrepreneurial

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[28] *See infra* note X and accompanying text.
[29] Christopher L. Peterson, *Predatory Structured Finance*, 28 CARDOZO L. REV. 2185, 2208-12 (2007).
[30] *Id.*
[31] POWELL ON REAL PROPERTY §82.01[1][b] (Michael Allen Wolf ed., 2007)
[32] *Id.*

spirit combined with the modest means of most colonists to create great demand for loans secured by the one widely available asset: land.[33]

Perhaps then, it is not surprising that in the early seventeenth century, Americans began experimenting with laws requiring that parties create public records of conveyances and mortgages.[34] For example, in 1636 the General Court of Massachusetts' Plymouth Bay Colony adopted its first recording law which required that "all sales exchanges fites mortgages leases or other Conveyences of howses and lands the sale to be acknowledged before the Governor or any one of the Assistants and committed to the public Record."[35] Similarly, in 1639 the Connecticut General Court insisted that "all bargines or mortgages of land whatsoever shall be accounted of no value until they be recorded."[36] Particularly suspicious of concealed ownership, early Virginia law only required public recording of real property interests when the grantee did not take possession of the property.[37] By the revolution, every English colony had adopted a statutes requiring that parties to a mortgage record their names, and a description of the property in public office designed for that purpose.[38] Then, as now, mortgagees that fail to record their mortgages or assignments, risk losing the ability to enforce their contract as against a subsequent purchaser for value. [39]

The necessity and usefulness of these early public title records is attested to by their nearly universal and uninterrupted force in subsequent American law. Indeed, Pennsylvania's first recording act, first adopted in 1717, remains in force to this day.[40] Currently, all fifty states and the District of Columbia have recording statutes similar to their colonial predecessors.[41] Moreover, preservation of public records of mortgages proved so successful, in the twentieth century, all fifty states have adopted Article 9 of the Uniform Commercial Code which creates an analogous recording system for virtually all forms of personal property.[42] The early colonial objective of these laws was, as it is today, to prevent disputes over property rights and to facilitate the use of land as collateral by creating a transparent public record that facilitates certainty in private bargains. Title recording acts preserve an accessible history of land ownership with "the same dignity and evidentiary value that attaches to public records" all for the benefit of

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[33] SYDNEY HOMER & RICHARD SYLLA, A HISTORY OF INTEREST RATES 280-81 (3d ed. 1996).

[34] *See, e.g.,* Piddge v. Tyler, 4 Mass. 541, 543-44 (1808) (discussing evolution of title and mortgage recording law in Massachusetts).

[35] Powell, *supra* note X, at § 82.01[1][b] (quoting 11 *Records of the Colony of New Plymouth in New England* 12 (D. Pulsifer ed. 1861)). The earliest American deed record was a deed copied into the Plymouth Bay Colony's record book in 1627. PATTON AND PALOMAR ON LAND TITLES § 4 (3d ed. 2003).

[36] *Id.* (quoting Trumbell, *Connecticut Public Records of the Colony Prior to the Union with the New Haven Colony May 1665* 35 (1850)).

[37] POWELL, *supra* note X, at §82.01[1][b]. Virginia adopted its first recording statute in 1639. PATTON AND PALOMAR, *supra* note X, at § 4 n.7.

[38] PATTON AND PALOMAR, *supra* note X, at § 4.

[39] 5 TIFFANY ON REAL PROPERTY § 1457 (1939); CARYL A. YZENBAARD, RESIDENTIAL REAL ESTATE TRANSACTIONS §5:7 (1991); GRANT S. NELSON & DALE WHITMAN, 1 REAL ESTSTE FINANCE LAW § 5.34 (5th ed. 2007

[40] PATTON AND PALOMAR, *supra* note X, at § 4 n.7.

[41] PATTON & PALOMAR, *supra* note X, at § 4.

[42] UNIF. COM. CODE. Art. 9. § X.

the entire community. [43] Real property recording systems create an archive that protects communities from commercial chaos following floods, earthquakes, fire, hurricanes, financial panics, wars, and other disasters. Public land title records created a platform, or infrastructure, upon which private commerce could take place. Indeed, real property recording statutes are the earliest and most practical expression of the American commitment to the use of transparent rule of law in the preservation and orderly exchange of property rights.

All this is not to suggest that maintaining public land title records has been easy or inexpensive. To record a mortgage or an assignment of a mortgage, the mortgagee must generally deliver a copy of the document in question (often executed in the presence of witnesses or a notary public) to a county clerk that time stamps, indexes, and files the document. Most counties charge a fee, ranging from $25 to $50, to cover the cost of maintaining the recording system, and possibly to generate revenue for other county services such as schools, roads, or legal aid offices.[44] The basic structure of most county title recording systems has included two indexes: one that alphabetically lists the name of every grantor that has recorded a document within a given time frame, and another that lists the name of every grantee that has recorded a document within the same time frame.[45] When a mortgage lender—which, like a buyer, is characterized as a "purchaser" under property law—contemplates offering a loan secured by the land, it can use these indexes to verify that the debtor actually owns clear title to the land in question.[46] The lender wants to know whether the prospective debtor has already sold the land or granted a mortgage to someone else. Historically, prospective purchasers began their search by looking for the debtor's name in the grantee index in reverse chronological order. The prospective lender searches under the borrower's name until it finds a record showing the name of the individual or business that sold or gave the property to the borrower. This process is repeated for the debtor's grantor, and in turn the grantor's grantor, creating a chain of title all the way back until a "root of title" is found.[47] Next, the creditor searches the grantor index in chronological order for each past owner of the land to discover whether it has been sold or mortgaged to anyone not yet discovered. The creditor will want to find a release showing that any past mortgages granted by any past or present owner have been satisfied. After a thorough search, the recording system can reassure prospective purchasers of the safety of their investment.

As America's population has grown, time has passed, and commerce has become more complex, real property title recording systems have become voluminous and increasingly difficult to search.[48] In addition to deeds and mortgages, they also can now include other property interests such as mechanics' liens, tax liens, and easements. As a result, title insurance companies have

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[43] PATTON & PALOMAR, *supra* note X, at § 4.
[44] Lipton, *supra* note X, at 2.
[45] POWELL, *supra* note X, at § 82.03[2][b].
[46] POWELL, *supra* note X, at § 82.01[2][a].
[47] POWELL, *supra* note X, at § 82.03[2][b].
[48] Charles Szypszak, *Public Registries and Private Solutions: An Evolving American Real Estate Conveyance Regime*, 24 WHITTIER L. REV. 663, 665-67 (2003).

developed expertise in bearing the cost of uncertainty associated with purchasing interests in real property. Mortgage originators generally purchase insurance from companies that specialize in searching title records that can be transferred to secondary market mortgage assignees.[49] Moreover, because many counties continue to use older, paper-based real property records, title insurance companies have been maintaining "plant" copies of the public real property records since the 1960s.[50] These insurers, in effect, have carbon copies of most county real property records and continually update them by entering each new recorded document into their systems.[51] These private plant real property records are now generally maintained on computers and are easier to search than public title records, but they cannot function without the law creating legal incentives to deposit records into the central government maintained system. Moreover, private plant recording systems lack the permanence and stability of public records since title insurers are subject to computer malfunction, fires, theft, bankruptcy, and are only willing maintain records to the extent that is profitable to do so. While plant systems are easier to search, they do not have the track record of hundreds of years of stability that backs up public systems. Despite the introduction of private plant records, the public title records continue to serve as the authoritative evidentiary benchmark in disputes and as an archive upon which plant records can be constructed or reconstructed.

[49] Szypszak, *supra* note X, at 683.
[50] 11 THOMPSON ON REAL PROPERTY § 92.05(b) (David A. Thomas, ed., 2nd Thomas ed. 2002).
[51] Quintin Johnstone, *Land Transfers: Process and* Processors, 22 Valpo. U. L. Rev. 493, 507-08 (1988).

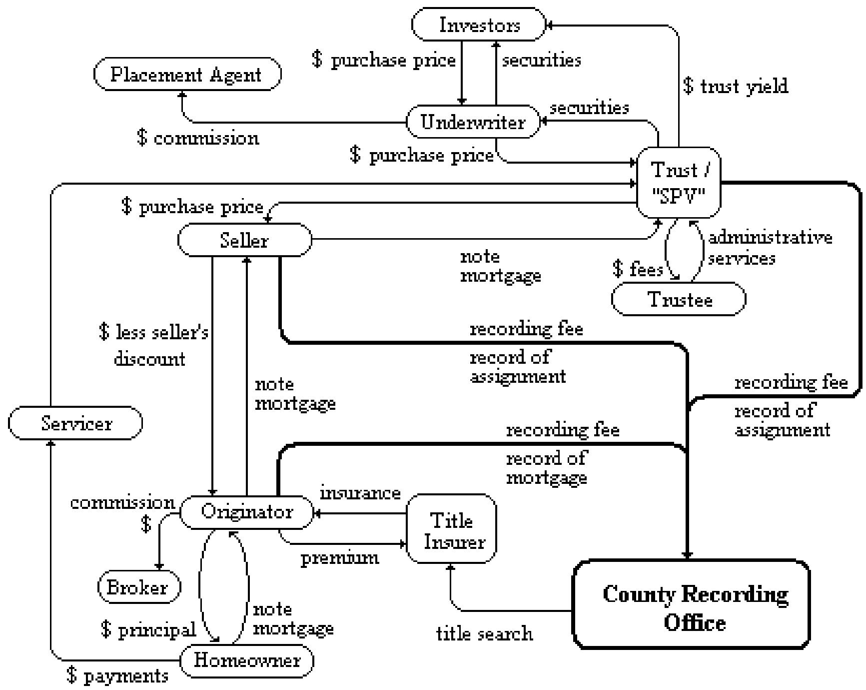

Figure A. Subprime Mortgage Loan Origination under Traditional Interpretation of State Land Title Recording Acts.

Figure A. provides a graphic representation of the origination, assignment, and recording of a typical subprime mortgage loan under a traditional interpretation of state land title recording acts. In a typical subprime mortgage loan, a homeowner communicates with a mortgage broker that receives a commission for selling the loan. At closing the homeowner signs a promissory note on behalf of the originating lender and a mortgage or deed of trust with the originator as the mortgagee or the trust beneficiary. Before closing the originator generally purchases a title insurance policy from a title insurer that searches the public land title records, or a plant copy taken from the public records. Typically subprime originators quickly assign their loans to a seller, which is usually a subsidiary of an investment bank. Ultimately the promissory note and mortgage are then assigned, along with many other loans, to a special purpose vehicle that usually takes the form of a trust. A special purpose vehicle is a business entity that is exclusively a repository for the loans—it does not have any employees, offices, or assets other than the loans it purchases. A pooling and servicing agreement specifies a trustee to manage the loan assets and a servicer to collect monthly payments and interact with the homeowner. The trust, then, transfers the right to receive the income stream to an underwriter and then various investors such as mutual funds, hedge funds, pension funds, and insurance companies. Under a traditional interpretation of state land title recording acts, the seller and the trust must both record their assignments in order to protect the priority of their mortgage against a subsequent bona fide purchaser for value. Despite the costs recording mortgages and assignments, not a single American legislature has ever seriously considered eliminating their public land title recording acts.[52]

II. THE ORIGIN AND OPERATION OF MERS

Given the venerable and uninterrupted legacy of land title recording acts, it is interesting that first fundamental change to the American public land title recording systems in over three hundred years was not initiated by publically elected leaders. Instead, the Mortgage Electronic Recording System was conceived of and created by a tight-knit group of powerful mortgage industry insiders.[53] In October of 1993, a task force of mortgage finance companies released a "white paper" at an annual convention of mortgage bankers.[54] The paper suggested that an electronic book entry system of tracking mortgage loans would be better for the mortgage lending industry than the legal system of county recording offices.[55] The paper encouraged comments from the real estate finance industry, leading to the formation of a steering committee affiliated with the Mortgage Bankers Association of America (MBA).[56] The MBA is a trade association supported through dues paid by mortgage lending companies that conducts public relations for the industry. This committee of mortgage bankers retained Ernst & Young, an accounting firm, to study the feasibility of developing MERS. In addition to studying the technological and financial hurdles, the accounting firm also did some telephone interviews with mortgage loan originators, servicers, warehouse lenders, custodians, assignment processors, and employees at Fannie Mae and Freddie Mac. The accountants' primary conclusion was that that the finance industry could save a lot of money by deciding not to pay the fees that local governments require to record mortgage assignments.[57]

The legislative history of the MERS concept is not found in Congressional or state assembly records, but in the trade magazine *Mortgage Banking.* In 1995 and 1996 the MBA trade association's steering committee developed a business plan that would make MERS a reality.[58] The principal consultant involved in creating MERS explained that the "[o]riginal investors came in 'on faith' … because the

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[52] PATTON & PALOMAR, *supra* note X, at §4 ("Recording acts are now in force in all the states and the District of Columbia.").
[53] Mullen, *supra* note X ("MERSCORP, Inc., was formed by Mortgage Bankers Association of America (MBA) member companies as a central electronic loan registry in an ambitious attempt to help lenders streamline the lending process and eliminate the need to record assignments when selling loans to other mortgage companies.").
[54] Phyllis K. Slesinger & Daniel McLaughlin, *Mortgage Electronic Registration System*, 31 ID. L. REV. 805, 810-11 (1995).
[55] *Id.*
[56] *Id.*
[57] Slessinger & McLaughlin, *supra* note X, at 811-12 (estimating savings of $51.7 million annually for mortgage servicers and $14.1 million annually for mortgage originators).
[58] Schneider, *supra* note X.

details of how MERS would work weren't ironed out until mid-1996 at working group meetings involving different industry players."[59] MERS' Senior Vice President of Operations and Information Management explained that the legal and technological questions behind MERS were answered when "[l]enders and servicers of various sizes, along with the secondary market agencies, 'got in a room together, walked through the process, and came to an agreement.'"[60] Two years after releasing the initial white paper, MERS, Inc. incorporated in Delaware as a non-stock corporation owned by mortgage banking companies that made initial capital contributions ranging from $10,000 to $1,000,000.[61] According to a Mortgage Banking Association Executive Vice President involved in the creation of MERS the primary goal of the MERS initiative was to "[l]ower costs for servicers."[62]

Although at first, MERS was only able to attract the participation of Fannie Mae and Freddie Mac, private label subprime mortgage securitizers began using MERS in 1999.[63] Today, mortgage finance companies currently use the MERS' name to interact with the land title recording system in one of two ways: either by recording MERS' name as an assignee, or by recording MERS' name as the original mortgagee. Figure B provides a graphic representation of the former. Under this recording strategy the originating lender makes a traditional mortgage loan by listing itself as the payee on the promissory note and as the mortgagee on the security instrument. The loan is then assigned to a seller for repackaging through securitization for investors. However, instead of recording the assignment to the seller or the trust that will ultimately own the loan, the originator pays MERS a fee to record an assignment to MERS in the county records. MERS' counsel maintains that MERS becomes a "mortgagee of record" even though its ownership of the mortgage is fictional.[64]

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[59] *Id.*

[60] *Id.*

[61] *Id.* The charter members of MERS, Inc. were: 1st Nationwide Mortgage; Allied Group Mortgage, Inc.; American Home Funding; American Land Title Association; Crestar Mortgage Corp.; Fannie Mae; Freddie Mac; GE Capital Mortgage Services, Inc.; GMAC Residential Funding Corp.; HomeSide Lending, Inc.; Knutson Mortgage Corp; Lau Capital Funding; Merrill Lynch Credit Corp; Mortgage Bankers Association of America; Mortgage Guaranty Insurance Corp.; Northwest Mortgage, Inc.; ReliaStar Mortgage Corp.; Source One Mortgage Services Corp.; Texas Commerce Bank, NA; Chase Manhattan Mortgage; and, Weyerhaeuser Mortgage Company. *Id.* Mortgage Electronic Registration Systems, Inc. is actually a wholly owned subsidiary of MERSCORP, Inc. The dual structure of the company was designed to prevent creditors of MERSCORP from attempting to seize loans recorded in the Mortgage Electronic Registration Systems, Inc.'s name in the event that MERSCORP, Inc. declares bankruptcy. Mullen, *supra* note X, at 62.

[62] *Id.*

[63] Mullen, *supra* note X.

[64] R.K. Arnold, *Yes, There is Life on MERS*, 11 PROBATE & PROPERTY 32, 34 (July/August 1997). Arnold explains:

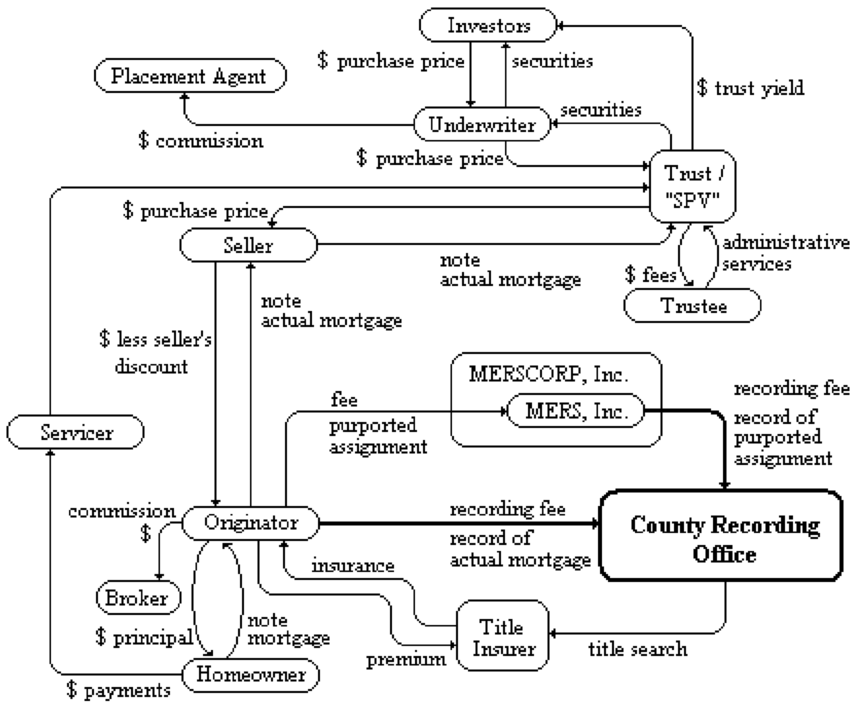

Figure B. Subprime Mortgage Loan Recording with MERS as Purported Assignee.

Although MERS records an assignment in the real property records, the promissory note which creates the legal obligation to repay the debt is not negotiated to MERS.[65] Everyone agrees that MERS is never entitled to receive a borrower's monthly payments, nor is MERS ever entitled to receive the proceeds of a foreclosure or deed of trust sale. MERS has no actual financial interest in any mortgage loan. MERS does not even provide lien releases of the mortgages it purports to own, instead referring title attorneys, refinancing lenders, and consumers to the loan's servicer.[66] MERS' revenue comes, not from repayment of

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> When a mortgage is registered on the MERS system, it receives a mortgage identification number (MIN). The borrower executes a traditional paper mortgage naming the lender as mortgagee, and the lender executes an assignment of the mortgage to MERS. Both documents are recorded in the public land records, making MERS the mortgagee of record. From that point on, no additional mortgage assignments will be recorded because MERS will remain the mortgagee of record throughout the life of the loan.

Id.

[65] Lipton, *supra* note X, at 3.

[66] *Please Release Me!*, INSIDE MERS, Jan./Feb. 2004, 2. MERS instructs servicers to prepare and record lien releases entirely on their own. But, the servicers are instructed to do so in MERS' name, even though MERS has nothing to do with the decision to release the lien. *Id.*

the loan or the disposition of collateral, but from fees that the originator and other mortgage finance companies pay to MERS. Once a loan is assigned to MERS, the public land title records no longer reveal who (or what) actually owns a lien on the property in question.

After a few years in business, MERS decided it could help mortgage financiers pay even less to county governments by simply doing away with the first assignment to MERS, and instead listing MERS as the mortgagee in the original mortgage. Figure C provides a graphic representation of subprime mortgage loan origination where the parties record MERS' name as the original mortgagee. Once again, although MERS does not actually advance any loan principal to the homeowner, does not have the right to receive any payments from the borrower, and is not the actual party in interest in any foreclosure proceeding. Nevertheless, the actual mortgagee pays a fee to MERS to induce MERS to record the mortgage in MERS' name. By eliminating the reference to an actual mortgagee or the actual assignee, MERS estimated it would save the originator an average of $22.00 per loan.[67]

[67] MERS Frequently Asked Questions, Does MERS change the current mortgage closing process?, www.mersinc.org/why_mers/faq.aspx, viewed June 9, 2004 ("[Y]ou'll save $22 or more per loan when you specify MERS as the Original Mortgage of Record in the mortgage or deed of trust."); Mullen, *supra* note X ("The good news for companies embracing the system changes was that using MOM [MERS as Original Mortgagee], as the practice has come to be known, provides an immediate cost reduction of approximately $22 per loan."). Early estimates suggest that the average cost reduction when MERS acts as an "assignee" were "between $15 and $17 a loan." Lipton, *supra* note X, at 2. More recent estimates suggest that using MERS saves lenders and servicers approximately $40 over the entire life of a mortgage loan. David F. Borrino, *MERS: Ten Years Old*, USFN, http://imis.usfn.org/Resources/ArticleLibrary/1733.aspx, (May 11, 2006) viewed July 13, 2006.

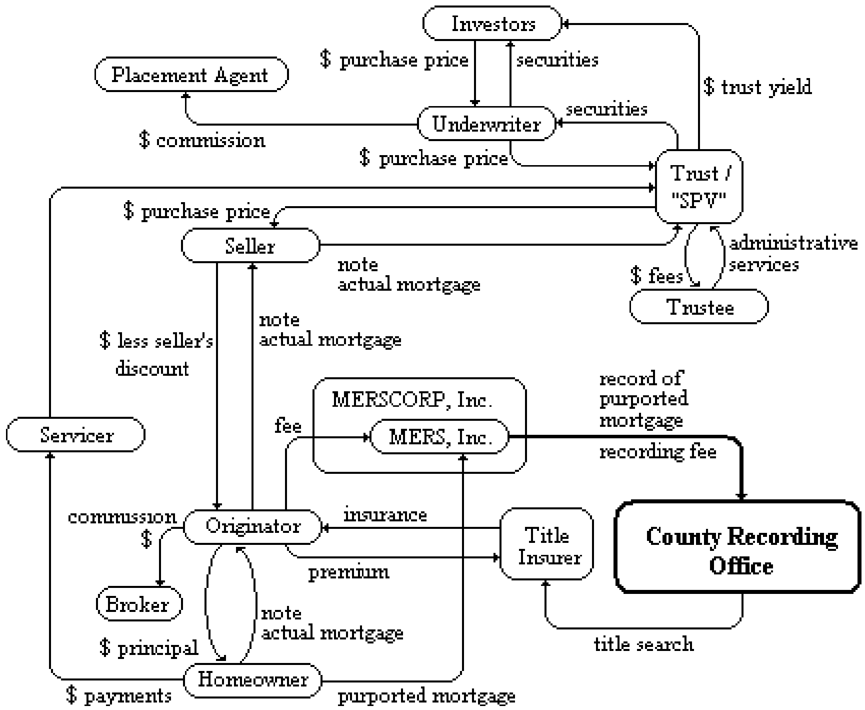

Figure C. Subprime Mortgage Loan Recording with MERS as Purported Mortgagee.

In addition to its record keeping and recording system liaison roles, MERS has also become directly involved in consumer finance litigation. Historically, when a homeowner defaults on a home mortgage the owner of the mortgage loan, or a servicer hired to collect borrower payments, sues the homeowner in a foreclosure action. In states requiring judicial proceedings for foreclosure, this process also typically involves either in-house or retained outside legal counsel.[68] In states that allow non-judicial foreclosure, this process is often faster and may not involve significant participation by attorneys.[69] But, when MERS is listed in county records as the owner of a mortgage, courts have generally made the natural assumption that the appropriate plaintiff to brining a foreclosure action is MERS. In order to move foreclosures along as quickly as possible, MERS has allowed actual mortgagees and loan assignees or their servicers to bring foreclosure actions in MERS' name, rather than in their own name.[70] Thus, not only does use of MERS' services allow financiers to avoid county recording taxes, it also allows

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[68] 12 THOMPSON ON REAL PROPERTY § 101.04(b)(1) (1994 & Supp. 2007).
[69] 12 THOMPSON ON REAL PROPERTY § 101.04(c)(1) (1994 & Supp. 2007).
[70] MERS, STATE BY STATE MERS RECOMMENDED FORECLOSURE PROCEDURES, *supra* note X, at 8 ("Employees of the servicer will be certifying officers of MERS. This means thay are authorized to sign any necessary documents as an officer of MERS. . . . In other words, the same individual that signs the documents for the servicer will continue to sign the documents, but now as an officer of MERS.")

them to list an obscure, evidently official institution as the instigator of a foreclosure.

With these services on offer, the mortgage finance industry quickly and wholeheartedly embraced recording and foreclosing its mortgage loans in the name of MERS, rather than the actual parties in interest. Instead of legislation or a landmark court ruling, mortgage industry insiders report that the key development in the acceptance of the MERS was the endorsement of credit rating agencies such as Moody's, Standard and Poor's, and Fitch Investment.[71] For example, in 1999—before any significant appellate judicial opinion on the subject—Moody's investor services issued a report concluding that MERS' mechanism to put creditors on notice of a mortgage would not be harmed.[72] Moody's concluded without citation to any court opinion, or even to any state recording statute, that "subsequent creditors of the entity selling the mortgages to the MBS [mortgage backed securities] transactions [sic] should not be able to contest the conveyance of the mortgages based on lack of notice."[73] In a front page article covering the Moody's opinion *Mortgage Banking* reported that "the most significant finding in the report specified that in transactions where the securitizer used MERS, there would be no need for new assignments of mortgages to the trustee of MBS transactions."[74]

With the rating agencies' stamp of approval, the use of MERS exploded in the early 2000s. By late 2002 MERS had recorded its name, instead of the actual assignee or mortgagee, in ten million residential home mortgages.[75] As the subprime mortgage refinancing boom took off, MERS registered an average of 21,000 loans on its system per day.[76] Only a year later, the total number of loans recorded in MERS name doubled to 20 million.[77] By May of 2007, this number had tripled again to 60 million loans.[78] Sixty percent of all new mortgage loan originations are recorded under MERS' name, and more than half of the nation's existing residential loans are recorded under MERS name.[79] Not satisfied, MERS' CEO insists that "[o]ur mission is to capture every mortgage loan in the country."[80]

III. THE QUESTIONABLE LEGAL FOUNDATION OF MERS

Because MERS came to "own" over half of the nation's mortgage loans in a time span more brief than many lawsuits, there is sparse appellate law explicitly dealing with the company and its unprecedented attempt to usurp county title recording systems and become the national foreclosure plaintiff. The few opinions that exist confronted issues of first impression with little in the way of legislative

[71] Mullen, *supra* note X.
[72] Lipton, *supra* note X, at 3.
[73] Lipton, *supra* note X, at 3.
[74] Mullen, *supra* note X.
[75] *MERS Registers 10 Million Loans*, INSIDE MERS, Nov./Dec. 2002, 1.
[76] *Id.*
[77] *MERS Registers 20 Million* Loans, INSIDE MERS, Jan./Feb. 2004, 1.
[78] Berry, *supra* note, X, at 1.
[79] MERS Registers 20 Million Loans, *supra* note X, at 1; Berry, *supra* note X.
[80] *Id.*

or scholarly advice. Moreover, most of these opinions were written without the benefit of hindsight brought to light by the recent collapse of the nation's subprime mortgage lending industry. Accordingly, as the judiciary presides over the forced displacement of millions of American families from their homes, it is worthwhile to take a fresh look at the legal foundation of MERS' role in the land title recording and home foreclosure systems. This Part looks at three important doctrinal questions that remain unanswered regarding MERS: whether MERS owns title to mortgages either as a mortgagee or an assignee; whether MERS has standing to bring foreclosure lawsuits; whether MERS is a "debt collector" for purposes of the federal Fair Debt Collection Practices Act; and, whether MERS has priority against subsequent bona fide purchasers for value (including bankruptcy trustees). While these are basic doctrinal questions, they nonetheless have profound consequences, not only for the mortgage lending industry, but also for the world economy.

A. MERS Does Not Own Legal Title to Mortgages Registered on Its Database

While the preceding Parts of this article have explained what MERS does, it remains unclear what MERS *is*. Obviously, at the most simple level, MERS is a Delaware corporation that provides mortgage loan related services. But even MERS' own contracts, attorneys, and spokespersons present a muddled account of MERS' identity in relationship to the mortgage loans registered on its database. For example, the boilerplate contract provision used by mortgage originators in "MERS as original mortgagee" loan contract states:

> "MERS" is Mortgage Electronic Registration Systems, Inc. MERS is a separate corporation that is *acting solely as nominee for Lender* and Lender's successors and assigns. *MERS is the mortgagee* under this Security Instrument. MERS is organized and existing under the laws of Delaware, and has an address and telephone number of P.O. Box 2026, Flint, MI 48501-2026, tel. (888) 679-MERS.[81]

The second sentence seems to suggest that MERS is some sort of agent—a "nominee"—of the actual mortgagee. Yet, the third sentence flatly asserts that "MERS is the mortgagee." Which is it?[82] What is clear is that MERS cannot be both. Surely, it is axiomatic the same entity cannot simultaneously be both an agent *and* a principal with respect to the same property right.[83]

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[81] Mortgage Electronic Registration Systems, Inc. v. Bluming, No. GD05-16795, Civil Division, Court of Common Pleas of Allegheny County, PA, slip op. (May 31, 2006) (J. Timothy Patrick O'Reilly).

[82] *Cf* Landmark Nat. Bank v. Kesler, No. 98489, 2008 WL 4180346, (Kan. App. Sept 12, 2008) ("Specifically, the mortgage says that the mortgagee is MERS, though 'solely as nominee for the Lender.' Does this mean that MERS really *was* the mortgagee, even though it didn't lend money or have any rights to loan repayments?").

[83] The very first section of the Restatement of Agency Law clearly delineates that an agent and a principal are different persons. Restatement (Third) of Agency Law

Nevertheless, other explanatory materials written by MERS to assist its members in understanding the MERS system are equally schizophrenic. For example, the company's *Recommended Foreclosure Procedures* report takes the position that MERS is merely an agent:

> MERS acts as a *nominee (a form of agent)* for the servicer and beneficial owner of a mortgage loan in the public land records. MERS is designed to operate within the legal framework in all U.S. jurisdictions and did not require any changes to existing laws.[84]

In contrast, MERS takes the opposite position when confused loan officers and foreclosure attorneys press with pointed questions like "Under what section of law does MERS, if named 'nominee' have the authority to assign and/or discharge the mortgage?"; "Is a nominee like a power of attorney for the lender?"; and, "How ought the mortgage be recorded in the clerk's office?"[85] In response to these three questions MERS' Vice President and Corporate Counsel explained:

> Mortgage Electronic Registration systems, Inc. (MERS) gets its authority to assign and/or discharge a mortgage because *MERS is the mortgagee,* and as such holds legal title to the mortgage. … The nominee language does not take away from the fact that *MERS is the mortgagee*.[86]

MERS' position is no clearer in litigation. Interestingly, the company tends to argue it is an actual mortgagee or assignee when it brings foreclosure actions; but, when sued in cases alleging fraud, deceptive practices, or other statutory consumer protection claims associated with loans registered on its system, MERS argues it is merely an agent without exposure to liability.[87] Even more

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§1.01 ("Agency is the fiduciary relationship that arises when one person (a "principal") manifests assent to another person (an "agent") that the agent shall act on the principal's behalf and subject to the principal's control. . . ."). Moreover, neither the popularity of MERS' self-characterization, nor its contractual recitation, are controlling. *Id.* § 1.02 ("An agency relationship arises only when the elements stated in § 1.01 are present. Whether a relationship is characterized as agency in an agreement between the parties or in the context of industry or popular usage is not controlling.").

[84] MORTGAGE ELECTRONIC REGISTRATION SYSTEM, INC., STATE-BY-STATE MERS RECOMMENDED FORECLOSURE PROCEDURES 4 (2002) (hereinafter "MERS STATE-BY-STATE FORECLOSURE PROCEDURES"). Interestingly, the report does not cite any legal authority for the proposition that MERS operates within the legal authority of every state in the Union.

[85] MERS Forum, FAQ with Sharon Horstkamp, MERS Vice President and Corporate Counsel, www.mersinc.org/forum/viewreplies.aspx?id=13&tid=73 last viewed June 9, 2004.

[86] *Id.* (emphasis added).

[87] *Compare* Landmark Nat. Bank v. Kesler, No. 98,489, 2008 WL 4180346, at *1-*2 (Kan. Ct. App., Sept. 12 ,2008) ("What is MERS's interest? MERS claims that it holds the title to the second mortgage . . . . MERS objects to its

perplexing, in a series of bankruptcy cases filed and then consolidated in the same bankruptcy court, MERS simultaneously brought the same type of foreclosure related actions *both* solely in its own name *and* as a nominee on behalf of other entities.[88]

While the language in MERS boilerplate contracts is not particularly enlightening, the basic economic principals of the law provide a simple answer to this puzzle. The American legal tradition looks to the economic realities of a transaction in determining whether a business is a secured creditor—including a mortgagee.[89] The most familiar application of this principal is found in the Uniform Commercial Code's distinction between a security interest and a lease.[90] The U.C.C. insists that the words used by the parities to a contract are not controlling.[91] Contracts where the parties explicitly describe a transaction as a lease are universally construed as a security agreement where there is no reasonably foreseeable likelihood of the "lessor" regaining possession of the goods after the "lease" term.[92] Security agreements governing realty—mortgages and deeds of trust—are no different on this point. Contracts creating mortgages are construed as such even where the parties choose to describe the bargain with different language.[93] It is equally axiomatic that where contracts do not create a

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characterization as an agent…") *with In re* Escher, 369 B.R. 862 (E.D. Pa. 2007) ("MERS' role as nominee leads the Court to conclude that it cannot be liable on any of the Plaintiff's [Truth in Lending or Pennsylvania consumer protection] claims. A nominee is understood to be an agent for another. . . . Therefore MERS will be dismissed from this action and no further reference to MERS will be made."); Hartman v. Deutsche Bank Nat. Trust Co., No. 07-5407, 2008 WL 2996515, *2 (E.D.Pa. Aug. 1, 2008) (accepting MERS' argument that it could not be liable under the Truth in Lending Act because there was no colorable allegation "that … [the plaintiff's] mortgage loan was assigned to MERS, or that MERS was ever the owner of that obligation."); Brief in Support of Defendant's Motion to Dismiss at 3, King v. Ocwen, Civil Action No. 07-11359, 2008 WL 2063553 (E.D.Mich, April 14, 2008) (arguing that MERS could not be liable for Fair Debt Collection Practices Act violations because "*HSBC was the mortgagee* for the property. Ocwen is the servicer for the property. [And,] MERS acted solely as the nominee for the original mortgagee of the property") (emphasis added).

[88] In re Hawkins, No. BK-S-07-13593-LBR, 2009 WL 901766 (Bkrctcy.D.Nev. March 31, 2009) (holding MERS lacks standing to lift automatic stay).

[89] Blanco v. Novoa, 854 So.2d 672, 674 (Fla.App.Ct., 2003); Land Mark Nat. Bank v. Kessler, No. 98,489, 2008 WL 4180346, at *1 (Kan. Ct. App., Sept. 12 ,2008); Major's Furniture Mart, Inc. v. Castle Credit Corp., Inc., 602 F.2d 538, 543 (3rd Cir.1979)

[90] U.C.C. § 1-203 (2005).

[91] In re Homeplace Stores, Inc., 228 B.R. 88, 94 (Bankr.D.Del.1998).

[92] In re WorldCom, Inc., 339 B.R. 56, 64 (Bankr..S.D.N.Y. 2006); Edwin E. Huddleson, III, Old Wine in New Bottles:UCC Article 2a Leases, 39 Ala. L. Rev. 615, 627 (1988).

[93]Standard Leasing Corp. v. Schmidt Aviation, Inc., 576 S.W.2d 181, 184 (Ark., 1979); Trustees of Zion Methodist Church v. Smith, 81 N.E.2d 649, 650 (Ill.App. Ct.,1948); Parry v. Reinertson, 224 N.W. 489, 490 (Iowa 1929); Hargrove v. Gerill

mortgage, courts will not construe one to exist merely because of boilerplate language in the written memorialization of the deal.[94] MERS is not a mortgagee (or an assignee) simply because ink on paper makes this assertion—rather the law compels courts to look to the economic nature of the transaction to identify MERS' role.[95]

Indeed, the fundamental economic reality of MERS involvement in the mortgage lending industry suggests that MERS is not a mortgagee with respect to any loan registered on its database. A mortgagee is simply the party to whom a parcel of real estate is mortgaged. Or, as Blacks Law Dictionary explains, a "mortgagee" is "[o]ne to whom property is mortgaged; the mortgage creditor, or lender. -- Also termed *mortgage-holder*."[96] MERS is not the party to whom family homes are mortgaged for at least three fundamental economic reasons. First, MERS does not fund any loans. No money coming out of a MERS deposit account is tendered as loan principal to homeowners. Second, no homeowners promise to pay MERS any money. To this effect, MERS is never identified as the payee in a promissory note and MERS is never entitled to receive any monthly payments from the mortgagor. Finally, and perhaps most important, MERS is never entitled to receive the proceeds of a foreclosure sale. Instead, these funds go to the actual mortgagee (or assignee of the mortgagee) that is the true owner of the lien.

In cases where MERS claims to own legal title to mortgages by virtue of assignment its position is no stronger. Unlike the investment trust that actually owns the mortgage in a typical subprime securitization structure, MERS does not pay the loan originator value in exchange for the mortgage. On the contrary, the originator or a servicer *pays MERS* to take the "assignment."[97] In these cases

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Corp., 464 N.E.2d 1226, 1230, (Ill.App. Ct.1984); In re Berg, 387 B.R. 524, 555 (Bankr..N.D., 2008).

[94] Secretary of Veterans Affairs v. Roma Food Enterprises of Florida, Inc., 840 So.2d 1066, 1066-67 (Fla.App.Ct., 2003); Moon v. Moon, 776 N.Y.S.2d 324, 325 (N.Y.A.D., 2004).

[95] Ja-Mo Associates, Inc. v. 56 Fulton St. Garage Corp. 30 A.D.2d 287, 290 (N.Y. A.D. 1968) ("While the court is not bound by the label which the parties applied to the payment and may examine the true nature of the transaction, the payment here bore none of the distinguishing characteristics which would render section 233 (of the Real Property Law . . .) applicable. There was no intention that the landlord hold the money as security.") (citations omitted); Szabo Food Service, Inc. of North Carolina v. Balentines, Inc., 206 S.E.2d 242, 249 (N.C. 1974); ("It has long been the rule with us that in determining whether a contract is one of bailment for use, a lease with an option to purchase, or one of sale with an attempt to retain a lien for the purchase price, the courts 'do not consider what description the parties have given to it, but what is its essential character.") (citation omitted); Lee v. Barnes, 362 P.2d 237, 240 (Wash. 1961) ("The label affixed to a security interest by the parties does not necessarily determine its legal significance."); *See also* Dougherty v. Salt, 125 N.E. 94 (1919) (widely studied case explaining that "[a] note so given is not made for "value received," however its maker may have labeled it.")

[96] BLACK'S LAW DICTIONARY (8th ed. 2004), mortgagee.

[97] Arnold, *supra* note , at 33.

MERS is still not entitled to receive repayment of the mortgage loan.[98] Nor is MERS entitled to the proceeds of a foreclosure sale.[99] MERS is being paid fees to provide record keeping and foreclosure services, rather than MERS paying to own liens on family residences.

Federal consumer protection and bankruptcy law also suggests that the MERS does not own legal title to loans registered on its database. For example, under both the Truth in Lending Act and the Home Ownership and Equity Protection Act a mortgage assignee can be liable for an original lender's violations of those statutes.[100] If MERS actually does own legal title mortgages it takes on "assignment," then it would have taken on potential liability under these statutes for millions of the nation's residential mortgage loans. Perhaps even more absurd, suppose for a moment that MERS were to declare bankruptcy. If courts ultimately agreed that MERS owns legal title to mortgage liens, it stands to reason that the company's creditors would have a claim on that property. Yet it is commercial madness to suggest that the right to foreclose on over half nation's residential loans could be sucked into one small company's bankruptcy proceedings—even though that company never paid value for a single mortgage loan.[101]

Moreover, the venerable rule that a mortgage follows a negotiated promissory note belies MERS' claim of owning legal title to mortgages.[102] Courts are virtually unanimous in holding that where a mortgage lender with a promissory note negotiates that note to a holder, the holder of the promissory note also obtains any mortgage securing that note.[103] Indeed, this is the very reason why the U.S.

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[98] MERS RECOMMENDED FORECLOSURE PROCEDURES, *supra* note X, at 4 ("MERS does not create or transfer beneficial interests in mortgage loans or create electronic assignments of the mortgage. What MERS does do is eliminate the need for subsequent recorded assignments altogether. The transfer process of the beneficial ownership of mortgage loans does not change with the arrival of MERS.").

[99] *Id.*

[100] 15 U.S.C. § 1641 (2006).

[101] Section 541 of the Bankrtupcty Code states that a bankrupt company's estate "is comprised of all the following property, wherever located and by whomever held: all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1) (2009). Realistically, if the issue were ever forced to the forefront, one would expect a court to conclude that the liens "owned" by MERS were not included in MERS, Inc.'s bankruptcy estate because "[p]roperty of the states does not include . . . any power that the debtor may exercise soley for the benefit of an entity other than the debtor." *Id.* at 541(b)(1). This merely affirms the point: MERS does not own mortgages.

[102] RESTATMENT (THIRD) OF PROPERTY: MORTGAGES §5.4 (a), cmt. B (1997); NELSON & WHITMAN, *supra* note X, at §5.27; GEORGE E. OSBORNE, HANDBOOK ON THE LAW OF MORTGAGES § 223 (1970);

[103] In re Ivy Properties, Inc., 109 B.R. 10, 14 (Bkrtcy.D.Mass.,1989) (under Massachusetts common law the assignment of a debt carries with it the underlying mortgage); Margiewicz v. Terco Properties of Miami Beach, Inc., 441 So.2d 1124, 1125 (Fla.Dist. Ct. App.1983) (When a note secured by a mortgage is assigned, the mortgage follows the note into the hands of the assignee); Rodney v. Arizona

Supreme Court held—over a century ago—that a "mortgage can have no separate existence" from its promissory note.[104] MERS claim to own legal title to mortgages, despite the promissory notes those mortgages secure having been negotiated elsewhere, flies in the face of the legal maxim endorsed by the Supreme Court: *accessorium non ducit, sequitur principalem*—the accessory does not lead, but rather follows the principal.[105] Mortgages are inseparable from promissory notes because of "the 'dependent and incidental relation' that a mortgage has with the obligation it secures…."[106] The parties to mortgage securitizations do not generally negotiate promissory notes to MERS.[107] Doing so would make no sense, since MERS does not pay value for the note and is not entitled to receive payment. Moreover, negotiating a note to MERS would expose MERS to assignee liability for misbehavior on the part of loan originators by virtue of statutory and common law assignee liability rules.[108] If a mortgage follows the note, then ultimately the mortgage is owned by the trustee (assuming the securitization parities successfully complete their paperwork), to whom the note is eventually endorsed. Suppose for a moment that a disagreement arose between MERS and a securitization trustee over who had legal title to a mortgage loan deposited into a securitization trust: No one

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Bank, 836 P.2d 434, 436 (Ariz. Ct. App.1992); Brewer v. Atkeison, 25 So. 992, 993 (Ala. 1899) ("[A]n assignment by the mortgagee of one of the mortgage notes operates as an assignment pro tanto of the lien upon the lands."); Martindale v. Burch, 10 N.W. 670, 671 (Iowa 1881) ("That an assignment or transfer of a note, secured by a mortgage, operates as an assignment of the mortgage lien, is a settled rule of law."); Robinson Female Seminary v. Campbell, 55 P. 276. 277 (Kan. 1898) ("the assignment of the note operated as an assignment of the mortgage made to secure the note."); Page v. Pierce, 26 N.H. 371, 1853 WL 2428, at *4 (1853) ("It is settled in this State, that the assignment of a debt secured by a mortgage of land, is *ipso facto* an assignment of the security also.").

[104] Carpenter v. Longan, 83 U.S. 271, 274 (1872). *Compare* Jackson v. Mortgage Electronic Registration Systems, Inc., Slip Op., 2009 WL 2461257, *5 (Minn. Aug. 13, 2009) ("By acting as the nominal mortgagee of record for its members, MERS has essentially separated the promissory note and the security instrument, allowing the debt to be transferred without an assignment of the security instrument.") *with* MERS STATE-BY-STATE FORECLOSURE PROCEDURES, *supra* note X, at 5 ("To reflect the interrelationship of the promissory note and mortgage and to ensure these two instruments are tied together properly, the recital paragraph names MERS, solely as nominee for Lender, as benefirciary.").

[105] *Id.* at 276.

[106] *In re* Hwang, -- B.R--, 2008 WL 4200129 at *5 (Bkrtcy.C.D.Cal. Sept. 4 2008) (quoting Carpenter, 83 U.S. at 276).

[107] Landmark Nat'l Bank v. Kessler, Land Mark Nat. Bank v. Kessler, No. 98,489, 2008 WL 4180346, at *1 (Kan. Ct. App., Sept. 12 ,2008); Peterson, *Predatory Structured Finance*, *supra* note X, at X; Steven L. Schwarcz, *The Alchemy of Asset Securitization*, 1 STAN. J.L. BUS. & FIN. 133, X (1994).

[108] *See, e.g.*, 15 U.S.C. § 1641. Furthermore, although MERS would be considered a holder, it would not be considered a holder in due course, since it does not pay value for the negotiated instrument. Uniform Commercial Code § 3-3XX.

can seriously claim that courts would award legal title to MERS instead of the trustee acting on behalf of investors that actually paid for the loan.

In thousands of cases around the country MERS' counsel continues to recite the statement that "MERS holds legal title to the mortgage" as though it were the finance equivalent of some tantric mantra. Yet, any meaningful economic analysis of this claim exposes it as a simple falsehood. MERS does not own the lien because it does not own the proceeds of the sale rendering disposition of the property seized in exercising the lien.

B. MERS Lacks Standing to Bring Foreclosure Actions

If MERS does not own the liens on which it is recorded as mortgagee or assignee, this naturally raises the question of where it gets the authority to bring lawsuits attempting to eject families from their homes. The concept of standing, or *locus standi*, refers to the capacity of a litigant to show a sufficient connection to the subject matter of a lawsuit to justify the party's participation in the case. In state courts, the requirement of standing sounds in the police powers of the state's sovereign authority to administer justice.[109] But in federal courts, the standing doctrine derives from the justiciability requirement of Article III, §2 of the Constitution which grants the federal judiciary the power to resolve only actual cases and controversies.[110] The Supreme Court has developed an extensive jurisprudence for determining whether the standing requirement of Article III is satisfied.[111] Many state supreme courts have imbedded this federal jurisprudence into their own state law, making their standing doctrines indistinguishable despite differing sources of law.[112] On the other hand, some states have not followed federal law in resolving the outer bounds of their standing requirements.[113] States that have developed their own standing rules have generally been more permissive

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[109] *See* Hawkeye Bancorporation v. Iowa College Aid Com'n, 360 N.W.2d 798, 802 (Iowa 1985) (Unlike the federal courts, state courts are not bound by constitutional strictures on standing; with state courts, standing is a self-imposed rule of restraint); N.Y. State Club Ass'n, Inc. v. City of New York, 487 U.S. 1, 8 n.2 (1988) ("the special limitations that Article III of the Constitution imposes on the jurisdiction of the federal courts are not binding on the state courts"); Asarco Inc. v. Kadish, 490 U.S. 605, 617 (1989) (holding that the constraints of Article III do not apply to state courts).

[110] U.S. CONST. Art. III, § 2.

[111] Allen v. Wright, 468 U.S. 737, 751 (1984) (court recognizes the extensive body of case law on standing).

[112] *See* Stasha D. McBride, Civil Procedure: Time to Stand back: Unnecessary Gate-Keeping to Oklahoma Courts, 56 Okla. L. Rev. 177, 177 (2003) (the Oklahoma Supreme Court has implemented state standing requirements that precisely mirror the federal standing doctrine)

[113] Helen Hershkoff , State Courts and the "Passive Virtures": Rethinking the Judicial Function, 114 Harv. L. Rev. 1833, 1838 (2001) (Many state courts do conform the scope of their judicial function to the Article III model).

in allowing plaintiffs to state a claim.[114] And, the Supreme Court has conceded to states the power to do so, even where state courts adjudicate federal questions.[115]

Federal courts, and states that model federal justiciability requirements, impose a three part standing test requiring: (1) an injury in fact, (2) causation, and (3) redressability.[116] Under the injury element, the Supreme Court has explained that courts must find a "concrete and particularized invasion of a legally protected interest."[117] The causation element requires a fairly traceable connection between the alleged injury in fact and the alleged conduct of the defendant.[118] And, for an injury to be redressable, it must be likely that "the plaintiff's injury will be remedied by the relief the plaintiff seeks in bringing the suit."[119] When a debtor cannot repay a mortgage loan this causes a clear injury in fact to the investors that have purchased securities that draw on revenue from that loan's monthly payments. What is less is clear how a debtor's failure to pay causes an injury in fact to MERS, a company that has no factual expectation of receiving loan payments or the proceeds of a foreclosure sale. MERS makes the same amount of money with respect to the original mortgage agreement whether the borrower repays or not.

Even if a court is willing to accept MERS' dubious claim that it owns legal title to a mortgage, this purely nominal ownership does not give rise to an actual injury in fact required by the latest standing precedent. In June of 2008 the Supreme Court confronted for the first time the question of whether "bare legal title" to a financial obligation is sufficient to create standing under Article III. In *Sprint Communications, Co. v. APCC Services, Inc.*[120] the Court heard facts which bear a resemblance to those involved in MERS transactions. The *Sprint* case involved public payphone customers who made long-distance telephone calls using

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[114] It is unclear whether under their police powers states may adopt more restrictive standing rules than federal courts. Arguably state courts may be obliged to apply law at least as permissive on standing as federal standing rules when adjudicating a federal claim. However, when adjudicating a state claim, one would suspect that state courts are free to decline to exercise their sovereign power provided that doing so does not deny due process of law. *See generally* Helen Hershoff, *State Courts and the "Passive Virtues": Rethinking the Judicial Function*, 114 HARV. L. REV. 1833, 1835-37 (2001) (analyzing relationship of state standing law in relation to the federal case and controversy requirement).

[115] Asarco, Inc. v. Kadish, 490 U.S. 605, 617-18 (1989) (permitting adjudication of federal claims in state court where plaintiff would not have met federal justiciability requirements). In contrast, where a state claim is removed from state court to federal court, the federal judiciary applies federal standing law. Int'l Primate Prot. League v. Adm'rs Tulane Educ. Fund, 895 F.2d 1056, 1058 (5th cir. 1990).

[116] Sprint Communications Co., L.P. v. APCC Services, Inc., 128 S.Ct. 2531, 2535 (2008).

[117] *Id*.

[118] *Id.*

[119] *Id.*

[120] Sprint Communications Co., L.P. v. APCC Services, Inc., 128 S.Ct. 2531 (2008).

a toll free "1-800" telephone number and an access code that allowed customers to draw on prepaid calling cards issued by Sprint Communications, a long-distance carrier.[121] Sprint Communications, in turn, had contracts with payphone operators to pay "dial-around" fees to the operators to compensate them for the cost of allowing payphone users to connect to Sprint's long-distance services in the first place.[122] Because payphone operating companies have had difficulty obtaining payment from Sprint and other long distance carriers, many operators assigned their dial-around claims to billing and collection firms called "aggregators" to sue on their behalf.[123] The named plaintiff, an aggregator called APCC Services, had separately agreed to remit all the proceeds of its lawsuit back to the payphone operators and that the operators would pay quarterly fees for the aggregator's services based on the number of payphones maintained by each operator.[124] In defending the lawsuit, Sprint argued that the APCC services did not have standing because it was the payphone operators, rather than the aggregator that brought the suit, that were injured in fact.[125] The federal district court disagreed arguing that an assignee for purposes of collection is entitled to bring a lawsuit when an assignor transfers absolute legal title to a debt.[126] The U.S. Court of Appeals for D.C. Circuit eventually agreed, allowing APCC's claims to go forward.[127] In a close 5-4 decision, Justice Breyer delivered a majority opinion with an extensive discussion of the history of standing in assignment. Although prior to the 17th century English law did not recognize assignments at all, by the early 18th century equity would allow suits by an assignee of the equitable interest in a debt where the assignee also had a power of attorney granted by the original obligee.[128] The original obligee could also sue based on the theory that it retained legal title to the debt, even though it had assigned away its beneficial interest.[129] The majority then went on to point to a more recent history suggesting that "courts have long found ways to allow assignees to bring suit; that where assignment is at issue, courts—both before and after the founding—have always permitted the party with legal title alone to bring suit; and that there is a strong tradition of specifically so suits by assignees for collection."[130]

Chief Justice Roberts, writing the *Sprint* minority, focused on the fact that under its compensation arrangement with payphone operators APCC did not was not entitled to any of the proceeds of a successful lawsuit. Chief Justice Roberts' dissent took issue with the majority's historical characterizations emphasizing that "[w]e have never approved federal-court jurisdiction over a claim where the entire

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[121] *Id* at 2534.
[122] Sprint Communications Co., L.P. v. APCC Services, Inc., 128 S.Ct. 2531, 2534 (2008).
[123] *Id*.
[124] *Id*.
[125] *Id.* at 2542.
[126] *Id.* at 2534.
[127] Id. at 2534–35.
[128] *Id*. at 2536–37.
[129] *Id*. at 2537.
[130] *Id.* at 2541.

relief requested will run to a party not before the court. Never."[131] The dissent expressed concern that by granting standing to collection agencies that lack some beneficial interest, such as the payphone claim aggregators, the right to sue risks becoming a "marketable commodity" severed from a personal stake in the litigation.[132] For its part, the majority contended that the dissent's concerns were over-stated since federal courts routinely entertain suits which will result in relief for parties that are not themselves directly bringing suit" such as where "[t]rustees bring suits to benefit their trusts."[133]

In its role as a foreclosure lawsuit plaintiff, MERS is in many respects comparable to APCC services and other payphone dial around fee claim aggregators. Like the aggregators, MERS does not own any equitable or beneficial interest in the debts it collects.[134] Similar to APCC, MERS remits the proceeds of any foreclosure sale to the actual, beneficial loan owners and is compensated out fees for registering loans on the MERS system.

Still, there are at least two crucial distinctions between payphone aggregators, such as APCC Services, and MERS. First, MERS' claim of ownership rests on an argument that it holds only legal title to the mortgage, rather than legal title to the debt. But this claim flies in the face of Supreme Court jurisprudence treating notes and mortgages securing notes as inseparable.[135] Thus, the Court's holding that "an assignment of the note carries the mortgage with it, while an assignment of the latter alone is a nullity."[136] Second (and perhaps even more fundamentally), the *Sprint* case is distinguishable from MERS because in the relationship between payphone operators and claim aggregators, such as APCC Services, there is only one assignment and one party that purports to hold legal title to the debt. In a mortgage securitization deals, there is *another* party that *already* lays claim to legal title to the debt: the trustee that holds legal title to trust assets on behalf of investors that purchase beneficial interests—meaning asset backed securities—drawn from the trust. In securitization deals, mortgage loans are deposited into a trust where the trustee holds legal title to trust assets for the benefit of the investors who, by definition, hold a beneficial interest in trust assets.[137] It is an ancient and universally accepted common law principal tested again and again on bar exams across our country that trustees derive their power to control trust assets by a

[131] Id. at 2551 (Roberts, C.J., dissenting).
[132] *Id*.
[133] *Id.* at 2543 (majority opinion).
[134] Landmark Nat'l Bank v. Kessler, X at *5 (labeling MERS as "a party with no beneficial interest [that] is outside the realm of necessary parties.")
[135] Carpenter v. Longan, 83 U.S. 271, 274, (1872). (Where negotiable note is secured by mortgage, "the note and mortgage are inseparable…, the assignment of the note carries the mortgage with it, while an assignment of the latter alone is a nullity.")
[136] *Carpenter*, 83 U.S. at 274. *See also In re Hwang*, -- B.R--, 2008 WL 4200129 at *6 (Bkrtcy.C.D.Cal. Sept. 4 2008) (holding "Only the Holder of the Note is the 'Real Party in Interest.'").
[137] Peterson, *Predatory Structured Finance*, *supra* note X, at 2209; Steven L. Schwarcz, *The Alchemy of Asset Securitization*, 1 STAN. J.L. BUS. & FIN. 133, 135 (1994).

dividing equitable ownership and legal ownership of trust assets.[138] Prior to the introduction of MERS to the mortgage markets, in the history of the Anglo-American common law, there has been no case that holds that a debt collection plaintiff that lacks any beneficial interest in the debt has standing to sue *even* where legal title to that debt is held by a trustee. Nor has there ever been a case that holds that there are *two* separate legal titles to the same property. Indeed, MERS owns neither the beneficial interest in the debt that is owned by investors; nor does it own legal title to the debt because that is held by the trustee. In order to reconcile MERS' claim to owning legal title to mortgage loans registered on its system, with the trustee's right to claim the same thing, one must hypothesize some new form of "meta" legal title hitherto unknown in our system. To grant MERS standing based on legal title held by someone else, is to treat the notion of legal title as some magical nonsense where ownership means nothing other than a willingness on the part of courts to let financiers seize homes however is most convenient for them.

The case against MERS' standing is only stronger where MERS acts as an "original mortgagee" instead of an assignee. In these cases, MERS is not an assignee at all, and therefore must base its claim to standing purely on its economically fictitious claim of owning a borrower's home in title theory states, or on owning a valuable lien in lien theory states.[139] Particularly in title theory states, surely it is absurd to claim that MERS, rather than the trustee of the investors that paid value, *legally owns* the hundreds of thousands of family homes with loans registered on MERS' record keeping system.

In at least one sense MERS' argument that it has standing to bring foreclosure lawsuits is fortuitous. Currently there is a growing split in authority on whether MERS has standing to bring foreclosure actions against homeowners.[140] Generally, courts that look beyond the formal labels affixed to MERS by the parties have been reluctant to grant standing.[141] In contrast, courts granting standing have generally

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[138] Rest. 2d Trusts § 2, cmnt. f. ("In a trust there is a separation of interests in the subject matter of the trust, the beneficiary having an equitable interest and the trustee having an interest which is normally a legal interest.").

[139] A majority of American jurisdictions adhere to a lien theory of mortgages that holds the mortgagor retains legal title to the realty, while mortgagee holds only a lien as security. Thompson on Real Property, *supra* note X at §101.01(b)(2). A minority of jurisdictions continue to adhere to the English view that mortgages are a conveyance of a defeasible interest. *Id.* at § 101.01(b)(1). In this older, minority view title shifts to the mortgagee, but the mortgagor retains a rights of possession and redemption. *Id.*

[140] *See* Baxter Dunaway, Statutory prerequisites--Standing and assignment of mortgages to be of record, 5 L. Distressed Real Est. § 73:15 (Updated 2008) (there has been litigation over the standing of MERS, however the majority of the cases have held MERS has standing); LaSalle Bank NA v. Lamy, 12 Misc.3d 1191, 824 N.Y.S.2d 796, at *2 (2006).

[141] *Compare* LaSalle Bank NA v. Lamy, 12 Misc.3d 1191, 824 N.Y.S.2d 796, at *2 (2006) ("[T]his court and others have repeatedly held that a nominee of the owner of the note and mortgage, such as Mortgage Electronic Registration Systems, Inc. MERS), may not prosecute a mortgage foreclosure action in its own name as

written conclusory opinions that refuse to look beyond MERS' nominal claims of ownership.[142] Perhaps the issue of whether MERS has standing to foreclose on homeowners will present an ideal test case to erect a bulwark on the holding in *Sprint Communications*. Chief Justice Roberts and the other *Sprint* dissenters were concerned that allowing debt collectors with only naked legal title to bring collection lawsuits would lead to the commoditization of standing. By holding that MERS does not have standing to bring lawsuits courts would at least take the position that assignees for purposes of debt collection lack standing where another party, such as a trustee for a loan held in trust, already holds legal title to the debt.

C. MERS' Foreclosure Efforts Implicate the Federal Fair Debt Collection Practices Act

The primary federal statute promoting civility, transparency, and accuracy in debt collection is the federal Fair Debt Collection Practices Act (FDCPA).[143] This statute, adopted in 1977, aims to provide minimum standards of public decency and civilized behavior in the collection of debts.[144] For example, the statute forbids harassment, false or misleading representations, and a variety of other unfair collection tactics, including threatening foreclosure when not legally entitled to do so.[145] The statute also includes disclosure provisions, such as a requirement that debt collectors give consumers written validation and verification of the debt itself as well as the identity of the creditor in order to prevent collection of debts or fees not actually owed.[146] The statute is enforced by the Federal Trade Commission, banking regulators, and a private right of action allowing consumers to sue for statutory punitive damages, costs, and attorney's fees.[147] While there is a well established tradition of robust judicial interpretation of the boundaries of this important federal statute, its application to MERS, the country's leading home mortgage foreclosure specialist, remains unsettled. At least two important legal

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nominee for the original lender because it lacks ownership of the note and mortgage at the time of the prosecution of the action.") (unreported disposition) *with In re* Sheridan, No. 08-20381-TLM, 2009 WL 631355 (Bkcrtcy.D.Idaho March 12, 2009) (In homeowner's bankrtupcy, MERS lacked standing to file a motion for relief from the automatic stay that would facilitate foreclosure under state law).

[142] *See, e.g., In re* Sina, 2006 WL 2729544 (Minn.App. 2006) ("Although the record shows that ALS serviced the mortgage, the assignment of the mortgage was recorded in MERS's name. And by agreement, MERS retained the power to foreclose the mortgage in its name. Because MERS is the record assignee of the mortgage, we conclude that MERS has standing to foreclose the property by advertisement.").

[143] Pub. L. No. 95-109, 91 Stat. 874, codified at 15 U.S.C. § 1692 et seq.

[144] *Id.*

[145] 15 U.S.C. §§ 1692d-1692f.

[146] 15 U.S.C. § 1692g(a); Hubbard v. Nat'l Bond & Collection Assocs., Inc., 126 B.R. 422, 427-28 (Bankr. Del. 1991).

[147] 15 U.S.C. § 1692k, l.

conclusions are likely: first, MERS itself should be covered by the statute; and second, servicers and foreclosure attorneys that use MERS' name without actual involvement of MERS itself should also be covered by the statute.

1. MERS is a Third Party Debt Collector Subject to the Fair Debt Collection Practices Act

While ambitious in its goals, the FDCPA is confined in scope. The statute only governs the practices of "debt collectors" which are generally defined as "any person who … regularly collects or attempts to collect, directly or indirectly, debts owed or due or asserted to be owed or due another."[148] By contrast, creditors—the entity that originally extends credit creating a debt—are generally not required to comply with the statute.[149] The purpose behind this somewhat artificial distinction was to focus enforcement independent third party debt collection agencies that specialize in collecting loans and accounts in default.[150] In the late '70s Congress believed that debt collection agencies accounted for the most serious and widespread debt collection abuses.[151] This view was supported by the belief that market forces would discipline abusive practices by creditors, since they could be expected to fear the loss of repeat business and reputational harm. In contrast, third party debt collectors are not selected by consumers in a market transaction. Since creditors contract with third party debt collectors, consumers do not have the ability to discipline collection agencies by refusing to do business with them.

Over the lifespan of the FDCPA, demarcating this important legal boundary between a creditor and a debt collector has proven troublesome, particularly with respect to residential mortgage markets. Thus, in an exception the statute directs that the definition of "debt collector" does not include:

> [A]ny person collecting or attempting to collect any debt owed or due or asserted to be owed or due another to the extent such activity … (ii) concerns a debt which was originated by such person [or] (iii) concerns a debt which was not in default at the time it was obtained by such person.[152]

Thus, in most cases, the FDCPA does not apply to servicers that collect monthly payments on behalf of the securitization trustee because the servicer generally obtains servicing rights prior to the borrower's default.[153] Indeed, Congress designed the exception for third party collectors that obtain debts prior to default with mortgage loan servicers primarily in mind.[154]

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[148] 15 U.S.C. § 1692a(6).
[149] 15 U.S.C. § 1692a(4), (6).
[150] SENATE REPORT NO. 95-382, at 3-4(1977).
[151] SENATE REPORT NO. 95-382, at 3-4(1977).
[152] 15 U.S.C. § 1692a(6)(F).
[153] Dawson v. Dovenmuehle Mortgage inc., No. 00-6171, 2002 WL 501499, at *5 ("A loan servicer, someone who services but does not own the debt, is not a 'debt collector' if the servicer begins servicing of the loan before default….").
[154] SENATE REPORT NO. 95-382, at 3-4(1977); Statements of General Policy or Interpretation Staff Commentary on the Fair Debt Collection Practices Act, 53 Fed. Reg. 50097, 50103 (Dec. 13, 1988) ("The exception [in 1692a(6)(F)(iii)] for debts

Unlike mortgage loan servicers and actual mortgage creditors, there is a strong argument that MERS should be treated as a debt collector under the FDCPA. Certainly, by bringing foreclosure lawsuits is MERS is “attempt[ing] to collect, [either] directly or indirectly, debts” within the meaning of the statute.[155] While some earlier cases dissented, the overwhelming majority of state and federal courts have concluded that bringing a foreclosure action is a debt collection activity governed by the Act.[156] Moreover, whatever the mortgage closing documents say, because MERS remits all proceeds of its collection activities to the actual owner of the loan (usually a securitization trustee) MERS is clearly collecting a debt that is owed to another business entity. MERS is also not a “creditor” as it is defined in the statue since creditors “offer or extend credit.”[157] While MERS does keep track of servicing rights on its database, and does allow actual creditors to use MERS’ name in communicating with county government officials, MERS does not ever extend credit by actually funding loans with its own capital. Similarly, unlike mortgage brokers or mortgage origination companies, MERS does not “originate” loans in any meaningful sense.[158] On the contrary, MERS is more akin to third party debt collectors that are immune from shopping discipline since it is the creditor that chooses to do business with MERS rather than the borrower.

MERS’ best argument that it is not merely a third party debt collector (that also happens to maintain a database and communicate with county officials) is that, like a mortgage loan servicer, MERS “obtains” its loans prior to those loans entering into default.[159] Unfortunately, the FDCPA does not provide a definition of the term “obtain.” Moreover, the word’s ordinary meaning, “to gain or attain usually by planned action or effort,” is not particularly enlightening in this commercial context.[160] Clearly if MERS “obtains” a mortgage loan by registering it on its database and by listing itself as a mortgagee or assignee on loan documents and with county officials, then the statute does not apply to the company. However, the legislative history of this provision of the statute was intended to provide an exception for mortgage loan servicers and assignees where servicing rights or ownership of the debt were transferred prior to the loan falling into

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not in default when obtained applies to parties such as mortgage service companies whose business is servicing current accounts.”); Wagner v. Am. Nat’l Educ. Corp., Clearinghouse No. 36,132 (D. Conn. 1983) (servicing company was not a debt collector for purposes of the FDCPA).

[155] 15 U.S.C. § 1692a(6). The Supreme Court has held that collection lawsuits are debt collection within the FDCPA. *Hientz v. Jenkins*, 514 U.S. 291, 294 (1995).

[156] Wilson v. Draper & Goldberg, 443 F.3d 373 (4th Cir. 2006); Kaltenbach v. Richards, 464 F.3d 524 (5th Cir. 2006); Shapiro & Meinhold v. Zartman, 823 P.2d 120 (Colo. 1992); Galusk v. Blumenthal, 1994 WL 323121 (N.D.Ill. June 26, 1994). *Cf* Bergs v. Hoover, Bax, & Slovacek, LL.P., 2003 WL 22255679 (N.D. Tex. Sept. 24, 2003).

[157] 15 U.S.C. § 1692a(4).

[158] 15 U.S.C. § 1692a(6)(F)(ii).

[159] 15 U.S.C. § 1692a(6)(F)(iii).

[160] MERRIAM-WEBSTER ONLINE DICTIONARY. 2009

arrears.[161] MERS is not a servicing company because, prior to default, it does not actually collect any payments nor communicate with debtors regarding loan repayment terms. Nor does MERS obtain a loan in the same way a traditional assignee would, since—at best—it only has a highly dubious claim of owning some form of nominal legal title.[162] The Senate Report accompanying passage of the original Act, explains that a loan is obtained by a servicer "when taken for servicing."[163] In this more meaningful and contextually relevant sense, MERS "obtains" an account to collect through foreclosure action once the loan servicer or trustee makes the effort of bringing a foreclosure suit in MERS' name. Indeed, the only time MERS ever has any actual responsibility with respect to any mortgage loan collection or servicing is when—*after default*—the actual parities in interest turn to MERS' legal identity to bring a foreclosure action. If, for a moment, one disregards the ink on paper and instead looks at the actual economic activity engaged in by the various parities, MERS looks much less like a servicer or creditor than it does a third party foreclosure specialist. Unlike servicers, "whose business is servicing current accounts," MERS' collection activities are focused exclusively and completely on collecting loans on the eve of foreclosure.

As FDCPA jurisprudence goes forward, failing to treat MERS as a debt collector risks opening up a gaping loophole in the FDCPA. If MERS is not a debt collector, third party debt collection mills may attempt to circumvent the statute by instructing doctors, hospitals, landlords, credit card lenders, and others to list MERS, or some similar company, as an "obligee of record in nominee capacity" in the loan or account origination documents. Even if the actual creditor only calls on the debt collector to collect the account or loan in the event that it falls into arrears, the debt collector's argument for a statutory exemption would be functionally indistinguishable from that currently asserted by MERS in foreclosure cases. Debt collection mills must not be allowed to insulate themselves from the FDCPA by including an economically meaningless claim of ownership in loan origination documents. Indeed, it was the possibility of just this type of circumvention that grounds the universally accepted rule that as a remedial consumer protection statute, the FDCPA must be construed broadly in favor of debtors.[164]

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[161] S. Rep. No. 95-382, at 3 (1977) (X- quote). The Federal Trade Commission's Staff Commentary also reflects this policy by explaining that: "The exception (iii) for debts not in default when obtained applies to parties such as mortgage service companies whose business is servicing current accounts."). 53 Fed. Reg. 500097, 50103 (Dec. 13, 1988).

[162] *See infra* note X and accompanying text.

[163] SENATE REPORT NO. 95-382, at 3-4(1977) ("[T]he committee does not intend the definition [of debt collector] to cover the activities of . . . mortgage service companies and others who service outstanding debts for others, so long as the debts were not in default *when taken for servicing*.") (emphasis added);

[164] *See, e.g.,* Brown v. Card Service Center. 464 F.3d 450, 453 ("Because the FDCPA is a remedial statute, we construe its language broadly, so as to effect its purpose. Accordingly, . . . we have held that certain communications from lenders to debtors should be analyzed from the perspective of the "least sophisticated debtor.").

2. Mortgage Servicers that Cloak Themselves in MERS' Name should be as Construed as Debt Collectors

One of the puzzling, and arguably suspicious, ironies behind the MERS' business model is the combination of its remarkable breadth in market share with translucent depth in market participation. Because MERS itself is a relatively small company, it does not have the resources to use its own employees to bring the hundreds of thousands of foreclosures in which it is a named party.[165] For MERS itself to participate in all of these foreclosures, the company would need loafers (as opposed to boots) on the ground in virtually every county courthouse in the nation. That would entail a large human resources operation, regional middle management, scores of leases on local office spaces, secretarial support, and many more costly expenses and managerial headaches.

MERS has solved this problem with characteristically novel and arguably flawed legal mumbo jumbo. MERS, and the mortgage servicers and foreclosure attorneys it works with, simply tell the court or anyone else that asks that the servicer's employee or the foreclosure attorney is an employee of MERS, even though MERS does not pay the individual a salary or any other compensation.[166] Indeed, MERS has adopted a company policy of naming thousands of individual employees of *other* companies and law firms "certifying officers" of MERS.[167] Employees of lenders, loan servicers, or foreclosure attorneys do not become

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[165] MERS' web page lists the contact information for only five attorneys and two paralegals. MERS Departments, http://www.mersinc.org/about/departments.aspx?id=2 (viewed Sept. 5, 2009).

[166] Mortgage Electronic Registration System, Inc., MERS Law Seminar for USFN Conference, 15 (April 21, 2002) (document on file with author) ("Question : *Who should be named as a certifying officer?* [Answer:] Anyone that signs 'documents for the Lender currently should be named as a certifying officer. This way, the Lender's procedures will not need to be changed and the same people will continue to execute the documents.").

[167] Question and Answer document produced by MERS for a training conference explains:

> Question: *What is a Certifying Officer?*
> A certifying officer is an employee of the Lender who is appointed a MERS officer by a MERS Corporate Resolution. The Resolution allows the certifying officer to execute documents as a MERS officer.
> Question: *Does the title that the employee holds as an employee of the Lender correspond to the title that the employee holds as a MERS Certifying Officer?*
> No. All MERS Certifying Officers are appointed assistant secretaries and vice presidents of Mortgage Electronic Registration Systems, Inc. That means that if an employee is a Senior Vice President of the Lender, that employee is not a Senior Vice President of MERS. The employee is an assistant secretary and vice president of MERS.

Mortgage Electronic Registration System, Inc., MERS Law Seminar for USFN Conference, 15 (April 21, 2002) (document on file with author).

officers of MERS through an actual, individually considered action on the part of the MERS' board of directors.[168] Rather, the employees of other companies and firms simply fill in a "Corporate Resolution Request Form" on MERS' web page.[169] The webpage, which includes fields for the employee's name, address, and the date, then automatically regurgitates a boilerplate document listing the names just entered on the electronic form.[170] The company even provides telephone customer support service by a paralegal for those who have trouble getting their corporate resolutions off of the web page.[171]

Courts and homeowners often actually believe servicer employees and foreclosure attorneys are employees of MERS because MERS makes an effort to give this relationship the appearance of a traditional employment. For example, "certifying officers" are given a job title.[172] In states where courts have not demanded greater authority "certifying officers" describe themselves as an "assistant secretary of MERS."[173] For more chary states, a MERS letter to servicers and foreclosure specialists explains further: "However, in a few states it has been brought to our attention that it is required that the signatory hold the office of vice president or above." No problem, explains the letter: "Therefore it is acceptable to use the title of vice president in Maryland, Mississippi, Nebraska, Oklahoma, Kansas, North Carolina, South Carolina and Pennsylvania."[174] For good measure the web page "corporate resolution request form" allows servicers and foreclosure specialists to order as many MERS corporate seals as they would like—for a convenient, reasonable fee of $25.00 each.[175] Perhaps, for a company that pretends to "own" half of the nation's mortgages, pretending to have hundreds of "vice presidents" all over the country is not much of a stretch.

However, for adjudicators hoping to faithfully implement the federal Fair Debt Collection Practices Act, the substance, rather than the form, of employment relationships of those that collect debts is meaningful. The FDCPA demands that courts look past the nominal labels debt collectors give themselves and determine who is actually engaging in what type of economic activity. For example, debt collectors that pretend to send letters from an attorney, where an attorney has not

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[168] Mortgage Electronic Registration System, Inc., MERS Law Seminar for USFN Conference, 15 (April 21, 2002) (document on file with author) ("Question: *How do we update our officer list?* [Answer:] Go to the MERS web site www:mersinc.org, and under MERS ProductPMERS Online>Foms, click on the Corporate Resolution Request Form and follow the instructions.").

[169] MERS, Corporate Resolution Request Form, www.mersinc.org/MersProducts/forms/crrf/crrf.aspx (last viewed: April 6, 2009).

[170] *Id. See also* Mortgage Electronic Registration System, Inc., MERS Law Seminar for USFN Conference, 15-16 (April 21, 2002) (document on file with author) (providing a sample certifying officer resolution).

[171] *Id.*

[172] Mortgage Electronic Registration System, Inc., MERS Law Seminar for USFN Conference, 14-15 (April 21, 2002).

[173] MERS, Corporate Resolution Request Form, www.mersinc.org/MersProducts/forms/crrf/crrf.aspx (last viewed: April 6, 2009).

[174] *Id.*

[175] *Id.*

actually reviewed the file in question, commit an actionable deception under the statute.[176] Similarly, third party debt collectors cannot obtain an exemption from the statute simply by pretending to be the original creditor.[177] And, importantly, creditors that pretend to be debt collectors are explicitly regarded as such under the statute.[178]

If the courts ratify MERS' claim to have hundreds or even thousands of "vice presidents" around the country (without paying a single cent in compensation to any of them) ejecting people from their homes, what is to prevent any credit card lender, hospital, or land lord from adopting "corporate resolutions" naming their third party debt collectors vice presidents of their own companies? Presumably, under MERS' rationale, the FDCPA could be circumvented simply by including a "corporate resolution" purporting give the debt collector a job title along with any assignment of a debt for collection.

Furthermore, courts have an obligation to take a step back for a moment to look at these relationships from the perspective of a confused, frightened homeowner teetering on the brink of foreclosure and possibly even homelessness.[179] How is a homeowner to understand with whom they can negotiate a settlement, or from whom to obtain additional information, or how to distinguish a legitimate employee of a legitimate company from the thousands of mortgage related con artists and charlatans currently swirling around American families?[180] The Consumer Credit Protection Act in general, and the Fair Debt Collection Practices title of that Act in particular, took the position that even misleading (as opposed to false) representations had no place in the debt collection industry because of the great potential for consumer abuse and the threat to the American economy from undermining our collective faith in financial markets and institutions.[181] To effectuate this policy of transparency and honesty,

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[176] Clomon v. Jackson, 988 F.2d 1314 (2d. Cir. 1993).

[177] 15 U.S.C. § 1692e(11) .

[178] 15 U.S.C. § 1692a(6) ("The term 'debt collector' . . . includes any creditor who, in the process of collecting his own debts, uses any name other than his own which would indicate that a third person is collecting or attempting to collect such debts, such term includes any person who uses any instrumentality of interstate commerce or the mails in any business the principal purpose of which is the enforcement of security interests.").

[179] Clommon, 988 F.2d at 1318 ("The basic purpose of the least-sophisticated-consumer standard is to ensure that the FDCPA protects all consumers, the gullible as well as the shrewd. This standard is consistent with the norms that courts have traditionally applied in consumer-protection law.").

[180] John Leland, *Swindlers Find Growing Market in Foreclosures*, N.Y. TIMES, January 15, 2009, at A1; Vivian S. Toy, *Penetrating the Maze of Mortgage Relief*, N.Y. TIMES, June 14, 2009, at RE1; Riva Richmond, *Online Scammers Target the Jobless*, N.Y. TIMES, August 6, 2009, at B6.

[181] 15 U.S.C. § 1692(a), (c) ("There is abundant evidence of the use of abusive, deceptive, and unfair debt collection practices by many debt collectors. Abusive debt collection practices contribute to the number of personal bankruptcies, to marital instability, to the loss of jobs, and to invasions of privacy. … Means other

misrepresentations and misleading statements are evaluated from the perspective of the "least sophisticated consumer" standard.[182] Unsophisticated consumers that receive communications from a MERS "vice president" or "assistant secretary" are likely to believe that this individual serves a different role in the foreclosure process than he or she actually does. Having foreclosure communications conducted in MERS' name may lead consumers to believe that the servicer has turned the case over to a quasi-official entity that lacks the authority to negotiate loan modifications, short sales, or settlements. The effect could be to pacify the consumer at the point they are most likely to resist through actively litigating (often in a *pro se* capacity) their all too often legitimate counter claims and defenses. Indeed, this is precisely the sort of deception targeted by the federal statute promoting "fair" debt collection.

D. Loans Recorded in MERS' Name May Lack Priority against Subsequent Purchasers for Value and Bankruptcy Trustees

Perhaps the single most troubling legal question that remains unanswered with respect to MERS' legal foundation is whether recording assignments or mortgages in MERS' name is sufficient protect lienors against subsequent purchasers, including especially a bankruptcy trustee. A primary objective of rules requiring recording mortgages in county recording systems is to provide a rough form of notice to subsequent purchasers of pre-existing ownership claims. To create an incentive to promptly and accurately record mortgages, state recording statutes often depart from the customary "first in time, first in right" priority rule when a mortgagee fails to properly record.[183] Under state law, if a mortgagee fails to properly record its mortgage, and then someone subsequently buys or lends against the home, the subsequent purchaser can often take priority over the first.[184] In jurisdictions stylized as "notice" states, a subsequent purchaser for value takes priority over an earlier mortgagee if the purchaser had no actual or constructive notice at the time of the conveyance.[185] A purchaser is generally thought to have constructive notice if the original mortgagee successfully recorded her mortgage with the appropriate county recording office.[186] In some states, a purchaser also has "inquiry notice" if there are facts, such as possession, that would alert the purchaser of the prior interest.[187] In "race-notice" states, the subsequent purchaser takes free of the prior mortgage only if she took without actual or constructive notice and successfully records before the prior mortgagee.[188] In all fifty states, if

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than misrepresentation or other abusive debt collection practices are available for the effective collection of debts.")

[182] Clomon v. Jackson, 988 F.2d 1314 (2d. Cir. 1993); Gammon v. GC Services Ltd. Partnership, 27 F.3d 1254 (7th Cir. 1996).

[183] POWELL ON REAL PROPERTY § 82.01[3].

[184] *Id.* at § 82.02[1][a].

[185] *Id.*

[186] *Id.* at § 82.02[1][d][ii].

[187] *Id.* at § 82.02[1][d][iii].

[188] *Id.* at § 82.02[1][a].

the original debtor files for bankruptcy, a chapter 7 trustee can avoid the mortgage loan if under state law a hypothetical bona fide purchaser would have had priority.[189] In such cases, the result is that mortgage lenders are treated as unsecured creditors and are likely to receive only pennies on the dollar, rather than the full fair market value of the home at the time of the bankruptcy petition.[190]

Indeed, state recording statutes and the federal bankruptcy code, place severe financial penalties on mortgage lenders that make even minor clerical errors in recording their home mortgage liens. Taking only few examples from the many possible is sufficiently illustrative. Courts have invalidated recorded mortgages because a notary acknowledgment form, although signed by a mortgagor and a witness, did not clearly indicate who was physically present before the notary at the time of signing—even when there was no actual dispute over the identity of the individuals in question.[191] Merely forgetting to affix a notary's seal can lead to avoidance.[192] The lack of a second witness signature rendered a mortgage avoidable by a bankruptcy trustee, even though the mortgage was physically registered with the town clerk and fully searchable in the title records.[193] There are many cases where incorrect property descriptions rendered mortgages avoidable.[194] Even omission of the amount t of a mortgage debt has led to invalidation of a mortgage record.[195] In all of these cases, the result of the minor variation from the norm contemplated by the state legislature was the avoidance of

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[189] 11 USC 544(a)(3); *In re Seaway Exp. Corp*., 912 F.2d 1125, 1128 (9th Cir. 1990) ("[A] bona fide purchaser prevails over a prior unrecorded conveyance.").
[190] David Lloyd & Ariane Holtschlag, *Chapter 13 Strip-Off of Junior Mortgages: Not Whether, But How Under Current Law*, 28 AM. BANKR. INST. J. 12, 12 (2009).
[191] *In re Stubbs*, 330 B.R. 717, 726-30 (N.D. Ind. 2005). *See also* In re Cocanougher, 378 B.R. 518 (Ky 2007) (omission of debtors' names on acknowledgement rendered mortgage avoidable).
[192] In re Marsh, 12 S.W.3d 449 (Tenn. 2000) (notary public's accidental failure to affix his seal on acknowledgement of deed of trust rendered instrument null and void as to subsequent bona fide purchaser).
[193] *In re Ryan*, 851 F.2d 502, 505 (1st Cir. 1988) ("Although "recorded" in the sense it was physically placed in the records of the town clerk, the original mortgage deed was not an "effectual" or valid recording under Vermont law because it was signed by only one witness. It was as if never recorded.") (citations omitted). *See also* In re Cornelius, 2009 WL 2179128 (Bank. Ohio 2009) (Chapter 7 trustee had priority over mortgagee because of improperly acknowledged mortgage).
[194] Poncelet v. English, 795 P.2d 436 (Mont. 1990); O'Neill v. Lola Realty Corp., 264 A.D. 60 (N.Y. 1942); Norton v. Fuller, 251 P. 29 (Utah 1926).
[195] Bullock v. Battenhousen, 108 Ill. 28, 1883 WL 10352, *5 (Ill. 1883) ("The spirit of our recording system requires that the record of a mortgage should disclose, with as much certainty as the nature of the case will admit, the real state of the incumbrance. If a mortgage is given to secure an ascertained debt, the amount of such debt should be stated. By omitting to so state the debt the widest door is opened for fraud of every description, and to prevent the same the law declares such a mortgage fraudulent and void as to creditors and subsequent purchasers.").

the mortgagor's lien—in effect reducing a home mortgage loan to a debt no different than an unsecured credit card.

While the results in these cases are easily criticized as harshly formalistic and unbridled from the parties' original contractual intentions, courts defend with stern sermons on the importance of maintaining transparent records of ownership interests in land. A federal bankruptcy judge's recent defense of these cases is worth quoting at length:

> Lest one think that the . . . Courts have exalted form over substance, it is critical to note several concepts. . . . [W]we are dealing with interests in land—not a security interest in an inventory of plumbing fixtures, in chinchillas, in canned corn, or in a lawn and garden tractor. Land. Land is certainly the asset which people deem to be their most important "possession": There is no other "thing" more important historically in our culture than an interest in land, whether that interest be in a condominium, in a house, or in farm. Land. The transferring of interests in land has been entrusted to a system of records that allows people to be certain that this single most important asset in their lives is *indeed* going to be theirs, and that the encumbrances recorded with respect to this asset are in fact accurate and valid. It is therefore absolutely imperative that transactions in land be guaranteed to vest title in the people who invested in those transactions, and that the investors know definitively the interests in the land in which they invest which may affect their interests in this singularly important asset. The record of land transactions in the Recorder's Office provides this critical assurance. Perhaps the most critical aspect of this "chain" of assurance is to guarantee as much as possible on the face of an instrument that a person purported to have signed a document which affects interests in land actually did sign that document.[196]

Financiers' decisions to record their mortgages and mortgage assignments in MERS' name, rather than their own, must be judged within this contextual tradition.

Historically, virtually no state recording statutes have explicitly authorized mortgagees or mortgage assignees to vicariously record using the name of an agent or nominee. Nevertheless, in its landmark legal opinion that does not cite cases or statutes, Moody's Investor Service asserted that "[t]he recording system has been set up to provide notice of security interests, but not necessarily the identity of secured parties."[197] This would be a more persuasive argument if virtually every recording act ever adopted did not, in fact, require record keeping for both the name of mortgagors and mortgagees—thus the use of grantor-grantee indexes in the vast majority of states.[198] Indeed, the very first American recording statute, adopted by Massachusetts Bay Colony in 1640, required recording of the names of

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[196] *Stubbs*, 330 B.R. at 730.
[197] Moodys, *supra* note X, at 3.
[198] 14 POWELL ON REAL PROPERTY §82.03[2][b].

the parties—including both “the names of the grauntor and grauntee.”[199] Under its most plain and simple reading, that statute does not contemplate nor allow obscuring actual ownership through naming only a “mortgagee of record in nominee capacity.” Indeed there are many cases, and compelling secondary authority, suggesting that errors in or omission of the name of a mortgagee invalidate either the recording or even the mortgage agreement itself, rendering the mortgage avoidable.[200] The policy of requiring the recordation of the actual mortgagee’s name sounds in the longstanding title recordation act goal of “prevent[ing] secret conspiracies between mortgagors and mortgagees as to the fact and amount of indebtedness to the prejudice of subsequent purchasers and creditors, by compelling them to at once make known the real claim.”[201] If the identity of mortgagees were unimportant, legislatures could easily have drafted recording statutes, and record keeping systems, to merely require disclosure of the existence of a lien, with no reference to who owns it. Moreover, rather than using a grantor-grantee index, real property records could have been designed to only use tract indexes. But, by and large, legislatures did not do this. And as much as MERS and the mortgage lending industry may wish it were otherwise, recording acts specify that the name of the mortgagee or assignee must be included and that records and indexes be drawn up from the names of both parties.[202] Surely MERS executives knew this and that fact more than any other explains why the company would so frequently engage in the contortioned linguistic gymnastics of claiming

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[199] 14 POWELL ON REAL PROPERTY §82.01[1][b] (*quoting* 1 RECORDS OF THE GOVERNOR AND COMPANY OF THE MASSACHUSETTS BAY IN NEW ENGLAND 306 (N. Shurtleff ed. 1853)).

[200] Disque v. Wright, 49 Iowa 538, 1878 WL 623 (Iowa 1878) (“It has been frequently held that slight omissions in the acknowledgment of a deed destroy the effect of the record as constructive notice. *A fortiori,* it seems to us, should so important and vital an omission as that of the name of the grantee have that effect.”); Chauncey v. Arnold, 24 N.Y. 330 (N.Y. 1862) (“No mortgagee or obligee was named in [a mortgage], and no right to maintain an action thereon, or to enforce the same, was given therein to the plaintiff or any other person. It was, *per se,* of no more legal force than a simple piece of blank paper.”); Richey v. Sinclair, 67 Ill. App. 580 (Ill. App. 1896) (mortgage that did not name mortgagee, though it described note secured thereby as payable "to the order of" named person, was void for failure to name mortgagee); Allen v. Allen, 51 N.W. 473, 474 (1892) (omission of name of grantee invalidated conveyance because “A legal title to real property cannot be established by parol.”) *See also* 2 PATTON AND PALOMAR ON LAND TITLES § 338 (3d ed. 2009) (“It is axiomatic that a deed will be inoperative as a conveyance unless it designates someone to whom the title passes. A grantee is as necessary to the validity of a grant as that there should be a grantor or a property granted.”); 59 CJS MORTGAGES § 306 (“Notice may be deemed not present in cases of insufficient attestation or where the instrument itself is so defective as to be void as a matter of law, as where it wholly omits the name of the mortgagee.”) (citations omitted).

[201] Bullock, 108 Ill. 28, at *5.

[202] 14 POWELL ON REAL PROPERTY §82.03[2][b].

that it is simultaneously both an agent and a principal with respect to the mortgages it "owns."

IV. ANALYZING MERS' ROLE IN THE RESIDENTIAL MORTGAGE MARKET

Looking beyond the problematic legal doctrine associated with MERS, an analysis of the role the company plays holds at least three important insights: (1) the MERS system was one additional contributing factor in the genesis of the mortgage foreclosure crisis; (2) the company's private, for profit, database and tax evasion services are causing atrophy in the nation's public real property information infrastructure; and (3), the financial industry's sponsorship and embrace of MERS in the absence of legislation or meaningful judicial precedent reflects a troubling anti-democratic shift in housing policy.

A. MERS and the Subprime Mortgage Lending Foreclosure Crisis

While there is plenty of blame to go around, the MERS recording and foreclosure system was yet one additional contributing cause of the American mortgage foreclosure crisis. MERS facilitates predatory structured finance by decreasing the exit costs of originators. As investment banks, hedge funds, institutional investors, and the credit rating agencies weighed the risks of dumping billions upon billions of dollars into mortgage securities drawn out of the balance sheets of thinly capitalized, bankruptcy-prone mortgage lenders, MERS provided an important additional inducement. In previous research I have argued that in the run-up to the foreclosure crisis mortgage origination companies were used as disposable liability filters.[203] When thinly capitalized originators churned out more and more securitized loans, claims against those lenders accumulated, while their assets did not.[204] Once the projected costs of disgruntled investor recourse demands and borrower predatory lending lawsuits exceeded the projected costs of bankruptcy and reformation under a new corporate guise, originator management would predictably discard their corporate identity.[205] MERS made this easier by offering a *super-generic placeholder* that transcended the aborted life of lenders. MERS reassured investors that even when an originator goes bankrupt, county property records would remain unaffected and foreclosure could proceed apace. By serving as the true mortgagee's proxy in recording and foreclosure, MERS abetted a fly-by-night, pump-and-dump, no-accountability model of structured mortgage finance.

Moreover, the use of MERS' corporate identity facilitates separation of foreclosure actions and litigation of predatory lending and servicing claims. When MERS (or more accurately servicers or foreclosure specialists acting in MERS' name) brings foreclosure actions, it justifies this entitlement based on a claim of legal ownership of mortgage liens. But, when borrowers attempt to assert counter claims challenging the legality of mortgage brokers, lenders, trusts, or servicers,

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[203] Peterson, Predatory Structured Finance, *supra* note X, at 2275.
[204] *Id.*
[205] *Id.*

MERS hides behind its claim of nominee status. One former mortgage lender has estimated that in the mid-2000s approximately 70 percent of brokered loan applications submitted to mortgage lenders involved some form of broker encouraged fraud.[206] Similarly, Professor Porter's study of mortgage loans in Chapter 13 bankruptcy found that residential mortgage creditors did not supply a promissory note in 41.1% of cases involving a home mortgage.[207] Because promissory notes are not recorded, nor where MERS is involved, is the actual identity of the note holder revealed, consumers and their counsel can verify neither the identity of the parties involved, nor even the amount of the debt in question. In an ordinary foreclosure, using MERS' name erects a tactical barrier to judicial resolution of these types of problems. MERS confuses and pacifies borrowers (and sometimes courts) at precisely the crucial moment: on the eve of foreclosure. Once a family looses their home, their leverage and appetite for litigation dissipate. The separation of predatory lending litigation from foreclosure litigation facilitated by bringing foreclosure in MERS' name decreases the costs of foreclosure and dulls the deterrent force of consumer protection law. MERS represents the mortgage finance industry's best effort to create a single, national foreclosure plaintiff that always has foreclosure standing, but never has foreclosure accountability.

Obviously MERS is not responsible for the failed monetary and regulatory policy of the Federal Reserve Board.[208] The President and Congress could have intervened in the troubling trends toward unrealistic mortgage loans.[209] Mortgage brokers and lenders systematically strove for volume and commissions, rather than sustainable home ownership.[210] Federal banking regulators obstructed the efforts of state legislators and attorneys general to bring the market to heel.[211] The credit rating agencies rashly gave their seal of approval to the risky, complex packaged and repackaged mortgage loans securities.[212] While MERS may have reassured investors of the viability of churned residential mortgage backed securities, it had little to do with the over-leveraging of hedge funds, bond insurers, or the government sponsored housing enterprises.[213] The recognition of MERS' role in

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[206] RICHARD BITNER, CONFESSIONS OF A SUBPRIME LENDER: AN INSIDER'S TALE OF GREED, FRAUD, AND IGNORANCE 45 (2008).
[207] Katherine Porter, *Misbehavior and Mistake in Bankruptcy Mortgage Claims*, 87 TEX. L. REV. 121, 147(2008).
[208] Paul Krugman, *How Did Economists Get it So Wrong?*, N.Y. TIMES, Sept. 6, 2009, MM36.
[209] Jo Becker, Sheryl Gay Stolberg, & Stephen Labaton, *White House Philosophy Stoked Mortgage Bonfire*, N.Y. TIMES, December 21, 2008, at A1.
[210] Bitner, *supra* note X, at 181-82.
[211] Christopher L. Peterson, *Federalism and Predatory Lending: Unmasking the Deregulatory Agenda*, 78 TEMPLE L. REV. 1, 96-97 (2005); Christopher L. Peterson, *Preemption, Agency Cost Theory, and Predatory Lending by Banking Agents: Are Federal Regulators Biting Off More than they Can Chew?*, 56 AM. U. L. REV. 515, 549-551 (2007).
[212] Steven L. Schwarcz, *Understanding the Subprime Financial Crisis*, 60 S.C. L REV. 549, 550-52 (2009).
[213] Frederick Tung, *The Great Bailout of 2008-09*, 25 EMORY BANKR. DEV. J. 333, 336 (2009); Binyamin Appelbaum, Carol D. Leonning & David S. Hilzenrath,

facilitating the foreclosure crisis is not to ignore nor excuse these other causal factors. Nevertheless, it is a mistake to list the contribute factors associated with the crisis and omit MERS.

B. MERS and Atrophy of the Land Title Information Infrastructure

Over time, the widespread recording of loans and loan assignments in MERS' name will assist fraudsters and cause decay in the accuracy of public real property records. Suppose, for example, in a transaction where MERS is recorded as the original mortgagee, a mortgage broker or originator convinces a homeowner to sign a renewal note and mortgage after the original note and mortgage have been assigned. (This is imminently plausible when many homeowners sign anything put in front of them.[214]) Then, further suppose the broker or originator attempts to sell the subsequent renewal note and mortgage to a bona fide purchaser for value. If the prospective purchaser wanted to rely on public records, it would search with the county and discover the original mortgage listed in MERS' name. If the originator acted quickly so that the date of the original loan was proximate in time to the subsequent loan, then the purchaser would naturally assume that the loan recorded in MERS' name was the self-same loan they planned to purchase. Because the original mortgage is recorded in the name of MERS, and because there is no public record of the assignment of the original note, the subsequent bona fide purchaser would have no publically available way to discover the fraud—and the entire transaction could be completed without recording a single fraudulent document. In the ironic and inevitable litigation both purchasers would claim that in MERS' original recording MERS was acting as *their* agent, leaving the court to award priority where both lenders have a essentially the same "claim" based on the same recording. Two or more mortgages against the same property could easily end up in different (or even *the same*) pool of mortgages that are securitized for investors. Recording real property ownership interests in the name of an agent, rather than the actual owner, opens the door to unscrupulous agents using the same record to fool multiple principals. And our long standing case law and statutes will have little advice on how to equitably resolve competing claims of priority since this body of authority assumes that purchasers will record their own, rather than their agent's name. Envy not the judges and law clerks assigned to write these forthcoming opinions.

Similarly, MERS may also spawn fraud, confusion, and litigation by facilitating fraudulent mortgage loan releases. One reason recording statutes require that the actual mortgagee's or mortgage assignee's name be kept in the

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How Washington Failed to Rein in Fannie, Freddie, WASH. POST., Sept. 14, 2008, Bus. Sec.

[214] JAMES M. LACKO & JANIS K. PAPPALARDO, FED. TRADE COMM'N, IMPROVING CONSUMER MORTGAGE DISCLOSURES: AN EMPIRICAL ASSESSMENT OF CURRENT AND PROTOTYPE DISCLOSURE FORMS 26-29 (2007), http://www.ftc.gov/os/2007/06/P025505MortgageDisclosureReport.pdf; Todd J. Zywicki & Joseph D. Adamson, *The Law and Economics of Subprime Lending*, 80 U. COLO. L. REV. 1, 72-73(2009).

records is to help ensure that liens can only be released by the party entitled to do so. For example, recording statutes attempt to prevent unscrupulous land owners from recording a false mortgage satisfaction and then obtaining another loan under false pretenses. Any of MERS' thousands of unmonitored, unpaid, and unsupervised vice presidents and assistant secretaries can file fraudulent satisfactions that are indistinguishable from authentic records. Homeowners that happen to be a MERS vice president (or have a coconspirator that is or posses as a MERS vice president) could record mortgage satisfactions, then sell the home or obtain a new loan and all-the-while the public real property records would not reveal the previous unpaid debt.

In the wake of the subprime crisis, this decline in the value of the public records is already occurring.[215] For example, in loans where MERS is listed as the mortgagee, virtually any company can show up, claim to own the note, and proceed to foreclose on a family that is in arrears. Because MERS has so many "certifying officers" a court cannot easily verify whether the individual acting in MERS' name is actually representing the real party in interest given that the public records do not reveal who that party is. One can imagine an original mortgagee, either through error or fraud, foreclosing on a defaulting family despite having assigned the loan into a structured finance deal. In a MERS as original mortgagee transaction, the assignment would not be recorded, and the only name on the public records would be MERS'. Neither the courts nor a purchaser at a judicial or non-judicial foreclosure sale could use the public records to discover that someone other than the company or individual bringing foreclosure action actually owns the proceeds of the sale.

Moreover, in recent years, many courts have been indulgent in dispensing with normal the requirement that a foreclosure plaintiff produce the original promissory note. Not wanting investors to suffer forfeiture because of a record keeping problem, many courts have instead accepted affidavits claiming that original note was lost or even a copy of the pooling and servicing agreement naming the servicer.[216] Conversely, because in structured finance deals, originators,

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[215] Creola Johnson, *Fight Blight: Cities Sue to Hold Lenders Responsible for the Rise in Foreclosures and Abandoned Properties*, 2008 UTAH L. REV. 1169, 1185.

[216] Porter, *supra* note X, at 172-74;Raymond H. Brescia, *Beyond Balls and Strikes: Towards a Problem Solving Ethic in Foreclosure Proceedings*, CASE W.R. L. REV. 305, 345 (2009); Chris Markus, Ron Taylor, & Blak Bogt, *From Main Street to Wall Street: Mortgage Loan Securitization and New Challenges Facing Foreclosure Plaintiffs in Kentucky*, 36 N. KY. L. REV. 395, 406 (2009). A few courts have begun insisting on more accurate documentation form foreclosure plaintiffs. , In re Foreclosure Cases, Nos. 1:07CV2282 (N.D. Ohio Oct. 31, 2007) (dismissing consolidated foreclosure cases for failure to produce evidence demonstrating ownership or assignment of promissory notes); Bank of New York v. Williams, 979 So. 2d 347 (Fla. Dist. Ct. App. 2008) (affirming dismissal of the foreclosure complaint for failure to show ownership interest in mortgage and note); HSBC Bank USA, Nat'l Ass'n v. Perboo, No. 38167/07, 2008 WL 2714686 (N.Y. Sup. Ct. July 11, 2008) (denying foreclosure plaintiff's application for default judgment); Wells Fargo Bank, Nat'l Ass'n v. Reyes, No. 5516/08, 2008 WL

securitizers, and trustees have been notoriously lax in keeping track of promissory notes, it is possible that an employee of an original lender or a broker (either of whom could credibly claim to represent MERS) could conceivably still retain possession of the actual original promissory note, despite having received funds from the assignment of the loan.[217] A court could easily order a foreclosure, sell the home, give the funds to someone not entitled to them, and the actual owner would never be the wiser. The clever thief would make payments on behalf of the defaulting borrower during the pendency of the foreclosure (the unwitting family would certainly not complain) to keep the actual loan assignee from investigating.[218] Because so many finance professional have lost their jobs, and some were not especially reliable in the best of times, one should think that the risk of such schemes is now acute.[219] Moreover, given the empirical and anecdotal evidence of shoddy record keeping in this industry, it is entirely possible that an originator or servicer could unintentionally foreclose on a loan that it does not actually own. [220] The ubiquitous use of the MERS label in our public real property records along with our new casual flexibility in notions of corporate identity facilitates this sort of fraud and mistake.

When half of the nation's mortgages are all recorded under the name of one company that does not publish its own records, the ability of the public (including both consumers and lenders) to use public records to evaluate who owns real property interests will inevitably decline. In county recording officers around the country, real property records increasingly repeated MERS' name over and over again. In an often repeated Irish fable a boy marks a leprechaun's gold with red handkerchief tied around a tree.[221] He returns only to find that the leprechaun has tied red handkerchiefs tied around every tree in the forest. Recording mortgages in MERS' name leaves a message signaling the existence of a lien. But it does not reveal who owns the lien or who has the right to release it. If present trends and the MERS agenda continue apace, we should expect that eventually virtually every home in the country will, at one point or another, have a MERS recording against it. Viewed alone, county real property records will become a forest where each tree has its own handkerchief. To discover a more accurate picture of the title status of

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2466257 (N.Y. Sup. Ct. June 19, 2008) (dismissing complaint for plaintiff's failure to establish ownership of mortgage).

[217] Johnson v. Melnikoff, Slip op., 20 Misc.3d 1142, 2008 WL 4182397, *1 (N.Y. Supp Sept. 11, 2008)

[218] An especially clever strategist would continue to make the payments for a year or more while concealing the proceeds and running the same scheme several times over.

[219] *See, e.g.,* Cary Spivak, *Criminal Past No Barrier to Mortgage Field: Ex-Cons Who Got Loan-Originating Licenses Commit Scores of Frauds that Cost Customers Millions*, MILWAUKEE J. SENT., March 14, 2009, A1.

[220] *Cf* Nosek v. Ameriquest Mortgage Company, 386 B.R. 374, 379 (2008) (attorneys sanctioned for defending Ameriquest in an eight day trial while never advising the Court that Ameriquest was neither the note holder nor the mortgagee).

[221] AMY T. PETERSON & DAVID J. DUNWORTH, MYTHOLOGY IN OUR MIDST: A GUIDE TO CULTURAL REFERENCES 93 (2004).

a home, the public will be forced to turn to MERS, Inc. This will makes the public records derivative of and subordinate to the MERS system.[222]

Moreover, this decline in the usefulness of public records is exacerbated financially because MERS is usurping the recording fees that once funded maintenance, innovation, and vigilance in public record keeping systems. Proponents of MERS often cite figures on how much money the mortgage finance industry "saves" by recording under MERS' name rather than real parties in interest. In some sense, this notion of savings is a misnomer. One could just as easily characterize the commercial pattern as crippling budget cuts in public information infrastructure designed to create transparency in ownership of real property. By allowing the mortgage lending industry to circumvent their traditional obligation to maintain fraud resistant public records, in the long run, the courts will facilitate commercial uncertainty, inefficient litigation, and disappointed expectations.

Recording mortgages in the name of MERS and subsequent refusal to record assignments is not a technological innovation. On the contrary, it is an example of atrophy in the mortgage market's legal infrastructure. Companies that specialize in shipping goods need highways, bridges, and ports—physical infrastructure completely indispensible to commerce. But despite the importance of creating and maintaining such infrastructure, collective action problems make the hard work of facilitating infrastructure impossible for individual market actors. These companies and the consumers they serve need the firm hand of government to organize the leadership and extract the resources necessary to facilitate infrastructure for the benefit of all. Commerce in shared human obligation—loans—is not so terribly different. Profit-seeking individual companies are not well suited to maintaining a platform of transparent information systems easily accessible to our communities. MERS and its proponents are no doubt sincere in their belief that their private, undemocratic information system is a boon to business. However, this belief is premised on a short term view of maximizing profit at the expense of maintaining a public information system. It is certainly true that county recording systems are technologically outdated. However, the solution to outdated infrastructure is to modernize that infrastructure, not abandon it. If MERS is allowed to continue to plot its own course as the national residential property ownership oracle and foreclosure plaintiff, the burden of reconstructing chains of real property ownership in cases of fraudulent or erroneous conveyance will increasingly shift from county recorders to litigation.[223] The national system of public land title record keeping will become derivative and its usefulness will decay.

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[222] MERSCorp, Inc. v. Romaine, 861 N.E.2d 81, 88 (N.Y. 2006) (Kaye, J. dissenting in part) ("[T]he MERS system will render the public record useless by masking beneficial ownership of mortgages and eliminating records of assignments altogether. Not only will this information deficit detract from the amount of public data accessible for research and monitoring of industry trends, but it may also function, perhaps unintentionally, to insulate a noteholder from liability, mask lender error and hide predatory lending practices.")

[223] It is likely that this litigation will often be *pro se* or will be handled by consumer attorneys that are not paid enough to assemble and wade through the factually complex private land title evidence. Cases where courts maledict pro se

C. Title Recording Law and Democratic Governance

A fair critique of MERS must include recognition of the dated, expensive, and cumbersome nature of county real property records and state recording statutes. Unlike the relatively homogenous personal property lien recording systems governed by Article 9 of the Uniform Commercial Code, the National Conference of Commissioners on Uniform State Laws and the American Law Institute have not been able to prevail on state legislatures to standardize real property mortgage and recording laws. Moreover, unlike personal property lien records, which are usually maintained by a Secretary of State, real property records are generally maintained by each county. This further diversifies record keeping standards and operating procedures. It is only fair to say that, even with the use of title insurer plant copies, recording and searching in county property records is time consuming, expensive, and often not especially reliable.[224] In contrast, MERS gives each loan a unique identifier, is accessible through the internet, and is organized n one nationwide system.[225]

Still, the consumer protection critique of MERS is not just about what MERS does wrong, but also what the process of creating MERS prevented. By taking upon itself the reformation of the county recording systems created by state law, MERS and the mortgage finance industry circumvented the state and national debate that normally precedes significant legislative change. The MERS system, while digital and nationwide in scope, is not equally available to all. It has given a single corporation the opportunity to grant special "vice president" status to its favored side in foreclosure disputes. It has been manipulated into a device to make foreclosure easier and more anonymous for financiers. The financial industry could have channeled its dissatisfaction with county property records into a campaign for legal reform. This would have necessitated a debate where consumers, county officials, researchers, poverty advocates, and anyone else could have participated. Fifteen years ago, if the finance industry put its formidable legislative muscle behind a public reformation of county recording systems, perhaps today we would have a national system maintained by a federal regulator, or a statewide systems supported by a new Article of the Uniform Commercial Code. Instead financiers chose to act alone, creating an entirely new system that competes financially with public records, undermines the accuracy of public records, and was never authorized by the elected leaders that guide a republican system of law.

In a moment of refreshing candor, not long ago a MERS senior vice president concluded an extolling public relations piece with the explanation that "MERS is

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foreclosure defendants and underpaid consumer counsel are illustrative of the MERS led trend toward erosion of clear, public mortgage records. *See, e.g.*, Lumzy v. Mortgage Electronic Registration Systems, Inc., Slip op., 2008 WL 3992671 (S.D. Miss. Aug. 21, 2008) (dismissing Fair Debt Collection Practices Act suit against MERS because "her conclusory and convoluted allegations do not pass muster.") .

[224] 14 POWELL ON REAL PROPERTY § 82.03[2].

[225] Arnold, *supra* note X, at 35.

owned and operated by and for the mortgage industry."[226] It is ironic and perhaps not coincidental that the syntactical form of the sentence bears such close resemblance to President Lincoln's Gettysburg address. One will no doubt recall that Americans have generally aspired to "government of the people, by the people, for the people," rather than of, by, and for the mortgage bankers.[227] MERS' attempt to "capture every mortgage loan in the country"[228] is an effort to supplant the public land title recording systems' lien records, many of which predate the Constitution itself, with a purely private system. Perhaps MERS, Inc. is correct that doing so is more efficient; is more modern; and, maybe they are right that it is even be better for the American people at the margin. But, this effort is without question a surrender of the messy compromises inherent in representative democracy to the seductively easy lure of mercantile oligarchy. Bankers just complain so much less when courts, regulators, and legislators let them do whatever they want. Still, perhaps those of us with romantic attachments to our Republic and the rule of law will be excused for supposing that if the mortgage bankers wanted a newer, more efficient, national land title recording system, they should have asked Congress or the legislatures first.

VI. CONCLUSION

This Article has explored the legal and public policy foundations of the Mortgage Electronic Registration System. MERS maintains a central national database tracking mortgage servicing rights for loans registered on its system. In addition to its database, MERS has taken on two related but distinct roles in the American home mortgage market. First, mortgage finance companies use MERS' name as a proxy in county land title records in order to avoid paying taxes to local governments for recording assignments during the life of a loan. Second, where local courts have allowed it, MERS creates something of a foreclosure doppelganger by allowing the actual parties in interest to bring residential foreclosures under MERS' corporate identity instead of their own. Recording loans in the name MERS, rather than the actual parities in interest, has generally not been explicitly authorized under the state title recording acts that trace their lineage back to the earliest years of the American republic. By adopting such a radical shift in how mortgages are recorded and foreclosed without legislative change, the mortgage finance companies have rebuilt their industry on a legal foundation of sand. MERS' claim to own legal title to a mortgage loan's security interest, divorced from the promissory note and entitlement to receive loan payments, is in direct tension with precedent that has been well settled for over a hundred years. MERS' role in prosecuting home mortgage foreclosures should bring it within the scope of the federal Fair Debt Collection Act—a statute that MERS has generally made little attempt to comply with. And it is unclear whether recording a mortgage or mortgage assignment in the name of someone other than that actual mortgagee and assignee should be sufficient to protect those actual

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[226] Arnold, *supra* note X, at 36.
[227] GARRY WILLS, LINCOLN AT GETTYSBURG: THE WORDS THAT REMADE AMERICA 145-47 (1992) .
[228] MERS Registers 20 Million Loans, *supra* note X, at 1.

parties in interest from subsequent purchasers. Indeed there is a compelling argument that loans where MERS is recorded as the original mortgagee should be avoidable by bankruptcy trustees in many states.

The shift away from recording loans in the name of actual mortgagees and assignees represents an important policy change that erodes not only the tax base of local governments, but also the usefulness of the public land title information infrastructure. MERS did not, by itself, cause the mortgage finance crisis and its ensuing aftermath. However, it was an important cog in the machine that churned out the millions of unsuitable, poorly underwritten, and incompletely documented mortgages that were destined for foreclosure. In the aftermath of the mortgage finance crisis that has crippled the American economy, necessitated massive taxpayer bailouts of financial institutions, and left millions of American families ejected from their homes, the judiciary has an obligation to aggressively reexamine our financiers' cut corners, false assumptions, and jaundiced legal theory.