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The End of MERS?

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It has not been a good year for Mortgage Electronic Registration Systems, Inc. As the "mortgagee of record" for over half the residential mortgages in the United States, the much-maligned entity known as "MERS" has come to occupy a critical role in the foreclosure process. A plaintiff seeking to foreclose on a MERS-related loan invariably offers a written assignment of the note and mortgage from MERS as proof of its standing to maintain the action. In recent months, however, the legal effect of such assignments has been called into question in several highly-publicized judicial opinions issued in New York's state and federal courts. The most far-reaching of these arrived on June 7, 2011, with the Appellate Division, Second Department's decision in Bank of New York v. Silverberg, 2011 NY Slip Op. 05002U (2d Dep't 2011). Faced with what the Court characterized as a choice between enforcing the rules governing real property or bending those rules "to accommodate a system that has taken on a life of its own", the Second Department panel held that MERS, as nominee and mortgagee for purposes of recording, could not assign the right to foreclose a consolidated mortgage to a plaintiff where MERS itself had never been the holder or assignee of the underlying promissory notes. In so holding, as evidenced by subsequent decisions interpreting Silverberg, the Second Department triggered a significant shift in the type of proof that will need to be offered in the foreclosure of MERS-related loans in New York and further incentivized lenders to transition away from MERS.

The Case

The facts in Silverberg largely mirrored those in countless other foreclosures across the State. The defendant-borrowers, Stephen and Frederica Silverberg, obtained a $450,000 loan from Countrywide Home Loans, Inc. ("Countrywide") in October of 2006. In connection with the loan, the Silverbergs executed a promissory note in favor of Countrywide and a mortgage in favor of MERS as nominee for Countrywide and mortgagee for recording purposes. Six months later, in April of 2007, the Silverbergs executed a second note in favor of Countrywide, a second mortgage in favor of MERS as nominee and mortgagee of record, and a consolidation, extension and modification agreement ("CEMA") which purported to merge the two sets of notes and mortgages into a single loan obligation. Both the first and second mortgage contained express language providing that MERS had the right "to exercise any or all of those rights, [granted by the Borrowers to Countrywide], including but not limited to the right to foreclose and sell the Property" and further provided that MERS had the right "to take any action required of Lender including, but not limited to, releasing and canceling this Security Instrument."

Following the Silverbergs' default under the CEMA, a foreclosure action was commenced in Supreme Court, Suffolk County on May 6, 2008. The named plaintiff was not Countrywide, but rather the Bank of New York

("BNY"), acting as trustee for a mortgage-backed securitized trust to which the Silverbergs' consolidated loan had allegedly been transferred. When the Silverbergs moved to dismiss the complaint about lack of standing pursuant to CPLR 3211(a)(3), the plaintiff produced a "corrected assignment of mortgage" from MERS as nominee, dated April 30, 2008, which purported to assign the subject notes and mortgages to the plaintiff one week before the summons and complaint were filed. Pointing to MERS's status as Countrywide's nominee, as well as the express grant of authority recited in the mortgage documents themselves, the Supreme Court found that the written assignment was sufficient to vest the plaintiff with standing to foreclose and denied the defendants' motion to dismiss.

On appeal, the Second Department reversed and observed that while the CEMA gave MERS the right to assign the mortgages, it did not specifically give MERS the right to assign the underlying notes. MERS could not, therefore, effectuate a transfer of the notes pursuant to its authority as a nominee or limited agent for the lender under the mortgage documents. Further, MERS simply could not assign notes in which it had no interest. MERS had never loaned the Silverbergs any money and never had a right to receive payment under the loan. Moreover, the record was devoid of any evidence that the notes had been physically delivered to MERS at any point, as was the case in the Second Department's oft-cited decision in Mortgage Elec. Registrations Sys., Inc. v. Coakley, 41 A.D.3d 674 (2d Dep't 2006). Thus, notwithstanding the broad language in the first and second mortgages, MERS itself never had a right to foreclose. Because the plaintiff, as MERS's assignee, could inherit no greater rights than MERS itself had possessed, it too lacked standing to commence the action.

How to Demonstrate Standing Post-Silverberg

By rejecting the plaintiff's argument that the mortgage documents authorized MERS's assignment of the notes underlying the mortgages, the Second Department in Silverberg appeared to raise the bar for the level of proof needed to demonstrate standing in pending and future MERS-related mortgage foreclosures. For at least the time being, foreclosing lenders should be prepared to offer additional evidence which either (1) validates the MERS assignments themselves; or (2) confirms their physical possession of the promissory note at the outset of the action. Some useful guidance on this issue – as well as a few cautionary tales – can be found in other recent cases in which MERS assignments have been held invalid.

One way of establishing the validity of assignments executed by MERS is to demonstrate that the original lender granted MERS specific authority beyond that recited in the mortgage documents. Courts appear to agree that a written power of attorney is an ideal means of doing so. See Aurora Loan Servs., LLC v. Weisblum, 85 A.D.3d 95 (2d Dep't 2011); Bank of New York v. Alderazi, 2011 NY Slip Op. 50547U (Sup. Ct. Kings Co. 2011); In re Agard, 444 B.R. 231 (Bankr. E.D.N.Y. 2011); Aurora Loan Servs., LLC v. Thomas, 2010 NY Slip Op. 33023U (Sup. Ct. Suffolk Co. 2010); HSBC Bank USA, N.A. v. Yeasmin, 2008 NY Slip Op. 50924U (Sup. Ct. King Co. 2008). By comparison, reliance on the MERS membership rules and agreements, or on affidavits based on a review of books and records, but which do not attach any records themselves, have generally been rejected as a means to corroborate MERS's authority to transfer a lender's interest in a mortgage note. See In re Agard, 444 B.R. at 252-53; Alderazi, 2011 NY Slip Op. 50547U, at *2-4.

Ultimately, in terms of sheer effectiveness, nothing settles a dispute over authority or standing like physical possession of the promissory note. Given the long-standing rule in New York that the mortgage passes with the debt as an inseparable incident, a plaintiff who can demonstrate possession of a properly endorsed promissory note at the commencement of the action – preferably by annexing a copy to its summons and complaint – will almost certainly moot any subsequent challenge to standing. By attaching a fully executed copy of the note to the initial filings, the plaintiff also preserves the record as to the chain of ownership; an especially advisable strategy where the note has been endorsed in blank or where the endorsement is updated. The dangers of not doing so were on full display in Alderazi, where the plaintiff annexed an unendorsed copy of the note to its summons and complaint, only to later produce a copy with an updated special endorsement when moving for an order of reference. Because the plaintiff could not explain the discrepancy and, as mentioned above, did not provide copies of internal business records which may have verified the timing of the endorsement and the transfer, the plaintiff's motion was denied and the action was dismissed.

Thus, the case law suggests that foreclosing parties will need to meet a more scrutinized standard of proof to demonstrate ownership. Unsupported affidavits will not suffice. Rather, courts expect documentary evidence which unequivocally demonstrates ownership of the note.

Conclusion

In the aftermath of the Silverberg decision, both litigators and lenders will need to alter their standard practices in order to preserve mortgage foreclosure as a viable remedy in cases involving MERS. It remains to be seen whether those adjustments will satisfy the justices of the Second Department's trial courts as they too adjust to the decision in the coming months.

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