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Homebuyer Beware: MERS and the Law of Subsequent Purchasers

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Homebuyer Beware

MERS AND THE LAW OF SUBSEQUENT PURCHASERS

INTRODUCTION

Imagine you are in the market for a new home. You scour local real estate listings, you vet real estate agents, and you canvas neighborhoods until finally a property grabs your attention. You know this is where you will spend the rest of your life. So you make the homeowner an offer, he accepts, and you proceed to the closing. Lawyers, real estate agents, and title insurers all gather around a table. Everything appears to be going smoothly: you distribute your purchase funds to the seller, he pays his remaining balance on the mortgage, and the owner of his mortgage—a company named Mortgage Electronic Registration Systems, Inc. (MERS)—discharges the mortgage and removes its lien on the property. Because your title search revealed that MERS possessed the only outstanding interest against the property, you are satisfied that the title is free from adverse claims. Accordingly, you close the deal.

Six months pass. You have finally finished moving into your new home. You have met your new neighbors, found a new favorite restaurant, and enrolled your children into a new school. Moreover, your finances have remained stable, and you are current on your mortgage payments. As a result, you are perplexed when you return home one day to an unwelcome surprise: a foreclosure notice. You immediately call your bank in protest, but the bank actually confirms its receipt of your mortgage payments. In fact, the foreclosure notice is not even from *your lender*.

You hire a lawyer to represent you, but to no avail. The law is not on your side. Although you performed a title search and found only MERS's name in the land records, another unrecorded claim existed. As it turns out, MERS held only "legal title" to the property, while another party actually owned the right to the mortgage payments.[1] Accordingly, after the seller tendered the remaining balance to MERS, the company encountered a problem when it could not determine who was entitled to the funds. MERS later distributed the funds to the wrong individual. As a result, the true owner retains a claim against the underlying property. You lose your dream home. Worse still, you may not be alone.

Subsequent purchasers of MERS-mortgaged properties throughout the nation may find themselves in similar danger. MERS is listed on more than 65 million mortgages,[2] or "approximately 60% of all mortgage loans in the United States."[3] Moreover, due to documentation errors[4] and "shoddy recordkeeping practices,"[5] the likelihood that MERS cannot identify the true owner of a particular mortgage note is quite substantial.[6] This generates tremendous risks for subsequent purchasers. For example, under New York law, a discharge of the mortgage without a corresponding discharge of the mortgage note remains ineffective as against the owner of the note.[7] Therefore, when MERS discharges a mortgage without knowledge of the note owner's identity and later distributes funds to the wrong MERS member, the owner of the note can

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[1] Sample MOM Mortgage, MERS, at 3 (2001), *available at* http://www.mersinc.org/MersProducts/forms.aspx?mpid=1 (follow "Sample Mortgage" hyperlink) ("Borrower understands and agrees that MERS holds only legal title to the interests granted by Borrower in this Security Instrument . . . .").

[2] Brady Dennis & Ariana Eunjung Cha, *In Middle of Foreclosure Chaos, Local Firms Keep Popping Up*, WASH. POST (Oct. 8, 2010), http://www.washingtonpost.com/wp-dyn/content/article/2010/10/07/AR2010100706667.html [hereinafter Dennis & Cha, *Foreclosure Chaos*].

[3] Bank of N.Y. v. Silverberg, 926 N.Y.S.2d 532, 539 (App. Div. 2011).

[4] *See* CONGRESSIONAL OVERSIGHT PANEL, NOVEMBER OVERSIGHT REPORT: EXAMINING THE CONSEQUENCES OF MORTGAGE IRREGULARITIES FOR FINANCIAL STABILITY AND FORECLOSURE MITIGATION 48 n.171 (2010) ("[A]buses include misapplying payments, force-placing insurance improperly, disregarding requirements to evaluate homeowners for nonforeclosure options, and fabricating documents related to the mortgage's ownership or account status." (citations omitted) (internal quotation marks omitted)); *see also* Mark Gongloff, *Foreclosure Crisis Slams into Banks: After Days of Shrugging Off the Debacle, Financial Markets Start to Penalize U.S. Banks*, WALL ST. J. (Oct. 15, 2010), http://online.wsj.com/article/SB10001424052748704361504575552380138195848.html.

[5] Tanya Marsh, *Foreclosures and the Failure of the American Land Title Recording System*, 111 COLUM. L. REV. SIDEBAR 19, 24 (2011), http://www.columbialawreview.org/assets/sidebar/volume/111/19_Marsh.pdf.

[6] *See* CONGRESSIONAL OVERSIGHT PANEL, *supra* note 4, at 48 (finding that "mortgage companies who filed claims . . . in bankruptcy cases of homeowners did not attach a copy of the note to 40% of their claims").

[7] *See* Assets Realization Co. v. Clark, 98 N.E. 457, 458-59 (N.Y. 1912); CIT Grp./Bus. Credit, Inc. v. Walentas, 813 N.Y.S.2d 370, 370 (App. Div. 2006); Signal Fin. of N.Y., Inc. v. Polomaine, 519 N.Y.S.2d 933, 934 (Civ. Ct. 1987); *see also* 59 C.J.S. *Mortgages* § 628 (2011); 78 N.Y. JUR. 2D *Mortgages and Deeds of Trust* § 375 (2011).

redeem his security interest in the property.[8] Even where the property is conveyed to a subsequent purchaser, courts will refuse to protect that party because he cannot satisfy the requirements of a bona fide purchaser for value.[9] As demonstrated, this will cause a subsequent purchaser to lose his property.

These problems could have a devastating effect on the real estate market.[10] As prospective purchasers and title insurers become aware of these risks, owners of MERS-mortgaged properties will suffer from "clouded title"[11] as potential buyers begin to avoid their properties.[12] This will affect homeowners' ability to alienate their property, and it could cause widespread deadlocks in the real estate market—at least to the extent that MERS encounters documentation problems.[13] Nevertheless, courts can avoid these dangers by utilizing principles of agency law. In particular, if courts accept MERS's authority to act as an agent for lenders, those lenders would be bound by MERS's discharges and would lose any claims against the property.[14] Although the adoption of an agency theory might harm some homeowners by insulating MERS from attack in other areas,[15] it would actually *protect* the vast majority of homeowners of MERS-mortgaged

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[8] *See Assets Realization Co.*, 98 N.E. at 458-59; *Walentas*, 813 N.Y.S.2d at 370; *Polomaine*, 519 N.Y.S.2d at 934.

[9] *See* Curtis v. Moore, 46 N.E. 168, 169 (N.Y. 1897).

[10] *See* 1 JOYCE D. PALOMAR, TITLE INSURANCE LAW § 1.2 (1994) ("Stability of land titles is critical not only to individual property owners, but also to society as a whole. . . . Development will not occur if lenders cannot be relatively certain that their real property collateral will be marketable.").

[11] *Robo-Signing, Chain of Title, Loss Mitigation, and Other Issues in Mortgage Servicing Before the Subcomm. on Hous. & Cmty. Opportunity of the H. Fin. Servs. Comm.*, 111th Cong. 1 (2010) (written statement of Adam J. Levitin, Associate Professor of Law, Georgetown University Law Center), *available at* http://financialservices.house.gov/Media/file/hearings/111/Levitin111810.pdf; *see* 65 AM. JUR. 2D *Quieting Title* § 13 (2011) ("A cloud upon title may . . . be defined as . . . an apparent defect in the title that has the tendency, even in a slight degree, to cast doubt upon the owner's title, and to stand in the way of the full and free exercise of his or her ownership.").

[12] *See* 1 JOYCE D. PALOMAR, *supra* note 10, § 1.2 ("Purchasers want assurance that the title is good before they invest money, time, and care, not damages from the grantor when the title proves to be defective.").

[13] *See* CONGRESSIONAL OVERSIGHT PANEL, *supra* note 4, at 46-51 (explaining that lenders' "documentation irregularities" may be quite "pervasive").

[14] *See* 2A N.Y. JUR. 2D *Agency* § 291 (2011) ("A principal is liable on contracts entered into on its behalf by an authorized agent.").

[15] In particular, a court's recognition of MERS's agency relationship with lenders would enable the company to initiate foreclosure actions on lenders' behalf. *See, e.g.*, Pantoja v. Countrywide Home Loans, Inc., 640 F. Supp. 2d 1177, 1188-89 (N.D. Cal. 2009) (internal quotation marks omitted) (holding that "[u]nder California law, a trustee, mortgagee, or beneficiary or any of their authorized agents may conduct the foreclosure process" and finding that "the Deed of Trust expressly designated MERS as the nominee of the lender and as the beneficiary").

properties, as well as prospective purchasers of those properties.[16]

This note, in Part I, provides a brief overview of the MERS registry and how it operates within the mortgage finance industry. Part II provides a historical background of the property doctrines affecting MERS and the law of subsequent purchasers, including law pertaining to mortgages and the recording statutes. Part III discusses modern developments in mortgage finance by tracing the market's evolution toward mortgage securitization and explaining how MERS alters the traditional securitization framework. Part IV explores public reactions to MERS, including various courts' decisions relating to MERS, the company's recent legal battles with county recorders and Attorneys General, scholarly analysis of MERS, as well as attention MERS has received from the public at large. Part V analyzes the frequently overlooked problems MERS poses for subsequent purchasers. In particular, this Note argues that subsequent purchasers of MERS-mortgaged properties will not constitute bona fide purchasers for value and that MERS's documentation problems pose severe risks to them and to the real estate market generally. Finally, Part VI suggests that courts can avoid these issues by recognizing MERS's authority to act as an agent for its members.

I. MERS

MERS operates a large, electronic document registry that "track[s] ownership interests in residential mortgages."[17] Financial institutions[18] created MERS in response to the perceived inefficiency and costliness of the traditional recording system,[19] under which lenders were required to

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[16] Recent census data reveal that most Americans are current on their mortgage payments, while less than 19 percent are delinquent or involved in foreclosure. *See* U.S. CENSUS BUREAU, STATISTICAL ABSTRACT OF THE UNITED STATES: 2012, at 743 tbl.1194 (131st ed. 2011) (estimating that 4.6 percent of residential mortgage loans were in the foreclosure process at year-end in 2010, 5.0 percent were entering the foreclosure process at year-end 2010, and 9.3 percent were "delinquent 30 days or more").

[17] MERSCORP, Inc. v. Romaine, 861 N.E.2d 81, 83 (N.Y. 2006).

[18] MERS shareholders who "played a critical role in the development of MERS" include Bank of America, CitiMortgage, Inc., HSBC Finance Corp., Wells Fargo Bank, GMAC Residential Funding Corp., Mortgage Bankers Association, Fannie Mae, Freddie Mac, the American Land Title Association, and First American Title Insurance Corp. *Shareholders*, MERS, http://www.mersinc.org/about/shareholders.aspx (last visited Sept. 23, 2011).

[19] Phyllis K. Slesinger & Daniel McLaughlin, *Mortgage Electronic Registration System*, 31 IDAHO L. REV. 805, 810 (1995) ("Over the life of a loan, the

record changes in mortgage ownership with county recorders and pay a fee.[20] Indeed, on its website, MERS states that it was "created . . . to streamline the mortgage process by using electronic commerce to eliminate paper"[21] and that its "mission is to register every mortgage loan in the United States on the MERS® System."[22] Not surprisingly, financial institutions that are active in the mortgage finance industry find MERS attractive precisely for these reasons: it facilitates the efficient transfer of mortgages and mortgage notes among numerous parties,[23] and it avoids the costly and often slow process of recording these transfers with the county clerk.[24]

MERS alters the traditional mortgage financing system by permitting "[l]enders [to] identify MERS as nominee and mortgagee for its members' successors and assignees."[25] Once a mortgage is registered with MERS, "the beneficial ownership interest or servicing rights may be transferred among MERS members"[26] in order to bundle mortgages into securities more effectively.[27] However, throughout this entire process, "MERS remains the mortgagee of record in local county recording offices regardless of how many times the mortgage is transferred, thus freeing MERS's members from paying the recording fees that would otherwise be furnished to the relevant localities."[28] Only

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current environment is very costly to the industry."); *see also* Bank of N.Y. v. Silverberg, 926 N.Y.S.2d 532, 535 (App. Div. 2011) ("MERS's implementation followed the delays occasioned by local recording offices, which were at times slow in recording instruments because of complex local regulations and database systems that had become voluminous and increasingly difficult to search . . . ." (citation omitted)).

[20] *See generally Romaine*, 861 N.E.2d at 83 (analyzing the propriety of MERS's business model with respect to avoiding recording fees traditionally associated with mortgage assignments).

[21] *About Us*, MERS, http://www.mersinc.org/about/index.aspx (last visited Sept. 22, 2011).

[22] 3 JOYCE PALOMAR, PATTON & PALOMAR ON LAND TITLES § 567.50 n.3 (3d ed. 2011).

[23] *See* Dennis & Cha, *Foreclosure Chaos*, *supra* note 2.

[24] *See* Christopher L. Peterson, *Foreclosure, Subprime Mortgage Lending, and the Mortgage Electronic Registration System*, 78 U. CIN. L. REV. 1359, 1362 (2010); Christian J. Hansen, Note, *Property: Innovations to Historic Legal Traditions—Jackson v. Mortgage Electronic Registration Systems, Inc.*, 37 WM. MITCHELL L. REV. 355, 383-85 (2010).

[25] Bank of N.Y. v. Silverberg, 926 N.Y.S.2d 532, 536 (App. Div. 2011).

[26] MERSCORP, Inc. v. Romaine, 861 N.E.2d 81, 83 (N.Y. 2006).

[27] *See* Slesinger & McLaughlin, *supra* note 19, at 806-07 (explaining that an express purpose of MERS from its outset was "to reduce processing costs" for members engaged in pooling and marketing mortgage notes on the secondary market); *see also* Brady Dennis & Ariana Eunjung Cha, *Loan Chaos May Pose Wider Peril*, WASH. POST (Oct. 7, 2010), http://www.washingtonpost.com/wp-dyn/content/article/2010/10/06/AR2010100607245.html [hereinafter Dennis & Cha, *Loan Chaos*].

[28] *Silverberg*, 926 N.Y.S.2d at 536.

upon a transfer to a nonmember[29] or a discharge of the mortgage[30] will the company seek to record any change in mortgage ownership. Moreover, notwithstanding its constructive claim of ownership with the county recording offices, "MERS does not lend money, does not receive payments on promissory notes, and does not service loans by collecting loan payments."[31]

II. PROPERTY DOCTRINES AFFECTING MERS

To fully understand the MERS system, how it operates, and its effects on the real estate market, one must first understand the property doctrines that provide its foundation.

A. Mortgages

"A mortgage is a conveyance or retention of an interest in real property as security for performance of an obligation,"[32] where the obligation "is almost always a loan of money evidenced by a promissory note."[33] To avoid confusion, one must distinguish between a mortgage, on one hand, and a mortgage note or promissory note, on the other. A "mortgage" is a security interest that a lender holds in the underlying property,[34] whereas a "promissory note" represents a borrower's obligation to repay his loan.[35] Conceptually, mortgage transactions are structured as follows. First, a lender provides funds to a borrower in order to initiate a property transfer from a third party.[36] Second, the borrower executes the transfer and obtains title to the property.[37] In exchange for the borrowed funds, the

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[29] *See Romaine*, 861 N.E.2d at 83 n.4 ("If a MERS member transfers ownership interest or servicing rights in a mortgage loan to a non-MERS member, an assignment from the MERS member to the non-MERS member is recorded in the County Clerk's office and the loan is deactivated within the MERS system.").

[30] *See Foreclosure & Bankruptcy*, MERS, http://www.mersinc.org/Foreclosures/index.aspx (follow "click here" hyperlink for Rules of Membership, Rule 2 § 8(a)) (last visited Sept. 23, 2011).

[31] *Silverberg*, 926 N.Y.S.2d at 536.

[32] RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 1.1 (1997).

[33] JOHN G. SPRANKLING, UNDERSTANDING PROPERTY LAW 358 (2d ed. 2008) (emphasis omitted).

[34] *See* GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW § 1.1 (5th ed. 2007).

[35] *See* GEORGE LEFCOE, REAL ESTATE TRANSACTIONS 369-70 (1993).

[36] *See* NELSON & WHITMAN, *supra* note 34, § 1.1.

[37] *See id.* § 1.5. Depending on the jurisdiction, the borrower may hold legal title to the property—subject to his satisfaction of the mortgage—or the lender may hold legal title to the property, which reverts back to the borrower upon satisfaction of the mortgage. *See id.* (explaining the distinction between the "title theory" and "lien theory").

borrower (mortgagor) delivers to the lender (mortgagee) a promissory note and a mortgage.[38]

A mortgage is commonly terminated either by foreclosure[39] or through a satisfaction and discharge.[40] Where a borrower defaults on his obligation to the lender, the lender has the power to redeem his security interest in the property through foreclosure.[41] By contrast, where a borrower makes "payment at or before maturity,"[42] the borrower's payment will terminate the mortgage.[43] Nevertheless, whether the owner of the mortgage—as opposed to the owner of the mortgage note—can properly discharge a borrower's debt may prove important to borrowers and their successors in interest. For example, in New York, a note secured by a mortgage "will not be discharged by payment to the record holder if . . . the note and mortgage ha[ve] already been transferred . . . , even though no assignment has been recorded."[44] Indeed, courts have cautioned that "[t]he satisfaction of the mortgage [is] not a blanket release of [a borrower's] obligations under the note."[45] Accordingly, a payment to the wrong individual would be "at [the borrower's] peril."[46]

B. Recordation and the Recording Acts

The recording acts were developed "to secure a permanent record of landholding, and to prevent fraudulent

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[38] *See* RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 1.1 cmt. a, illus. 1 (1997).

[39] *See, e.g.*, N.Y. REAL PROP. ACTS. LAW § 1301 (McKinney 2009).

[40] *See, e.g.*, *id.* § 1921(1) ("After payment of authorized principal, interest and any other amounts due . . . , a mortgagee of real property . . . must execute and acknowledge . . . a satisfaction of mortgage . . . .").

[41] *See* RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 8.2 (1997).

> When an obligation secured by a mortgage becomes due, the mortgagee may either . . . obtain a judgment against any person who is personally liable on the obligation and, to the extent that the judgment is not satisfied, foreclose the mortgage on the real estate for the balance . . . or . . . foreclose the mortgage and, to the extent that the proceeds of the foreclosure sale do not satisfy the obligation, obtain a judgment for the deficiency against any person who is personally liable on the obligation . . . .

Id.

[42] 12 THOMPSON ON REAL PROPERTY, SECOND THOMAS EDITION § 101.03(c) (David A. Thomas ed., 2008).

[43] *See id.*

[44] Assets Realization Co. v. Clark, 98 N.E. 457, 458 (N.Y. 1912).

[45] CIT Grp./Bus. Credit, Inc. v. Walentas, 813 N.Y.S.2d 370, 370 (App. Div. 2006); *see* Signal Fin. of N.Y., Inc. v. Polomaine, 519 N.Y.S.2d 933, 934 (Civ. Ct. 1987) (holding that "[t]he underlying obligation, as evidenced by the note, survive[d] the Discharge of the Mortgage"); *see also* 59 C.J.S. *Mortgages* § 628 (2009); 78 N.Y. JUR. 2D *Mortgages and Deeds of Trust* § 375 (2003).

[46] *Assets Realization Co.*, 98 N.E. at 459.

claims to lands by concealment of transfers."[47] In large part, the recording acts effectuate these purposes by providing a "fruitful source[] of notice to a purchaser"[48] or by documenting which landowners have won the "race to the record."[49] United States jurisdictions emphasize these features of recordation to varying degrees through their recording statutes.[50] In particular, jurisdictions utilize three variations: race statutes,[51] notice statutes,[52] and race-notice statutes.[53]

Race statutes[54] "protect[] the first purchaser to record."[55] Accordingly, a purchaser's "notice or knowledge of prior unrecorded claims is irrelevant" to determining his protection under the statute.[56] Simply put, as between two competing interests in land, "the first to record has priority."[57]

By contrast, notice statutes[58] generally protect only those subsequent purchasers who can satisfy the requirements of a "bona fide purchaser for valuable consideration."[59] A bona fide purchaser is a purchaser "without notice of prior unrecorded interests that are subject to the recording act."[60] Under this standard, "several kinds of notice . . . may disqualify a person from . . . protection,"[61] including actual notice, constructive notice, and inquiry notice.[62] Actual notice occurs where the purchaser has "actual knowledge of the prior interest."[63] Constructive notice occurs where "a reasonable title

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47 4 AMERICAN LAW OF PROPERTY § 17.5 (A. James Casner ed., 1952).

48 *Id.* § 17.17.

49 *Id.* § 17.5.

50 *See generally id.* (explaining the various recording statutes that states have adopted).

51 *See* 11 THOMPSON ON REAL PROPERTY, *supra* note 42, § 92.08(a).

52 *See id.* § 92.08(b).

53 *See id.* § 92.08(c).

54 Race statutes are very uncommon across United States jurisdictions. Only Arkansas, Louisiana, North Carolina, Ohio, and Pennsylvania have enacted race statutes for mortgages. 4 AMERICAN LAW OF PROPERTY, *supra* note 47, § 17.5, 545 n.63; 11 THOMPSON ON REAL PROPERTY, *supra* note 42, § 92.08(a), 158 nn.283-84.

55 11 THOMPSON ON REAL PROPERTY, *supra* note 42, § 92.08(a).

56 *Id.*

57 *See id.*

58 Notice statutes are far more common than race statutes. Alabama, Arizona, Connecticut, Delaware, Florida, Iowa, Kansas, Kentucky, Maine, Massachusetts, Missouri, New Hampshire, New Mexico, Oklahoma, Rhode Island, South Carolina, Tennessee, Texas, Vermont, Virginia, and West Virginia have all enacted notice statutes for mortgages. 4 AMERICAN LAW OF PROPERTY, *supra* note 47, § 17.5, 545 n.63; *see also* 11 THOMPSON ON REAL PROPERTY, *supra* note 42, § 92.08(b), 159 n.286.

59 4 AMERICAN LAW OF PROPERTY, *supra* note 47, § 17.10; *see* 11 THOMPSON ON REAL PROPERTY, *supra* note 42, § 92.08(b).

60 11 THOMPSON ON REAL PROPERTY, *supra* note 42, § 92.09(c).

61 *Id.*

62 *Id.*

63 *Id.*

search of the public real estate records would have revealed" a prior interest.[64] Inquiry notice occurs where a purchaser has "notice of facts which would have caused a reasonable person to make further inquiries."[65] Pure notice statutes therefore represent the converse of race statutes: a subsequent purchaser must be bona fide,[66] but he "need not record to qualify for . . . protection."[67]

Race-notice statutes[68] occupy an intermediary position between race and notice statutes, combining elements of both.[69] In particular, race-notice statutes require both that the subsequent purchaser record first[70] and that he represent a bona fide purchaser for value.[71] So long as a purchaser can satisfy these requirements, the statutes will protect his interest.[72]

III. MODERN MORTGAGE FINANCE: THE RISE OF SECURITIZATION AND MERS

Developments in mortgage finance that have occurred over the last century illustrate why financial institutions created MERS and how MERS facilitates their businesses. Perhaps the most important development for mortgage finance has been the creation of the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac).[73] As a matter of financial policy, Fannie Mae and Freddie Mac both serve important functions for the mortgage market.[74] First, "[t]hey facilitate the flow of capital from areas of the country where funds are plentiful to places in which mortgage money is in short supply," thereby providing liquidity to local banks.[75] Second, "they move capital investment from other

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[64] *Id.*

[65] *Id.*

[66] *See* 4 AMERICAN LAW OF PROPERTY, *supra* note 47, §§ 17.10-17.11; 11 THOMPSON ON REAL PROPERTY, *supra* note 42, § 92.09(c).

[67] 11 THOMPSON ON REAL PROPERTY, *supra* note 42, § 92.08(b).

[68] Race-notice statutes are the most common recording statute. Alaska, California, Colorado, District of Columbia, Georgia, Hawaii, Idaho, Illinois, Indiana, Maryland, Michigan, Minnesota, Mississippi, Montana, Nebraska, Nevada, New Jersey, New York, North Dakota, Oregon, South Dakota, Utah, Washington, Wisconsin, and Wyoming have all enacted race-notice statutes for mortgages. 4 AMERICAN LAW OF PROPERTY, *supra* note 47, § 17.5, 545 n.63; *see also* 11 THOMPSON ON REAL PROPERTY, *supra* note 42, § 92.08(c), 160 n.288.

[69] *See* 11 THOMPSON ON REAL PROPERTY, *supra* note 42, § 92.08(c).

[70] *See id.*

[71] *See id.*

[72] *See id.*

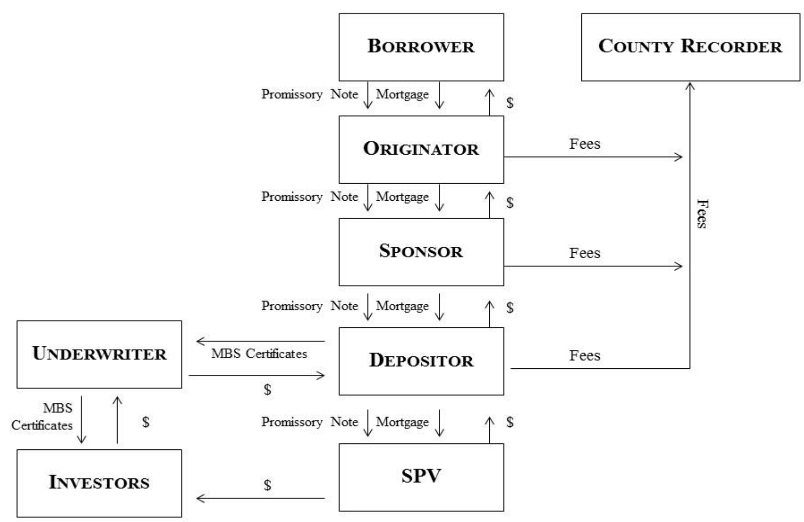
[73] *See* NELSON & WHITMAN, *supra* note 34, § 11.3.

[74] *See id.*

[75] *See id.*

sectors of the national economy into the mortgage market."[76] Finally, they "even out regional differences in interest rates" and "create a means of spreading the risks inherent in mortgage portfolios that [are] heavily concentrated in one state or region."[77] Fannie Mae and Freddie Mac accomplish these goals by purchasing "vast amounts of home loans from savings banks and other lenders" throughout the country.[78] The companies then issue "mortgage-backed securities,"[79] which are based on pools of the underlying mortgage loans.[80] This process requires the cooperation of several different entities.[81] Additionally, prior to the creation of MERS, most of these transactions were recorded with the county recorder's office.[82] Figure A[83] below represents a securitization chain where MERS is not involved.

FIGURE A



In the wake of MERS's implementation, financial institutions could execute the securitization process much more

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[76] *See id.*

[77] LEFCOE, *supra* note 35, at 453 n.205.

[78] *Id.* at 454.

[79] *See* NELSON & WHITMAN, *supra* note 34, § 11.3.

[80] *See* LEFCOE, *supra* note 35, at 452.

[81] *Id.* at 454.

[82] *See* Bank of N.Y. v. Silverberg, 926 N.Y.S.2d 532, 536 (App. Div. 2011).

[83] This diagram is based on a symposium presentation on Securitization and Governance given by Nancy Wallace. *See* Nancy Wallace, Presentation at the U.C. Berkeley Symposium: Private-Label Residential Mortgage Securitization: Recording Innovations and Bankruptcy Remoteness 7 (Mar. 11, 2011), *available at* http://www.law.berkeley.edu/files/bclbe/Wallace_MERS.pdf.

quickly.[84] Indeed, some have even suggested that this may have played a role in causing the financial crisis.[85] Nevertheless, speed is not MERS's only advantage for financial institutions. The MERS system also allows its members to avoid paying recording fees on transfers occurring within the registry.[86] Indeed, county recorders around the country have begun to file lawsuits against MERS in an effort to recover lost fees.[87] Moreover, financial institutions appear to lose nothing by utilizing this system. Once a loan enters the MERS system, members authorize MERS to act on their behalf with respect to the property.[88] Accordingly, financial institutions are able to increase the volume of their business and reduce costs while also retaining the ability to initiate legal proceedings through MERS.[89] Figure B[90] below represents a securitization chain where MERS acts as mortgagee of record.

[84] *See* Dennis & Cha, *Loan Chaos*, *supra* note 27 ("MERS allow[s] big financial firms to trade mortgages at lightning speed . . . .").

[85] *See id.* (suggesting that "[w]ithout this system, the business of creating massive securities made of thousands of mortgages would likely have never taken off").

[86] *See Silverberg*, 926 N.Y.S.2d at 536 ("MERS delivers savings to the participants in the real estate mortgage industry by allowing those entities to avoid the payment of fees which local governments require to record mortgage assignments." (citation omitted)).

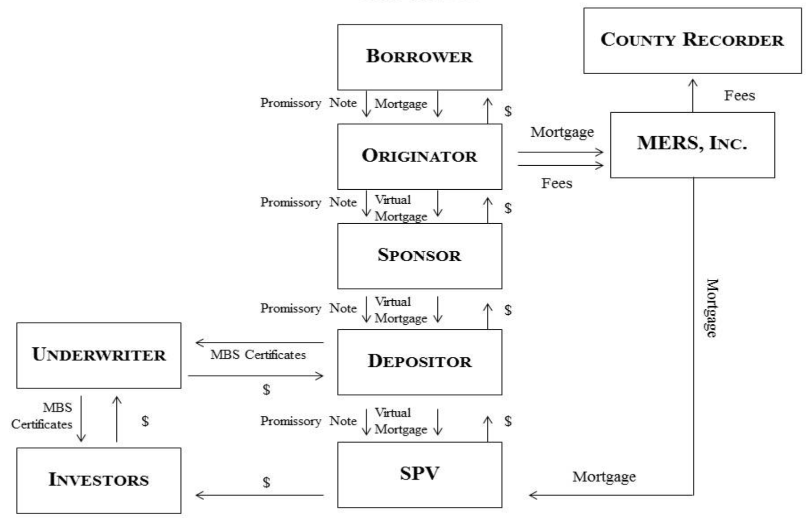
[87] *See, e.g.*, Complaint at ¶ 67, Dallas Cnty. v. MERSCORP, Inc., No. CC-11-06571-E (Tex. Cnty. Ct. Sept. 20, 2011).

[88] *See* Sample MOM Mortgage, *supra* note 1, at 3 ("Borrower does hereby mortgage, grant and convey to MERS (solely as nominee for Lender and Lender's successors and assigns) and to the successors and assigns of MERS, the following described property . . . .").

[89] *See, e.g.*, Pantoja v. Countrywide Home Loans, Inc., 640 F. Supp. 2d 1177, 1188-90 (N.D. Cal. 2009).

[90] This diagram is based on a symposium presentation on Securitization and Governance given by Nancy Wallace. *See* Wallace, *supra* note 83, at 11.

FIGURE B



IV. PUBLIC REACTIONS TO MERS

MERS has achieved significant notoriety in the wake of the financial collapse. MERS currently finds itself at the center of a national foreclosure crisis—where approximately one in twenty homeowners faces foreclosure[91] and MERS is listed on more than 60 percent of mortgages nationwide.[92] As a result, MERS's name has surfaced in thousands of foreclosure and bankruptcy actions throughout the country.[93] Nevertheless, courts remain divided over the legal status of MERS's business practices.[94] Some have held that MERS lacks standing to

[91] *See* U.S. CENSUS BUREAU, *supra* note 16, at 743 tbl.1194 (estimating that 4.6 percent of residential mortgage loans were in the foreclosure process at year-end in 2010 and that 5.0 percent were entering the foreclosure process at year-end 2010).

[92] *See* Bank of N.Y. v. Silverberg, 926 N.Y.S.2d 532, 539 (App. Div. 2011).

[93] *See* John R. Hooge & Laurie Williams, *Mortgage Electronic Registration Systems, Inc.: A Study of Cases Discussing MERS' Authority to Act*, No. 8 NORTON BANKR. L. ADVISOR 1, 8-13 (Aug. 2010) (collecting cases examining MERS's authority to act in foreclosure proceedings); Sharon McGann Horstkamp, *MERS Case Law Overview*, 64 CONSUMER FIN. L. Q. REP. 458, 459-75 (2010) (collecting cases regarding MERS's ability to foreclose); *see also* MERS LAW DEP'T, MERSCORP, INC. & MORTGAGE ELEC. REGISTRATION SYS., INC., CASE LAW OUTLINE 8-93 (July 2011), *available at* http://www.mersinc.org/files/filedownload.aspx?id=302&table=DownloadFile; MERS LAW DEP'T, MERSCORP, INC. & MORTGAGE ELEC. REGISTRATION SYS., INC., CASE LAW OUTLINE at 10-76 (Mar. 2011), *available at* http://www.mersinc.org/files/filedownload.aspx?id=241&table=DownloadFile.

[94] *Compare Pantoja*, 640 F. Supp. 2d at 1188-89 (holding that "[u]nder California law, a trustee, mortgagee, or beneficiary or any of their authorized agents may conduct the foreclosure process" and finding that "the Deed of Trust expressly designated MERS as the nominee of the lender and as the beneficiary" (internal quotation marks omitted)), *with In re* Agard, 444 B.R. 231, 253 (Bankr. E.D.N.Y. 2011)

pursue foreclosure actions[95] or bankruptcy stay relief motions.[96] Other courts have ruled to the contrary.[97] This lack of uniformity has created potentially devastating uncertainty for the mortgage industry.

Recent lawsuits from Attorneys General and county recorders throughout the country have only added to this uncertainty. In particular, Attorneys General in Delaware and Massachusetts have both filed recent lawsuits against MERS, alleging "deceptive trade practices"[98] and "deceptive business practices,"[99] respectively. Moreover, Nevada's Attorney General has brought suit against Lender Processing Services, a major "default and foreclosure processor that works behind the scenes for most large banks," alleging "deceptive foreclosure practices" in the wake of the robo-signing scandal.[100] Finally, county recorders throughout the United States have mounted legal attacks against MERS by claiming that the MERS system "bypass[es] local recording laws"[101] and deprives counties of "millions in property recording filing fees."[102]

Given the current economic climate, it is not hard to understand why MERS has captured such widespread attention from the public and from publicly elected officials. Although economists declare that the U.S. recession officially

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(citing Steinbeck v. Steinbeck Heritage Found., 400 F. App'x 572, 575 (2d Cir. 2010)) ("[T]he record of this case is insufficient to prove that an agency relationship exists under the laws of the state of New York between MERS and its members. . . . [T]he fact that MERS is named 'nominee' in the Mortgage is not dispositive of the existence of an agency relationship and does not, in and of itself, give MERS any 'authority to act.'").

[95] *See, e.g.*, *Silverberg*, 926 N.Y.S.2d at 539.

[96] *See, e.g.*, *In re Agard*, 444 B.R. at 253.

[97] *See, e.g.*, *Pantoja*, 640 F. Supp. 2d at 1188-89.

[98] Nathalie Tadena, *Delaware Files Complaint Against Mortgage Registry*, WALL ST. J. (Oct. 27, 2011), http://online.wsj.com/article/SB10001424052970203687504577002173640854262.html.

[99] Gretchen Morgenson, *Massachusetts Sues 5 Major Banks over Foreclosure Practices*, N.Y. TIMES (Dec. 1, 2011), http://www.nytimes.com/2011/12/02/business/major-banks-face-new-foreclosure-suit.html.

[100] Gretchen Morgenson, *From East to West, Foreclosure Horror Stories*, N.Y. TIMES (Jan. 7, 2010), http://www.nytimes.com/2012/01/08/business/mortgage-servicing-horror-stories-fair-game.html?pagewanted=all; *see id.* ("The complaint, which came after a 14-month inquiry, contends that [Lender Processing Services] deceived consumers by committing widespread document execution fraud, misrepresenting its fees and making deceptive statements about its efforts to correct paperwork.").

[101] Ariana Eunjung Cha & Brady Dennis, *Aggressive Lobbying Defends Mortgage-Trading System*, WASH. POST (Nov. 18, 2010), http://www.washingtonpost.com/wp-dyn/content/article/2010/11/18/AR2010111806137_pf.html.

[102] Alex Ortolani, *Mortgage Registry Falls Under Attack over Foreclosure*, LAW360 (Dec. 16, 2011, 1:49 PM), http://www.law360.com/articles/290977/mortgage-registry-falls-under-attack-over-foreclosures.

ended in June 2009,[103] household incomes have continued to fall by approximately 7 percent,[104] unemployment rates have remained well above equilibrium levels,[105] and foreclosure rates have continued to surge.[106] Many Americans appear to be upset over a crisis that banks caused primarily through their risky business practices.[107] Now that many Americans are facing foreclosure[108] at the hands of those very same institutions,[109]

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[103] NAT'L BUREAU OF ECON. RESEARCH, BUS. CYCLE DATING COMM. (Sept. 20, 2010), http://www.nber.org/cycles/sept2010.pdf ("The Business Cycle Dating Committee of the National Bureau of Economic Research . . . determined that a trough in business activity occurred in the U.S. economy in June 2009. The trough marks the end of the recession that began in December 2007 . . . .").

[104] Robert Pear, *Recession Officially Over, U.S. Incomes Kept Falling*, N.Y. TIMES (Oct. 9, 2011), http://www.nytimes.com/2011/10/10/us/recession-officially-over-us-incomes-kept-falling.html?_r=1.

[105] *Compare* U.S. DEP'T OF LABOR, BUREAU OF LABOR STATISTICS, USDL-12-0402, THE EMPLOYMENT SITUATION—FEBRUARY 2012 summary tbl.A (2012), *available at* http://www.bls.gov/news.release/pdf/empsit.pdf (citing unemployment rates of 8.3 percent nationally in February 2012), *and* U.S. DEP'T OF LABOR, BUREAU OF LABOR STATISTICS, USDL-12-0012, THE EMPLOYMENT SITUATION—DECEMBER 2011 summary tbl.A (2011), *available at* http://www.bls.gov/news.release/archives/empsit_01062012.pdf (citing unemployment rates of 9.4 percent nationally in December 2010), *with* Robert Shimer, *The Cyclical Behavior of Equilibrium Unemployment and Vacancies*, 95 AM. ECON. REV. 25, 27 (2005) (calculating an average monthly unemployment rate of 5.67 percent between 1951 and 2003); *see also* CONG. BUDGET OFFICE, THE BUDGET AND ECONOMIC OUTLOOK: FISCAL YEARS 2008 TO 2017, at 25-26 (2007) (forecasting long-term unemployment rates of 5.0 percent).

[106] *See* Alex Tanzi, *Bloomberg U.S. Mortgage Delinquency, Foreclosure Rates*, BLOOMBERG (Oct. 17, 2011) (showing increases in foreclosure rates between September 30, 2009 and September 30, 2011 from 7.22 percent to 9.13 percent for prime loans, from 11.68 percent to 13.45 percent for Alt-A loans, and from 16.51 percent to 18.03 percent for subprime loans); Alex Tanzi, *Bloomberg U.S. Mortgage Delinquency, Foreclosure Rates*, BLOOMBERG (Oct. 15, 2009) (showing increases in foreclosure rates between September 30, 2007 and September 30, 2009 from 0.79 percent to 7.22 percent for prime loans, from 1.56 percent to 11.68 percent for Alt-A loans, and from 6.16 percent to 16.51 percent for subprime loans).

[107] *See* FIN. CRISIS INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES xv-xxviii (2011) (tracing the origins of the financial crisis to "excessive borrowing" by individuals and financial institutions, "collapsing mortgage-lending standards," an overactive mortgage securitization industry, "failures [by] credit rating agencies" to adequately assess risk, "corporate governance and risk management" failures, "breakdown[s] in accountability and ethics," and over "30 years of [financial] deregulation").

[108] *See* U.S. CENSUS BUREAU, *supra* note 16, at 743 tbl.1194.

[109] Even a cursory review of recent foreclosure litigation demonstrates that most major financial institutions have initiated foreclosure actions against borrowers. *See, e.g.*, Mejia v. GMAC Mortg. LLC, No. CV 11-01140-PHX-FJM, 2012 WL 786328 (D. Ariz. Mar. 9, 2012) (GMAC); Benford v. CitiMortgage, Inc., No. 11-12200, 2011 WL 5525942 (E.D. Mich. Nov. 14, 2011) (Citi); Vela v. Freddie Mac Loan Mortg. Corp. (*In re* Vela), Adversary No. 11-5004, 2011 WL 3439256 (S.D. Tex. Aug. 2, 2011) (Wells Fargo); Matthews v. JPMorgan Chase Bank, NA, No. 3:11-CV-00972-M, 2011 WL 3347920 (N.D. Tex. Aug. 1, 2011) (JPMorgan Chase); Liu v. Bank of America, No. 08-CV-3358 (JG), 2010 WL 1702537 (E.D.N.Y Apr. 28, 2010) (Bank of America); DiGiovanni v. BAC Home Loans Servicing, L.P., No. 2D11-5265, 2012 WL 832790 (Fla. Dist. Ct. App. Mar.

they may view MERS as a symbol of the same overzealous financial culture that contributed to the crisis.[110] Indeed, some have even advocated confronting MERS directly in quiet-title actions and foreclosure proceedings.[111]

V. RISKS FOR SUBSEQUENT PURCHASERS OF MERS-MORTGAGED PROPERTY

While MERS has captured widespread public attention for its role in the foreclosure crisis,[112] the company's business practices raise equally important questions for purchasers of MERS-mortgaged properties. As recent events have shown, failures by financial institutions and MERS to properly document assignments of mortgage notes have created a risk that neither can determine who owns the note or recreate the chain of title for any particular mortgage.[113] Courts in several states have already held that MERS's inability to produce both the mortgage and the

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14, 2012) (Bank of America and Countrywide); HSBC Bank USA, N.A. v. Taher, No. 9320/09, 2011 WL 2610525 (N.Y. Sup. Ct. July 1, 2011) (HSBC).

[110] This is particularly true where many of the most prominent banks "played a critical role in the development of MERS." *Shareholders*, MERS, http://www.mersinc.org/about/shareholders.aspx (last visited Sept. 23, 2011) (identifying Bank of America, CitiMortgage, Inc., HSBC Finance Corp., Wells Fargo Bank, GMAC Residential Funding Corp., Mortgage Bankers Association, Fannie Mae, and Freddie Mac as MERS shareholders).

[111] *See* Christopher Ketcham, *STOP PAYMENT! A Homeowners' Revolt Against the Banks*, HARPER'S, Jan. 2012, at 29 (chronicling homeowners' efforts to "attack the banking industry with the fine print of real estate law" by "demanding proof of who really own[s] their loan").

[112] *See, e.g.*, Scot J. Paltrow, *Facing Criticism, MERS Cuts Role in Foreclosures*, REUTERS (July 27, 2011, 4:52 PM), http://www.reuters.com/article/2011/07/27/us-mers-foreclosure-idUSTRE76Q67L20110727; Michael Powell & Gretchen Morgenson, *MERS? It May Have Swallowed Your Loan*, N.Y. TIMES (Mar. 6, 2011), http://www.nytimes.com/2011/03/06/business/06mers.html; Tadena, *supra* note 98; Nick Timiraos, *Oregon Judge Denies Foreclosure, Challenges MERS*, WALL ST. J. DEVS. BLOG (May 26, 2011, 5:03 PM), http://blogs.wsj.com/developments/2011/05/26/oregon-judge-denies-foreclosure-challenges-mers/.

[113] *See* Verified Complaint at 30, Delaware v. MERSCORP, Inc., No. 6987, (Del. Ch. Oct. 27, 2011) (citing Transcript of Hearing at 6-8, 16-17, *In re* Kemp, 440 B.R. 624, 626 (Bankr. D.N.J. 2010) (No. 08-18700) (Aug. 11, 2009)) ("[I]n a 2009 hearing . . . , an employee for the Bank of America entity responsible for servicing the securitized Countrywide mortgage loans testified under oath that Countrywide did not have a practice of delivering original documents such as the note to the Trustee . . . . In addition, the same employee further testified that allonges are typically prepared in anticipation of foreclosure litigation, rather than at the time the mortgage loans are purportedly securitized."); *see also* Gongloff, *supra* note 4 ("The crisis has been escalating for several weeks, as banks suspend foreclosures across the country, citing flaws they have uncovered, including faulty or missing documentation. Tales of mismanagement within the foreclosure process—including so-called robo-signers, who were paid to rubber stamp documents without properly reviewing them—are emerging daily."); Gretchen Morgenson, *Flawed Paperwork Aggravates Foreclosure Crisis*, N.Y. TIMES (Oct. 3, 2010), http://www.nytimes.com/2010/10/04/business/04mortgage.html.

note is fatal to its ability to foreclose.[114] However, MERS's inability to produce the note generates problems that transcend the foreclosure arena. In particular, it threatens title to MERS-mortgaged properties that are subsequently purchased by third parties, and it places a cloud on title for existing homeowners whose properties list MERS as the mortgagee of record.

A. Framing the Issue

MERS raises a host of issues that could pose risks to subsequent purchasers. For example, imagine the following scenario, represented below by Figure C.[115] *A* is a homeowner who financed the purchase of his home with a mortgage. *A*'s lender, Bank *Z*, provided funds to *A* in order make the purchase, but in exchange, Bank *Z* required *A* to execute two documents. First, *A* executed a mortgage on the property to MERS, "solely as nominee for [Bank *Z*] and [Bank *Z*]'s successors and assigns."[116] Second, *A* executed a promissory note to Bank *Z*, secured by the mortgage to MERS. After closing the transaction, MERS recorded its mortgage at the county recorder's office. Subsequently, Bank *Z* assigned the note to Bank *Y*, who then assigned the note to Bank *X*, who later assigned the note to Bank *W*. All of these assignments were executed in order to securitize *A*'s mortgage note, but none were recorded. Instead, the banks utilized MERS to track their assignments. However, MERS and the relevant banks either lost track of the note or failed to properly execute their assignments. As a result, the banks suffer from missing or inconsistent paperwork with respect to the note.

Meanwhile, *A* wanted to sell his home and remained current on his mortgage payments. *B* demonstrated interest in *A*'s property and decided to buy it. At the closing, *B* distributed funds to *A*, which *A* tendered to MERS in order to satisfy the remaining balance on his note. In exchange for *A*'s payment,

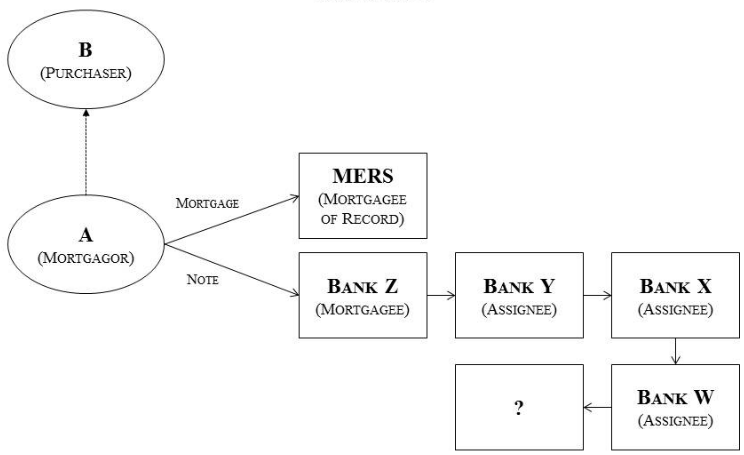
[114] *See, e.g.*, Mortg. Elec. Registration Sys., Inc. v. Sw. Homes of Ark., 301 S.W.3d 1, 3-8 (Ark. 2009); Landmark Nat'l Bank v. Kesler, 216 P.3d 158, 166-69 (Kan. 2009); Mortg. Elec. Registration Sys., Inc. v. Saunders, 2 A.3d 289, 295-97 (Me. 2010); Bank of N.Y. v. Silverberg, 926 N.Y.S.2d 532, 539 (App. Div. 2011).

[115] This visual representation is intended to provide the reader with a conceptual understanding of the various relationships that might exist in a common real estate transaction. For the purpose of clarity, many facets of these relationships have been simplified, and extraneous parties have been omitted. For a more comprehensive visual representation of the mortgage securitization process with MERS, see Wallace, *supra* note 83, at 11; *see also* Powell & Morgenson, *supra* note 112 (follow "How a Mortgage Moves Through MERS" hyperlink).

[116] Sample MOM Mortgage, *supra* note 1, at 3.

MERS discharged its mortgage on the property.[117] *A* then conveyed title to *B*. However, neither *A* nor *B* received any assurance that *A*'s debt was satisfied from the actual owner of *A*'s note. Instead, both relied on MERS's discharge of the mortgage, in its capacity as mortgagee of record. Therefore, if MERS fails to distribute the proceeds to the owner of the note, it may be possible that the owner of *A*'s note has a claim against *B*'s property, which was pledged as security for the note. The viability of any claims against *B*'s property hinges on two critical questions. First, can MERS properly discharge *A*'s debt obligation and, in the process, extinguish any future claims by the owner of the note? Second, if MERS cannot properly discharge *A*'s debt, will courts recognize *B*'s claim to the property as superior to the noteholder's prior unrecorded interest, on the ground that *B* is a bona fide purchaser for value?[118]

FIGURE C



[117] Depending upon the jurisdiction, MERS's interest in the mortgage may represent legal title to the property or a lien against the property. *See* NELSON & WHITMAN, *supra* note 34, § 1.5 (explaining the distinction between the "title theory" and "lien theory"). Since New York adopts a lien theory, MERS technically does not convey legal title to the borrower but instead releases its lien on the mortgaged property. *See* Barson v. Mulligan, 84 N.E. 75, 78 (N.Y. 1908) ("[T]he mortgagee, having come to be regarded as a mere lienor, ha[s] no legal estate in the land covered by his mortgage . . . .").

[118] *See* 4 AMERICAN LAW OF PROPERTY, *supra* note 47, §§ 17.10-17.11; 11 THOMPSON ON REAL PROPERTY, *supra* note 42, § 92.09.

B. MERS's Ability to Discharge the Debt

As a threshold matter, it is unclear whether MERS can properly discharge the borrower's obligation, given that MERS holds only an interest in the mortgage.[119] For example, under New York law, a mortgagee is entitled to discharge a borrower's obligation upon the borrower's satisfaction of the mortgage debt.[120] Importantly for MERS, the relevant statute defines "mortgagee" as "the current holder of the mortgage of record or the current holder of the mortgage."[121] Therefore, one who holds only the mortgage without a corresponding interest in the note can nevertheless discharge a mortgage under the statute.[122] Indeed, the statute expressly provides for a discharge of the mortgage even where the mortgagee cannot produce the note.[123]

The inquiry does not end here, however. Notwithstanding MERS's ability to discharge a mortgage for recording purposes, a question remains as to what legal effect that discharge will have upon the owner of the note. In New York, a note secured by a mortgage "will not be discharged by payment to the record holder if . . . the note and mortgage ha[ve] already been transferred . . . , even though no assignment has been recorded."[124] In other words, a borrower cannot satisfy his debt by paying the record holder of the mortgage if the record holder has already assigned its interests to a third party, regardless of the third party's failure to record.[125] To that effect, the New York Court of Appeals has cautioned that "[w]here a

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[119] *See* Sample MOM Mortgage, *supra* note 1, at 3 ("Borrower understands and agrees that MERS holds *only legal title* to the interests granted by Borrower in this Security Instrument . . . ." (emphasis added)); *see also* Residential Funding Co., LLC v. Saurman, 807 N.W.2d 412, 417 (Mich. Ct. App.) ("MERS, as mortgagee, only held an interest in the *property* as security for the note, not an interest in the note itself."), *rev'd on other grounds*, 805 N.W.2d 183 (Mich. 2011).

[120] N.Y. REAL PROP. ACTS. LAW § 1921(1) (McKinney 2011) ("After payment of authorized principal, interest and any other amounts due . . . , a mortgagee of real property . . . must execute and acknowledge . . . a satisfaction of mortgage . . . .").

[121] *Id.* § 1921(9)(a). The statutory definition of "mortgagee" also includes "any person to whom payments are required to be made" or "their personal representatives, agents, successors, or assigns." *Id.*

[122] *See id.*

[123] *See id.* § 1921(4) ("If the mortgagee has delivered such satisfaction of mortgage in a timely manner and has certified that the note and/or mortgage are not in its possession as of such date, the mortgagee shall not be liable under this section if the mortgagee agrees to defend and hold harmless the mortgagor by reason of the inability or failure of the mortgagee to furnish the note or mortgage within the time period prescribed in this subdivision . . . .").

[124] Assets Realization Co. v. Clark, 98 N.E. 457, 458 (N.Y. 1912).

[125] *Id.*

party makes . . . a final payment in satisfaction of a bond and mortgage without taking a satisfaction and without requiring production of the instruments, or receiving some sufficient excuse for their nonproduction, the payment is at his peril and not good as against an assignee for value under an unrecorded assignment."[126] At bottom, New York law embodies the principle that a borrower should require his mortgagee to demonstrate contemporaneous ownership of the mortgage and note before tendering a final payment on the mortgage.[127] Otherwise, the payment is made "at his peril."[128] This appears to flow from the maxim that "a transfer of the mortgage without the debt is a nullity."[129] Given that "a mortgage is but an incident to the debt which it is intended to secure,"[130] it follows that the release of a mortgage should remain ineffective as against the owner of the note, who may not have received the final payment.[131]

Where MERS acts as mortgagee of record, these principles bear directly on MERS's ability to properly discharge a borrower's obligation. Since MERS has no interest in the underlying mortgage note,[132] the company can release only its interest in the mortgage. However, given that "a transfer of the mortgage without the debt is a nullity,"[133] a release of the

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[126] *Id.* at 459; *cf.* RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 6.4 cmt. c (1997) ("When payment or tender by the person primarily responsible for the debt has extinguished the mortgage, the payor derives little comfort unless a document can be recorded to clear the public records of the mortgage lien. . . . In some states it is customary for the mortgagee to provide an endorsement on the public records, *to display the promissory note, marked 'paid,' to the recorder's office personnel*, or to return the original mortgage document." (emphasis added)).

[127] *See Assets Realization Co.*, 98 N.E. at 458-59. It bears mentioning that this principle is analogous to the requirements imposed upon parties seeking foreclosure in New York. *See* Bank of N.Y. v. Silverberg, 926 N.Y.S.2d 532, 537 (App. Div. 2011) ("In a mortgage foreclosure action, a plaintiff has standing where it is both the holder or assignee of the subject mortgage and the holder or assignee of the underlying note at the time the action is commenced."); U.S. Bank v. Collymore, 890 N.Y.S.2d 578, 580 (App. Div. 2009); Kluge v. Fugazy, 536 N.Y.S.2d 92, 93 (App. Div. 1988).

[128] *Assets Realization Co.*, 98 N.E. at 459.

[129] Merritt v. Bartholick, 36 N.Y. 44, 45 (1867).

[130] *Id.*

[131] *See* CIT Grp./Bus. Credit, Inc. v. Walentas, 813 N.Y.S.2d 370, 370 (App. Div. 2006) ("The satisfaction of the mortgage was not a blanket release of defendants' obligations under the note."); Signal Fin. of N.Y., Inc. v. Polomaine, 519 N.Y.S.2d 933, 934 (Civ. Ct. 1987) (holding that "[t]he underlying obligation, as evidenced by the note, survive[d] the Discharge of the Mortgage"); *see also* 59 C.J.S. *Mortgages* § 628 (2011); 78 N.Y. JUR. 2D *Mortgages and Deeds of Trust* § 375 (2011).

[132] *See* Sample MOM Mortgage, *supra* note 1, at 3 ("Borrower understands and agrees that MERS holds *only legal title* to the interests granted by Borrower in this Security Instrument . . . ." (emphasis added)); *see also* Residential Funding Co, LLC v. Saurman, 807 N.W.2d 412, 417 (Mich. Ct. App.) ("MERS, as mortgagee, only held an interest in the *property* as security for the note, not an interest in the note itself."), *rev'd on other grounds*, 805 N.W.2d 183 (Mich. 2011).

[133] *Bartholick*, 36 N.Y. at 45.

mortgage without a release of the debt would likewise appear to be a nullity. Under these circumstances, a borrower's failure to require MERS to "produce and deliver up the instruments which are being paid and satisfied"—in particular, the mortgage note—could place his payment in jeopardy.[134]

Nevertheless, some authority exists[135] to suggest that MERS may have the ability to discharge the borrower's debt as an agent "for [the] Lender and Lender's successors and assigns."[136] In *MERSCORP, Inc. v. Romaine*,[137] the New York Court of Appeals held that MERS had authority to record discharges "[a]s the nominee for the mortgagee of record or for the last assignee."[138] Moreover, in an opinion dissenting in part, Chief Judge Kaye also appeared to accept MERS's agency theory, suggesting that "the use of a nominee as the equivalent of an agent for the lender is apparent, and not unusual."[139] Nevertheless, Chief Judge Kaye agreed with the majority by stating,

> [I]ssues concerning the underlying validity of the MERS mortgage instrument—in particular, *whether its failure to transfer beneficial interest renders it a nullity under real property law*, whether it violates the prohibition against separating the note from the mortgage, and whether MERS has standing to foreclose on a mortgage—are best left for another day.[140]

The extent to which courts will recognize MERS's agency powers beyond the context of the recording statutes remains to be seen. On one hand, some courts appear to have followed the Court of Appeals' formulation of MERS's agency authority.[141] In particular, one court has held that "the language of the mortgage appoints MERS as nominee, or agent, for the lender and its successors and assigns for the purposes set forth therein."[142]

[134] *Assets Realization Co.*, 98 N.E. at 459.

[135] *See* MERSCORP, Inc. v. Romaine, 861 N.E.2d 81, 84 (N.Y. 2006).

[136] Sample MOM Mortgage, *supra* note 1, at 3; *see* Brief for Petitioners-Appellants at 27, MERSCORP, Inc., v. Romaine, 743 N.Y.S.2d 562 (App. Div. 2002) (No. 2001-04792), 2001 WL 34687001 (citing RESTATEMENT (SECOND) OF AGENCY § 1 (1958)) ("MERS's relationship with its member lenders is that of agent and principal. This is a fiduciary relationship, which results from the manifestation of consent of one person to allow another to act on his behalf and subject to his control, and consent by the other to so act. The principal is the one for whom action is to be taken, and the agent is the one who acts.").

[137] *Romaine*, 861 N.E.2d 81.

[138] *Id.* at 84.

[139] *Id.* at 87 (Kaye, C.J., dissenting in part).

[140] *Id.* at 87 n.* (emphasis added).

[141] *See, e.g.*, Deutsche Bank Nat'l Trust Co. v. Pietranico, 928 N.Y.S.2d 818, 829-30 (Sup. Ct. 2011).

[142] *Id.*

Accordingly, the same court found that MERS was entitled "to exercise any and all of the interests granted by the borrower under the mortgage," including "the right to foreclose and sell the property[,] and to take any action required of the lender."[143]

However, other courts appear to have contradicted the Court of Appeals' approach in favor of a more exacting standard.[144] In particular, one court has refused to find that an agency relationship existed between MERS and its members by explaining that "the fact . . . MERS is named 'nominee' in the Mortgage is not dispositive of the existence of an agency relationship and does not, in and of itself, give MERS any 'authority to act.'"[145] Additionally, another court has held that, "as nominee, MERS's authority was limited to only those powers which were specifically conferred to it and authorized by the lender."[146] Although the mortgage gave MERS 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,"[147] the court nevertheless insisted that no party can initiate foreclosure without holding both the mortgage and the note at the time of the action.[148] The implication of these cases is clear. Both suggest that the power to foreclose must be specifically authorized by the principal and that the language contained in the mortgage provides insufficient authorization. The same logic would also seem to extend to MERS's ability to discharge the security instrument, which is another power the mortgage confers upon the mortgagee.[149]

Nevertheless, the fact remains that no court has squarely addressed the issue of whether MERS's discharges would be binding upon the owner of the note, particularly where the owner of the note is unknown[150] and perhaps

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[143] *Id.* (internal quotation marks omitted).

[144] *See, e.g.*, *In re* Agard, 444 B.R. 231, 253 (Bankr. E.D.N.Y. 2011); Bank of N.Y. v. Silverberg, 926 N.Y.S.2d 532, 537 (App. Div. 2011); Bank of N.Y. v. Alderazi, 900 N.Y.S.2d 821, 823-24 (Sup. Ct. 2010).

[145] *In re Agard*, 444 B.R. at 253.

[146] *Silverberg*, 926 N.Y.S.2d at 538 (internal quotation marks omitted).

[147] *Id.* at 534 (alterations in original).

[148] *Id.* at 537.

[149] *See* Sample MOM Mortgage, *supra* note 1, at 3 ("MERS (as nominee for Lender and Lender's successors and assigns) has the right . . . to take any action required of Lender including, but not limited to, releasing and canceling this Security Instrument.").

[150] MERS's principal might be unknown to MERS in two ways. First, MERS presumably cannot determine, upon origination of the mortgage, who will later receive an assignment of the note and on whose behalf MERS will act when discharging the obligation. Therefore, at the time of origination, the mortgage purports to create an agency relationship between MERS and a class of unknown third parties, one of whom

unknowable[151] to MERS. However, as courts continue to examine MERS's agency authority, they should recognize that their decisions carry immense implications for subsequent purchasers of MERS-mortgaged properties. In particular, where the note has been lost or improperly assigned, two dangers emerge. First, MERS may lack the ability to identify the note's true owner, which precludes the company from recording a proper discharge on behalf of the owner of the note.[152] Second, MERS may lack the ability to identify all assignees in the chain of title to the note,[153] which means that MERS cannot rule out the existence of potential claims by unknown assignees to a portion of the note's proceeds. Under these circumstances, unsatisfied parties to the original mortgage note may have claims against the property, as security for the note, if those parties do not receive the funds to which they are entitled.[154] Because MERS cannot determine how to distribute funds where it cannot identify the note's owner, this likelihood does not appear to be remote.

Accordingly, a subsequent purchaser may be at risk of losing his property when the note's owner attempts to redeem the security interest, even though he takes the property totally unaware of any prior unrecorded assignees of the note or any potential claims they might possess. Indeed, when MERS releases its mortgage lien and the borrower then conveys the property to a third-party purchaser, the third party relies on the fact that all recorded interests appear to have been satisfied. Therefore, the question arises whether the recording statutes will protect the subsequent purchaser against prior unrecorded interests. In most jurisdictions,[155] the third party must represent a bona fide purchaser for value.[156]

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will later receive the note. Second, MERS may also remain unaware of its principal's identity at the time of discharge, given that MERS has the apparent authority to discharge the obligation itself and may refrain from investigating the note's ownership.

[151] MERS's principal might be unknowable to the extent that documentation errors preclude MERS from ascertaining the true identity of the note's owner.

[152] *See supra* notes 132-34 and accompanying text.

[153] *See supra* note 113 and accompanying text.

[154] *See supra* notes 132-34 and accompanying text.

[155] *See* 4 AMERICAN LAW OF PROPERTY, *supra* note 47, § 17.5, 545 n.63 (demonstrating that nearly every United States jurisdiction requires some form of notice to a subsequent purchaser).

[156] *See id.* §§ 17.10-17.11; 11 THOMPSON ON REAL PROPERTY, *supra* note 42, § 92.09.

C. The Recording Acts and Bona Fide Purchasers for Value

1. Race Jurisdiction

In race jurisdictions,[157] the recording acts generally "protect[] the first purchaser to record."[158] Accordingly, a purchaser's "notice or knowledge of prior unrecorded claims is irrelevant" to determining his protection under the statute.[159] For example, North Carolina's statute provides that "instruments registered in the office of the register of deeds shall have priority based on the order of registration as determined by the time of registration."[160] Under this statute, a subsequent purchaser of a MERS-mortgaged property would be secure in his title to land only if he records his interest first in the local recorder's office. However, if the true owner of the note beats the subsequent purchaser to record, the true owner's prior unrecorded interest in the land would prevail.[161]

2. Race-Notice Jurisdiction

In race-notice jurisdictions,[162] a subsequent purchaser must satisfy two requirements. First, he must "record [his interest] before the prior unrecorded claim is recorded."[163] Second, he must be "a purchaser for value without knowledge or notice of the prior unrecorded claim."[164] This second requirement demands, in other words, that he represent a bona fide purchaser for

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[157] As discussed in Part II, the following jurisdictions have enacted race statutes for mortgages: Arkansas, Louisiana, North Carolina, Ohio, and Pennsylvania. 4 AMERICAN LAW OF PROPERTY, *supra* note 47, § 17.5, 545 n.63. However, some suggest that North Carolina "may have become a race-notice state by judicial decision." 11 THOMPSON ON REAL PROPERTY, *supra* note 42, § 92.08(a) n.283 (citing Rowe v. Walker, 441 S.E.2d 156 (N.C. Ct. App. 1994) (John, J., dissenting), *aff'd*, 455 S.E.2d 160 (N.C. 1995)).

[158] 11 THOMPSON ON REAL PROPERTY, *supra* note 42, § 92.08(a).

[159] *Id.*

[160] N.C. GEN. STAT. § 47-18 (2011).

[161] *See* 11 THOMPSON ON REAL PROPERTY, *supra* note 42, § 92.08(a).

[162] As discussed in Part II, the following jurisdictions have enacted race-notice statutes for mortgages: Alaska, California, Colorado, District of Columbia, Georgia, Hawaii, Idaho, Illinois, Indiana, Maryland, Michigan, Minnesota, Mississippi, Montana, Nebraska, Nevada, New Jersey, New York, North Dakota, Oregon, South Dakota, Utah, Washington, Wisconsin, and Wyoming. 4 AMERICAN LAW OF PROPERTY, *supra* note 47, § 17.5, 545 n.63; *see also* 11 THOMPSON ON REAL PROPERTY, *supra* note 42, § 92.08(c) n.288.

[163] 11 THOMPSON ON REAL PROPERTY, *supra* note 42, § 92.08(c).

[164] *Id.*; *see also* J.B. Ames, *Purchase for Value Without Notice*, 1 HARV. L. REV. 1, 5 (1887) ("[I]f a trustee, in violation of his duty, should sell the trust property to one who had no notice of the trust, and should deliver the deed in escrow, the defrauded *cestui que trust* could not restrain the innocent purchaser from performing the condition, nor could he obtain any relief against him after he had acquired title.").

value.[165] For example, New York's statute provides that "[e]very . . . conveyance not . . . recorded is void as against any person who subsequently purchases . . . the same real property . . . in good faith and for a valuable consideration, . . . and whose conveyance . . . is first duly recorded."[166] Of course, New York courts have supplied these statutory requirements with a judicially-crafted meaning. In particular, courts have refused to recognize a party's status as a bona fide purchaser where that party possesses one of three features: actual notice,[167] constructive notice,[168] or inquiry notice.[169] A purchaser has actual notice where he purchases land "with knowledge of a prior outstanding title by an unrecorded deed."[170] A purchaser has constructive notice based on documents found within the record and "is presumed to have investigated the title, . . . to have examined every deed or instrument properly recorded, and to have known every fact disclosed or to which an inquiry suggested by the record would have led."[171] A purchaser has inquiry notice where he "had knowledge of facts or circumstances that would have [led] a reasonably prudent person to make inquiry into a possible defect of title."[172] Finally, courts have also warned that "[a] bona fide purchaser or encumbrancer for value is protected in its title unless the deed is void and conveys no title . . . or it had previous notice of the alleged fraud."[173]

In the case of subsequent purchasers of MERS-mortgaged properties, regardless of whether such purchasers could win the "race to the courthouse,"[174] it is unlikely that they could meet the requirements of a bona fide purchaser. First, the subsequent purchaser does not have actual notice of the existence of the note owner's unrecorded claim to the

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165 *See* 4 AMERICAN LAW OF PROPERTY, *supra* note 47, §§ 17.10-17.11. While a purchase "for value" is required, this note assumes that all payments made by subsequent purchasers will satisfy this additional requirement. For a discussion of the "for value" requirement, see 11 THOMPSON ON REAL PROPERTY, *supra* note 42, § 92.09(c).

166 N.Y. REAL PROP. LAW § 291 (McKinney 2011).

167 *See* Todd v. Eighmie, 41 N.Y.S. 1013, 1015-16 (App. Div. 1896).

168 *See* HSBC Mortg. Servs., Inc. v. Alphonso, 874 N.Y.S.2d 131, 133 (App. Div. 2009).

169 *See* Chen v. Geranium Dev. Corp., 663 N.Y.S.2d 288, 289 (App. Div. 1997).

170 *Eighmie*, 41 N.Y.S. at 1015-16.

171 Fairmont Funding, Ltd. v. Stefansky, 754 N.Y.S.2d 54, 56 (App. Div. 2003).

172 *In re* Fitzsimmons, 2008-3420/H, 2011 WL 4346679, at *3 (N.Y. Sur. Ct. Aug. 10, 2011).

173 *Id.*

174 Kahan Jewelry, Inc. v. Korsinsky, No. 35022/02, 2004 WL 3078700, at *2 (N.Y. Sup. Ct. Aug. 18, 2004).

property.[175] However, the subsequent purchaser may have constructive notice. In particular, a thorough investigation of the record would have uncovered the fact that MERS recorded a discharge of mortgage in favor of the borrower, which "so state[d]" that the mortgage had not been assigned "of record."[176] A thorough investigation of the record also would have revealed that the note was never produced to accompany MERS's discharge, and that the note's owner never executed a separate discharge with respect to the note. These observations would have been sufficient to make the subsequent purchaser suspicious as to the state of his title.[177] Moreover, the subsequent purchaser was aware of facts that might put him on inquiry as to the state of his title—in particular, that MERS was named on the mortgage. In light of the recent notoriety MERS has received for its documentation problems,[178] this fact might cause a "reasonably prudent person to make inquiry into a possible defect of title."[179] Finally, it is also possible that, in some circumstances, courts will refuse to protect the subsequent purchaser because his deed is void by reason of fraud or forgery.[180] This may be particularly relevant in MERS's case if there were an allegation of forgery by a robo-signer.[181] Accordingly, a subsequent purchaser of MERS-mortgaged property is unlikely to warrant the protection of a race-notice recording statute under these circumstances, regardless of whether he records his interest first.

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175 *See Eighmie*, 41 N.Y.S. at 1015-16.

176 N.Y. REAL PROP. LAW § 321(3) (McKinney 2011); *see* MERSCORP, Inc. v. Romaine, 861 N.E.2d 81, 84-85 (N.Y. 2006).

177 *See* Curtis v. Moore, 46 N.E. 168, 169 (N.Y. 1897) ("[Defendant] was not a bona fide purchaser . . . because the record of the mortgage was notice to him that the mortgage was outstanding and unsatisfied, and it was no concern of his who happened to be the owner at the time. In dealing with the property on the assumption that [the record owner] still owned the mortgage, he acted at his peril, and assumed the risk that [the record owner] might have transferred the mortgage to someone else. He was put upon his inquiry, and it was not enough for him to examine the record, and see that no assignment of mortgage appeared thereon, but he should have required a satisfaction piece in due form, or the delivery of the mortgage and the note."); *see also* HSBC Mortg. Servs., Inc. v. Alphonso, 874 N.Y.S.2d 131, 133 (App. Div. 2009).

178 *See supra* notes 4-6, 113 and accompanying text.

179 *In re* Fitzsimmons, 2008-3420/H, 2011 WL 4346679, at *3 (N.Y. Sur. Ct. Aug. 10, 2011).

180 Marden v. Dorthy, 54 N.E. 726, 728, 730 (N.Y. 1899).

181 Robo-signing has captured significant public interest around the country and has also garnered recent attention from prosecutors. *See* Michael Kraus, *Nevada Attorney General Pursuing Criminal Charges Against Robo-signers*, TOTAL MORTG. SERVS. (Nov. 18, 2011), http://www.totalmortgage.com/blog/mortgage-rates/nevada-attorney-general-pursuing-criminal-charges-against-robo-signers/14741.

3. Notice Jurisdiction

In notice jurisdictions,[182] a subsequent purchaser need only meet the requirements of a bona fide purchaser for value in order to receive protection.[183] Indeed, an important distinction from a race-notice statute is that, under a pure notice statute, "[o]ne need not record to qualify for . . . protection."[184] Nevertheless, a subsequent purchaser is unlikely to receive protection from a notice statute under these circumstances. Following a substantially similar analysis to that outlined above, subsequent purchasers of MERS-mortgaged properties are likely to have constructive notice and inquiry notice.[185] Moreover, subsequent purchasers may face similar challenges due to robo-signing forgeries.[186] Accordingly, a notice statute is also unlikely to provide any refuge.

VI. IMPLICATIONS FOR SUBSEQUENT PURCHASERS

Because recording statutes cannot provide subsequent purchasers of MERS-mortgaged properties with adequate assurance to title, subsequent purchasers may suffer significant harms. Moreover, given MERS's prevalence in today's real estate market,[187] courts will inevitably address this issue. Agency theory offers the best solution for all parties in resolving this conflict.

A. Where MERS Cannot Properly Discharge the Mortgage

MERS's ability to properly discharge a borrower's debt plays a critical role in the real estate market. If courts follow the common law rule and find that a borrower must receive a discharge from the owner of the note—as opposed to a discharge from MERS as owner of the mortgage—then the debt will remain effective and the owner of the note will have

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182 As discussed in Part II, the following jurisdictions have enacted notice statutes for mortgages: Alabama, Arizona, Connecticut, Delaware, Florida, Iowa, Kansas, Kentucky, Maine, Massachusetts, Missouri, New Hampshire, New Mexico, Oklahoma, Ohio, Rhode Island, South Carolina, Tennessee, Texas, Vermont, Virginia, and West Virginia. 4 AMERICAN LAW OF PROPERTY, *supra* note 47, § 17.5, 545 n.63; *see also* 11 THOMPSON ON REAL PROPERTY, *supra* note 42, § 92.08(b) n.286.

183 *See* 4 AMERICAN LAW OF PROPERTY, *supra* note 47, § 17.11; 11 THOMPSON ON REAL PROPERTY, *supra* note 42, § 92.08(b).

184 11 THOMPSON ON REAL PROPERTY, *supra* note 42, § 92.08(b).

185 *See supra* Part V.C.2.

186 *See supra* Part V.C.2.

187 Bank of N.Y. v. Silverberg, 926 N.Y.S.2d 532, 539 (App. Div. 2011) (noting that MERS is listed on "approximately 60% of all mortgage loans in the United States").

recourse against the borrower's property.[188] Indeed, this remains true under New York's recording statutes.[189] As we have seen, this may have disastrous effects for subsequent purchasers under each of the different recording statutes.[190] In race jurisdictions, subsequent purchasers will face risks unless they can beat the note owner to the recorder's office.[191] And in the forty-six states[192] that have adopted some form of notice or race-notice statute, subsequent purchasers face risks that a note owner might seek to enforce his rights against the property on the ground that purchasers had constructive or inquiry notice of the prior unrecorded claim.

This scenario could have devastating consequences for subsequent purchasers and for the real estate market generally. First, subsequent purchasers throughout the country could face both economic loss and physical loss of property as a result of their defective titles.[193] If a prior unrecorded interest remains unsatisfied, that party might pursue foreclosure against the property to redeem its security interest,[194] leaving subsequent purchasers with nothing. In essence, they have "purchase[d] [not property but] a lawsuit."[195] However, it is likely that subsequent purchasers would have obtained title insurance to protect against the risk of defective title.[196] If subsequent purchasers have obtained title insurance, the title policy would likely insure "against loss or damage . . . sustained or incurred by the insured by reason of . . . [a]ny defect in or lien or encumbrance on the title."[197] This provision includes any liens created by a prior

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[188] *See* Assets Realization Co. v. Clark, 98 N.E. 457, 459 (N.Y. 1912); CIT Grp./Bus. Credit, Inc. v. Walentas, 813 N.Y.S.2d 370, 370 (App. Div. 2006); Signal Fin. of N.Y., Inc. v. Polomaine, 519 N.Y.S.2d 933, 934 (Civ. Ct. 1987); 78 N.Y. JUR. 2D *Mortgages and Deeds of Trust* § 375 (2011).

[189] Although section 1921 of the New York Real Property Actions and Proceedings Law protects the borrower from claims by a mortgagee who cannot produce the note, it does not appear to protect the borrower from claims by *the owner of the note*, whose security interest was discharged without his knowledge or assent. N.Y. REAL PROP. ACTS. LAW § 1921(4) (McKinney 2011).

[190] *See supra* Part V.C.

[191] *See supra* Part V.C.1.

[192] *See supra* notes 162, 182.

[193] *See, e.g.*, Curtis v. Moore, 46 N.E. 168 (N.Y. 1897) (affirming judgment of foreclosure against subsequent purchaser based on purchaser's inferior interest in the property).

[194] *See, e.g.*, *id.*

[195] *See* 1 JOYCE D. PALOMAR, *supra* note 10, § 1.2 ("The basis for making a real property transaction contingent on evidence of clear, marketable title is the consensus in the law that a buyer should not have to purchase a lawsuit.").

[196] *See id.* § 5.5 ("The title insurer . . . assumes the risk of loss to the insured by reason of any defect in or lien or encumbrance on the insured title."); 11 THOMPSON ON REAL PROPERTY, *supra* note 42, § 93.03(a)(2).

[197] 2 JOYCE D. PALOMAR, *supra* note 10, app. C2.

mortgage on the property.[198] Since the subsequent purchaser would suffer a loss when the owner of the prior unrecorded interest initiates foreclosure proceedings,[199] the title insurer would indemnify this loss and the purchaser would receive remuneration.[200]

Nevertheless, subsequent purchasers are still removed from their homes and businesses,[201] and any indemnification they receive may fail to account for the subjective value they derived from the property.[202] Homeowners "commonly value their own property in significant ways that the market does not recognize."[203] These values may include "investments in networks of friends and the development of social capital"[204] as well as "the search costs of finding shops and services in the new location."[205] Perhaps most significant, however, is the homeowner's personal attachment to the property[206] and the loss of autonomy he would experience by losing it.[207] Although the homeowner might receive reimbursement from a title insurer in order to purchase a new home, "the price of a replacement will not restore the status quo,"[208] and "perhaps no amount of money can do so."[209] Therefore, a title insurer's

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198 11 THOMPSON ON REAL PROPERTY, *supra* note 42, § 93.03(a)(2) ("A mortgage creates a voluntary lien.").

199 *Id.* § 93.04(b) ("An actual loss appears most clearly after foreclosure occurs, when a deficiency can subsequently be attributed to a covered superior lien or defect in title to the mortgage.").

200 *See* 1 JOYCE D. PALOMAR, *supra* note 10, § 10.8 ("[T]he insurer owes . . . a duty to reimburse for actual losses the insured has incurred because of the title defect.").

201 *See id.* § 1.2 (noting that "[p]urchasers of real property expect to be able to build businesses, establish homes, or otherwise improve their properties" and do not wish to "invest money, time, and care" into their properties if they will be subject to loss).

202 In large part, I owe many of my thoughts on this subject to Professor Brian Lee, whose notion of an "idiosyncratic premium" in eminent domain proceedings explores the problem of compensating property owners for subjective value. Brian Lee, Faculty Workshop at Brooklyn Law School: The Idiosyncratic Premium in Eminent Domain (Sept. 8, 2011).

203 John Fee, *Eminent Domain and the Sanctity of Home*, 81 NOTRE DAME L. REV. 783, 790 (2006); *see* Christopher Serkin, *The Meaning of Value: Assessing Just Compensation for Regulatory Takings*, 99 NW. U. L. REV. 677, 700 (2005) ("Sentimental attachments, or a unique business enterprise, may prevent the market from accurately reflecting the value of property to its owner."); *see also* Fee, *supra*, at 793 (explaining that "some business owners, like homeowners, [also] become personally attached to their business property in ways that the market . . . do[es] not value").

204 Lee Anne Fennell, *Taking Eminent Domain Apart*, 2004 MICH. ST. L. REV. 957, 964.

205 *Id.* at 963.

206 *See* Margaret Jane Radin, *Property and Personhood*, 34 STAN. L. REV. 957, 992 (1982) (recognizing "society's traditional connection between one's home and one's sense of autonomy and personhood").

207 *Id.* at 959.

208 *Id.*

209 *Id.*

reimbursement of the homeowner may prove inadequate in compensating for his subjective loss.[210]

The title insurer has also suffered an economic loss as a result of the defective title.[211] Given the title insurer's newfound appreciation for the title risks posed by MERS-mortgaged properties, most title insurers will simply refuse to insure them.[212] When a title search reveals that the owner of the note has not recorded a discharge, the title insurer will inform the prospective purchaser of the defect and refrain from issuing a policy.[213] To the extent that MERS and its members cannot produce documentation with respect to the note, the underlying properties will begin to suffer from the problem of clouded title.[214] Aware of potential defects in the chain of title, title insurers will refuse to issue policies on the properties,[215] and prospective purchasers will be unwilling to bear the risks of prior claimants.[216] Accordingly, they will seek to purchase property from another homeowner, and the initial borrower will be unable to alienate his property.[217] This will have significant adverse consequences for property owners and for the real estate

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[210] *See id.* ("[I]f a wedding ring is stolen from a jeweler, insurance proceeds can reimburse the jeweler, but if a wedding ring is stolen from a loving wearer, the price of a replacement will not restore the status quo—perhaps no amount of money can do so.").

[211] *See supra* notes 197-200 and accompanying text.

[212] Some title insurers have taken this position in the past as a result of lender document irregularities. *See* David Streitfeld, *Company Stops Insuring Titles in Chase Foreclosures*, N.Y. TIMES (Oct. 2, 2010), http://www.nytimes.com/2010/10/03/business/economy/03foreclose.html ("Old Republic National Title Insurance[] told its agents Friday that it would not write policies on foreclosed Chase properties until 'the objectionable issues have been resolved,' according to a memorandum sent out by the firm's underwriting department.").

[213] *See generally* 11 THOMPSON ON REAL PROPERTY, *supra* note 42, § 93.05(b) (surveying the title insurer's "duty to search title and report adverse matters").

[214] *See* 65 AM. JUR. 2D *Quieting Title* § 13 (2011).

[215] *See supra* note 212 and accompanying text.

[216] *See* 1 JOYCE PALOMAR, *supra* note 10, § 1.2 ("Purchasers of real property expect to be able to build businesses, establish homes, or otherwise improve their properties without the risk of having to begin again in another location because someone appears with a superior claim to the title. Purchasers want assurance that the title is good before they invest money, time, and care, not damages from the grantor when the title proves to be defective.").

[217] In this regard, it is worth noting the moral hazard concerns that this situation creates. If the borrower has a firm enough belief in the defunct status of his mortgage note—particularly where the borrower is unable to sell his property—he may be willing to cease payments on his mortgage altogether, betting on the fact that his lender cannot produce the note in order to pursue foreclosure proceedings. *See* Ketcham, *supra* note 111, at 36 (suggesting that current uncertainty surrounding MERS is "an opportunity to be embraced"). This particular danger arises in jurisdictions that require the lender to prove ownership of the note prior to foreclosure. *See, e.g.*, Bank of N.Y. v. Silverberg, 926 N.Y.S.2d 532, 537 (App. Div. 2011).

market generally.[218] If purchasers will not bear the risks of defective title and title insurers will not write policies on the affected properties, buyers and sellers will become stuck as their property loses its alienability. Given that MERS holds an estimated 65 million mortgages,[219] or approximately 60 percent of mortgages nationwide,[220] this could have a significant impact on the country's real estate market.

B. Where MERS Can Properly Discharge the Mortgage as Agent

However, if courts find that MERS has authority to act as agent for the original lender and the lender's assigns,[221] many of the problems for subsequent purchasers may disappear. A central principle of agency law is that a principal is "bound by the acts of its agent."[222] Accordingly, if courts accept MERS's authority to act as agent for lenders, those lenders would be bound by MERS's discharges to borrowers and would be prevented from bringing any claims against the property.[223] Where MERS has discharged the mortgage but the note owner fails to receive the proper funds, the remedy is no longer against the property but instead is against MERS as the note owner's fiduciary.[224] This solution alleviates any issues for subsequent purchasers since they would now be entitled to rely on MERS's discharge[225] and the note owner's privity to that transaction.[226] As a result, agency theory removes the cloud on title for owners

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[218] *See* 1 JOYCE PALOMAR, *supra* note 10, § 1.2 ("Stability of land titles is critical not only to individual property owners, but also to society as a whole.").

[219] Dennis & Cha, *Foreclosure Chaos*, *supra* note 2.

[220] *See Silverberg*, 926 N.Y.S.2d at 539.

[221] *See, e.g.*, Deutsche Bank Nat'l Trust Co. v. Pietranico, 928 N.Y.S.2d 818, 829 (Sup. Ct. 2011).

[222] Cange v. Stotler & Co., 826 F.2d 581, 590 (7th Cir. 1987); *see* 2A N.Y. JUR. 2D *Agency* § 291 (2009) ("A principal is liable on contracts entered into on its behalf by an authorized agent."); RESTATEMENT (THIRD) OF AGENCY § 6.02 (2006) ("When an agent acting with actual or apparent authority makes a contract on behalf of an unidentified principal, . . . the principal and the third party are parties to the contact.").

[223] *See* 3 AM. JUR. 2D *Agency* § 262 (2002) (citations omitted) ("A principal is bound by the act of its agent if the agent acts within the scope of the agent's authority, whether the authority of the agent is actual or real, or apparent. . . . [A]n agent acting with actual or apparent authority who enters a contract on behalf of a principal binds the principal but not himself.").

[224] *See, e.g.*, RESTATEMENT (THIRD) OF AGENCY § 8.08 (2006) ("Subject to any agreement with the principal, an agent has a duty to the principal to act with the care, competence, and diligence normally exercised by agents in similar circumstances.").

[225] *See supra* Parts V.B, V.C.2.

[226] *See* RESTATEMENT (THIRD) OF AGENCY § 6.02 (2006).

of MERS-mortgaged properties and breathes liquidity back into the real estate market.[227]

CONCLUSION

The MERS system could have dire effects on subsequent purchasers of MERS-mortgaged properties. Given the potential for widespread documentation errors and the fact that courts may refuse MERS's authority to discharge a mortgage without proof of the note, subsequent purchasers could be at risk of surprise foreclosures against their property—despite their timely mortgage payments. This would have severe effects on the real estate market and on homeowners' ability to alienate their property. No title bearing MERS's name would be certain.

Nevertheless, courts possess the ability to sidestep these problems. If courts recognize MERS's authority to act as agent for its members, they can achieve more desirable outcomes. In particular, this solution would alleviate the risks that subsequent purchasers otherwise face when acquiring MERS-mortgaged properties. It would also remove the cloud from homeowners' title. Perhaps most importantly, it would hold MERS accountable for its documentation errors and force the company to internalize the cost of its own mistakes.

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[227] *See supra* Part VI.A.

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