



Merscorp Lacks Right to Transfer Mortgages, Judge Says (Update4)

[Share](#) | [Email](#) | [Print](#) | [A A A](#)

By Thom Weidlich

Feb. 14 (Bloomberg) -- Merscorp Inc., operator of the electronic-registration system that contains about half of all U.S. home mortgages, has no right to transfer the mortgages under its membership rules, a judge said.

U.S. Bankruptcy Judge Robert E. Grossman in Central Islip, New York, in a decision he said he knew would have a "significant impact," wrote that the membership rules of the company's Mortgage Electronic Registration Systems, or MERS, don't make it an agent of the banks that own the mortgages.

"MERS's theory that it can act as a 'common agent' for undisclosed principals is not supported by the law," Grossman wrote in a Feb. 10 opinion. "MERS did not have authority, as 'nominee' or agent, to assign the mortgage absent a showing that it was given specific written directions by its principal."

Merscorp was created in 1995 to improve servicing after county offices couldn't deal with the flood of mortgage transfers, Karmela Lejarde, a spokeswoman for MERS, said in an interview last year. The company tracks servicing rights and ownership interests in mortgage loans on its electronic registry, allowing banks to buy and sell the loans without having to record the transfer with the county. It played a major role in Wall Street's ability to quickly bundle mortgages together in securitized trusts.

Lejarde said in an e-mailed statement today that MERS disagreed with the decision because "state courts in New York have already ruled that 'a written assignment of the mortgage by MERS, in its capacity as nominee, confers good title to the assignee.'"

Sending Message

A bankruptcy court in Kansas ruled Feb. 11 that MERS is the agent of its member, that the note and mortgage were never split due to this agency relationship and that the member could have MERS enforce its rights to the note and mortgage, she said.

"Don't come around here no more," is basically the message to MERS," said April Charney, a senior attorney with Jacksonville Area Legal Aid in Jacksonville, Florida. "The judge basically deconstructed MERS and said there's no possible way in any case you can come in and show you have this appropriate proper status to transfer the note."

"MERS and its partners made the decision to create and operate under a business model that was designed in large part to avoid the requirements of the traditional mortgage-recording process," Grossman wrote. "The court does not accept the argument that because MERS may be involved with 50 percent of all residential mortgages in the country, that is reason enough for this court to turn a blind eye to the fact that this process does not comply with the law."

Automatic Shield

In the case Grossman ruled on, [Credit Suisse Group AG's](#) Select Portfolio Servicing, a mortgage servicer, sought to bypass the automatic shield against legal claims triggered by Ferrel L. Agard's filing for personal bankruptcy in September.

Select Portfolio wanted permission to foreclose on Agard's home in Westbury, New York, on behalf of [U.S. Bancorp's](#) U.S. Bank unit, the trustee for the mortgage-backed trust the home loan was in. The house is worth

about \$350,000 and the mortgage amount was \$536,921, according to the decision.

Grossman ruled in favor of Select Portfolio because he couldn't overrule a November 2008 foreclosure judgment the servicer won in state court, he said. Without that state-court ruling, Select Portfolio wouldn't have had the right to bring its motion, Grossman said.

He then addressed whether a mortgage transfer by MERS is valid, because "MERS's role in the ownership and transfer of real-property notes and mortgages is at issue in dozens of cases before this court," including those where "there have been no prior dispositive state-court decisions," he wrote.

Original Lender

Select Portfolio argued in part that MERS's February 2008 assignment of the mortgage to U.S. Bank was valid because Agard agreed that MERS would hold title to it for the original lender, [Bank of America Corp.](#)'s First Franklin, and for whichever banks it was further assigned to. First Franklin transferred the promissory note the mortgage secured to Lehman Brothers Holdings Inc.'s Aurora Bank and Aurora to U.S. Bank, according to the decision.

"An adverse ruling regarding MERS's authority to assign mortgages or act on behalf of its member/lenders could have a significant impact on MERS and upon the lenders which do business with MERS throughout the United States," Grossman wrote. "It is up to the legislative branch, if it chooses, to amend the current statutes to confer upon MERS the requisite authority to assign mortgages under its current business practices."

Gave Authority

MERS intervened in the case and argued that Agard's mortgage, the terms of its membership agreement and New York state law gave it the authority to assign the mortgage. MERS says it holds title to mortgages for its members as both "nominee" and "mortgagee of record."

Grossman said Select Portfolio had to show that U.S. Bank owned both the note and the mortgage, and there was no evidence that it held the note. The judge disagreed with Select Portfolio's argument that U.S. Bank held the note because the note "follows" the mortgage, which it said U.S. Bank owned.

"By MERS's own account, the note in this case was transferred among its members, while the mortgage remained in MERS's name," Grossman wrote. "MERS admits that the very foundation of its business model as described herein requires that the note and mortgage travel on divergent paths."

In Writing

The judge said that the membership agreement wasn't enough to assign the mortgage and that to do so the lender would have to give power of attorney or similar authority to MERS.

MERS's membership rules don't create "an agency or nominee relationship" and don't clearly grant MERS authority to take any action with respect to mortgages, including transferring them, Grossman wrote. Because the interests at issue concern "real property" -- land and buildings -- under state law, any transfer has to be in writing, which isn't done under the MERS system, he said.

"Without more, this court finds that MERS's 'nominee' status and the rights bestowed upon MERS within the mortgage itself, are insufficient to empower MERS to effectuate a valid assignment of mortgage," the judge wrote. "MERS's position that it can be both the mortgagee and an agent of the mortgagee is absurd, at best."

Grossman said parties coming to him to seek to lift the automatic ban on legal claims in cases involving MERS will have to show they own both the mortgage and the note.

The decision will make it more difficult and expensive for banks to foreclose on properties, Paul Miller, an analyst at FBR Capital Markets, said today in an interview.

'Murkiness' on Process

"It casts a lot of murkiness on the process because it introduces the question of who really owns the title?" he said.

Miller, a former examiner for the Philadelphia Federal Reserve Bank, said he expects federal regulators will intervene if rulings on the electronic registration system threaten the solvency of the biggest U.S. banks. In one scenario, financial firms would have to repurchase loans included in improperly created securitizations, he said.

"The whole banking system would collapse if you nullified MERS," Miller said.

Christine Clifford, vice president of Access Mortgage Research & Consulting Inc. in Columbia, Maryland, said in an interview that MERS "helped bring liquidity to the market, so this will make liquidity more of a challenge.

"It's one more thing that raises the cost of being in the mortgage business and makes the process take longer," she said. "The private and secondary market won't open up until we get some closure on MERS."

The case is *In re Agard*, 10-77338, U.S. Bankruptcy Court, Eastern District of New York (Central Islip).

To contact the reporter on this story: [Thom Weidlich](#) in Brooklyn, New York, federal court at tweidlich@bloomberg.net.

To contact the editor responsible for this story: John Pickering at jpickering@bloomberg.net.

Last Updated: February 14, 2011 15:52 EST



© 2011 BLOOMBERG L.P. ALL RIGHTS RESERVED. [Terms of Service](#) | [Privacy Policy](#) | [Trademarks](#)