

MERS: Sometimes Agent, Sometimes Principal, Often Misconstrued

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In many different places and at many different times, the lawyers have been slow to learn that their technical rules must in the long run accommodate themselves to business needs -- that commercial law exists primarily to settle mercantile disputes and not to dictate to the merchants the modes in which they shall carry on their business. These instruments were absolutely necessary to commerce; and it was therefore inevitable that legal technicalities should, in the long run, yield to mercantile necessities.¹

I. Introduction

For most people, the reasons for the bursting mortgage bubble now seem common knowledge; it is difficult to go a week without reading or hearing news accounts about how the banking industry ruined the economy, how banks have stolen people's homes, and how so many Americans have been crushed beneath mortgage debt that they cannot afford.² While many banks (and governmental policies)³ have been associated with this economic crisis, two related private companies – MERSCORP, Inc. and Mortgage

Electronic Registration System, Inc.— have received an abundance of media and legal attention with regard to the bursting of the mortgage bubble and the related wave of mortgage foreclosures.⁴

In 1977, in an attempt to address perceived discrimination in lending practices,⁵ Congress enacted the Community Reinvestment Act (CRA) to ensure, in effect, that banks would lend to certain classes of borrowers even if the borrowers have “high-risk” credit profiles, and, pre-CRA, would not have had access to credit.⁶ During the next twenty years of CRA regulatory implementation, which essentially required lenient mortgage lending to subprime borrowers, based on CRA-mandated criteria, nearly everyone had access to easy mortgage credit.⁷

Together with accommodative monetary policies of the Federal Reserve Board, this helped generate a mortgage-credit-and-housing boom that spread throughout the country: “Consumers did not need to be [further] enticed; they were lining up to participate in the good times, clamoring for loans.”⁸ During this home-loan boom, to help

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1. W.S. Holdsworth, *The Origins and Early History of Negotiable Instruments I*, 31 L. Q. Rev. 12, 17 (1915).
2. See e.g.: Jesse Eisinger, *Financial Crisis Suit Suggests Bad Behavior at Morgan Stanley*, DEALBOOK (Jan. 23, 2013) (“On March 16, 2007 Morgan Stanley employees working on one of the toxic assets that helped blow up the world economy discussed what to name it. Among the... suggestions: ‘Subprime Meltdown,’... ‘Nuclear Holocaust’... then they gave it its real name and sold it to a Chinese bank.”); Takako Taniguchi & Shigeru Sato, *Japan Unveils Plans to Bolster Financial Crisis Response System*, BLOOMBERG (Jan. 24, 2013) (“Japan is seeking to bolster preparedness for financial crises after insurer American International Group, Inc. (AIG) was bailed out during the 2008 global market meltdown.”).
3. Alvin C. Harrell, *The Great Credit Contraction: Who, What, When, Where, and Why*, 26 Ga. St. U. L. Rev. 1209, 1222 (2009).

4. See, e.g., Donald W. MacPherson & Nathaniel K. MacPherson, “From a Syntactical Fog into an Impossible Swamp” *Fed Up Mortgage Foreclosure Judges Find “No Life on MERS*, 65 Consumer Fin. L.Q. Rep. 339 (2011).

5. See, e.g., Harrell, *supra* note 3, at 1222.

6. *Id.* at 1224 - 25.

7. *Id.* at 1225.

8. *Id.* at 1212. The CRA is merely one facet of an overall policy program designed to combat unlawful discrimination. See, e.g.: Christopher J. Willis, *The CFPB Previews Its Coming Auto Finance Fair Lending Enforcement Actions*, 67 Consumer Fin. L. Q. Rep. 212 (2013); John L. Ropiequet, *Fair Lending Litigation and the Impact of Wal-Mart Stores, Inc. v. Dukes*, 66 Consumer Fin. L.Q. Rep. 158 (2012); Joseph T. Lynyak, III., *Fair Lending 2012—Significant Risk Management Agenda Items*, 66 Consumer Fin. L.Q. Rep. 148 (2012); John L. Ropiequet, Christopher S. Naveja & L. Jean Noonan, *Update on Current and Prospective Fair Lending Enforcement and Litigation Developments*, 65 Consumer Fin. L.Q. Rep. 22 (2011).

handle the increased workload, the mortgage industry developed the Mortgage Electronic Registration System, Inc. and MERS CORP, Inc., which the general public and media refer to collectively by the popular name of MERS.

The idea behind MERS is that it serves to benefit mortgage lenders, investors in mortgage-backed securities, and mortgage loan borrowers by providing increased efficiencies in the registration and tracking of mortgage assignments, while reducing costs and transaction delays.⁹ However, this mechanism had never been utilized before in the mortgage industry, nor had there ever been an organization with the legal structure and responsibilities of MERS. When the mortgage and housing markets collapsed, the resulting unfamiliarity with MERS caused confusion and (in some cases) skepticism with regard to the legitimacy of MERS. Because of its internal structure, and seemingly creative concept, MERS has been perceived by some as a deceptive and cunning tool used by the mortgage industry to swindle home owners out of their homes.¹⁰ This fear and hostility toward MERS has been easily addressed by most courts, e.g., through the application of two established bodies of law: the Uniform Commercial Code (UCC) Article 3 and agency law.¹¹

Negotiable instruments law and agency law have shaped and encouraged the growth of business since the eighth century.¹² Today, one cannot conduct serious business transactions without the use of agents,¹³ and negotiability

concepts play a vital role in corporate financing, the funding and perseverance of the mortgage market, and other consumer credit transactions.¹⁴ Importantly, the financial markets and commerce rely on and utilize the transferability of negotiable instruments through the use of agents.¹⁵ UCC Article 3 and agency law thus have application and importance in many areas of everyday life, but the private secondary mortgage market is particularly dependent on these concepts.¹⁶

While some have sought to discredit the practices of MERS and have questioned its authority to carry out its intended purposes, few of the critics have attempted to recognize or explain the legitimate role of MERS.¹⁷ This article

describes MERS's authority to transfer and register mortgages and to effectuate foreclosures on behalf of member banks.¹⁸ Further, this article explains how MERS accomplishes these tasks largely pursuant to UCC Article 3 and agency law. The discussion begins by describing the securitization process, because it is the backdrop for secondary market transactions involving MERS member banks. Next, this article briefly notes the role of UCC Article 3, first discussing its history as applicable to the recognition of negotiable instruments and their transferability, and then noting the crucial role of Article 3 and its purposes in modern commerce, specifically within the secondary mortgage market. This article then discusses rules of agency law because its application is essential to effectuate the relationship between the MERS member banks and MERS. Next, this article describes the way MERS works and applies UCC Article 3 and agency law to its transactions to illustrate the purposes of MERS's practices. Finally, this article discusses recent case law, the authority of MERS's agents, and explains how courts and attorneys should evaluate the authority of MERS going forward.

9. Phyllis K. Slesinger, *Whole Loan Book Entry: A Blueprint for the Future*, 54 *Mortgage Banking* 169 (1993).

10. See, e.g., MacPherson & MacPherson, *supra* note 4.

11. See, e.g., Arthur B. Axelson, Heather C. Hutchings & Alvin C. Harrell, *Update on Mortgage Foreclosure Litigation: MERS, Standing to Sue and "Show Me the Note" as Defenses*, 67 *Consumer Fin. L.Q. Rep.* 155 (2013) and discussion below.

12. See Holdsworth, *supra* note 1, at 14 ("In Northern Italy... Lombardi lawyers of the eighth and ninth centuries...drew up documents in which the person liable promises performance not only to a specified creditor, but also to anyone who produces the document as the creditor's nominee."). Negotiable instruments law, however, did not become formalized as part of the law of contracts for another 1,000 years. See, e.g., *infra* this text Part IV.B.

13. See Paula J. Dalley, *A Theory of Agency Law*, 72 *U. Pitt L. Rev.* 495, 497 (2011) ("It would be difficult to function in a (Continued in next column)

13. (Continued from previous column)

modern economy for more than few hours without interacting with an agent of some kind.").

14. See, e.g.: Gary Gorton & Nicholas Souleles, *Special Purpose Vehicles and Securitization*, in *THE RISKS OF FINANCIAL INSTITUTIONS* 549 (Mark Carey & Rene' M. Stulz eds. 2005) (internal quotation marks omitted) ("[S]ecuritization and...Special Purpose Vehicles (SPVs)...are now pervasive in corporate financing."); Alvin C. Harrell, *Book Review and Commentary: James Stephen Rogers, The End of Negotiable Instruments*, 66 *Consumer Fin. L.Q. Rep.* 220, 225 (2012) [hereinafter Harrell Commentary] ("[W]hile there can be no doubt that much woe has befallen mortgagees (and assignees) who failed to consider the law of negotiability...it does not necessarily follow that negotiable instruments law is obsolete in this context.").

15. See, e.g.: FRED H. MILLER & ALVIN C. HARRELL, *THE LAW OF MODERN PAYMENT SYSTEMS* 88 (West Group ed. 2003) [Miller & Harrell] ("For 'issuance' to occur, delivery to the payee or to an agent of the payee of the instrument is sufficient."); Eldon's Super Fresh Stores, Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 207 N.W.2d 282 (1973) (delivery to the payee through the drawer's agent was sufficient for negotiation under Article 3). Further, if a principal intends to claim holder status or holder in due course status, but his or her agent is in possession of the instrument, this will be sufficient to establish that the principal is in possession for purposes of establishing holder or holder in due course status, as long as the agent's possession is within the scope of the agent's authority. See, e.g., *Georg v. Metro Fixtures Contractors, Inc.*, 178 P.3d 1209, 1213 - 14 (2008) (citations omitted) (quoting another source) (internal quotation marks omitted):

Sometimes the one claiming to be a holder in due course will not have possession of the instrument at the time of the suit. When a collecting bank holds the check, the solution is simple, for [the UCC] makes that bank the agent of the owner of the check. Under traditional analysis, the agent's possession would be the owner's possession and thus the owner would have possession.

16. Secondary market investors cannot realistically investigate each underlying mortgage transaction, and thus rely on the holder in due course doctrine in UCC Article 3 to assure themselves that the notes the purchase are enforceable. See UCC §§ 3-305 & 3-306. Of course, to the extent the federal government or its entities purchase these loans, it can absorb losses without this need. So this is primarily a concern for private parties and transactions.

17. See, e.g., Alvin C. Harrell, *Teaching Consumer Law Part Four*, 12 *J. Consumer & Com. L.* 8, 14 (2008) (quoting Professor Chris Peterson's observation that "no law review [article has] yet" attempted to justify or explain the business practice of (Continued in next column)

17. (Continued from previous column)

MERS Sub "except those written by MERS executives") (alteration in original); see also Kevin M. Hudspeth, *Clarifying Murky MERS: Does Mortgage Electronic Registration Systems, Inc. Have Authority to Assign the Mortgage Note in Standard Illinois Foreclosure Action?*, 31 *N. Ill. U. L. Rev.* 1, 15 (2010) ("MERS arguably maintains no authority to transfer the note or debt underlying the mortgage...To the extent that MERS only maintains authority to assign the mortgage, not the note, an assignment of the mortgage and the note by MERS is arguably meaningless."); David Weber, *The Magic of the Mortgage Electronic Registration System: It is and it isn't*, 85 *Am. Bankr. L.J.* 101 (2011) (arguing, in part, that MERS purports to have different roles depending on the case or situation and that, while the thought behind MERS was a good one, it has turned out to be quite the contrary); Christopher L. Peterson, *Two Faces: Demystifying the Mortgage Electronic Registration System's Land Title Theory*, 53 *Wm. & Mary L. Rev.* 111 (2011) (arguing that MERS is a detriment to the intent and purpose behind the recording statutes); Nolan Robinson, *The Case Against Allowing Mortgage Electronic Registration Systems, Inc. (MERS) to Initiate Foreclosure Proceedings*, 32 *Cardozo L. Rev.* 1621 (2011) (arguing that MERS has no authority to foreclose).

18. While it is not a requirement that a party be a bank in order to be a member of MERS CORP, Inc., the vast majority, if not all members of MERS CORP Inc. are banks.

II. Securitization¹⁹

When a home-mortgage loan is initially extended, or “originated,” the parties are the mortgagor (the borrower) and the mortgagee (the lender and originator).²⁰ The mortgagor borrows money from the lender, with the resulting debt evidenced by the promissory note (note), and the mortgage securing the promise to repay the money borrowed.²¹

In today’s typical home-loan scenario, unlike years past, generally the note and mortgage will not remain in the hands of the lender who originated it.²² While the resulting securitization process may seem complex, and can involve numerous parties and transactions not relevant here, the essential transfers of the note take place between the lender, the sponsor, and a Special Purpose Vehicle (SPV) trust.²³ The lender will sell, assign, and transfer the note and mortgage (collectively referred to as “the loan”) to the sponsor (or “issuer”).²⁴ The sponsor will evaluate the loan portfolio to determine

its level of legal compliance and creditworthiness, as well as other important information, combine the loans into a “pool” of similar loans, and then issue and sell the pool of loans to the SPV.²⁵

The SPV can take various forms, but it is usually a trust.²⁶ One purpose of the SPV is to be the nominal owner of the pool of loans behind the resulting mortgage-backed securities.²⁷ The scheduled principal and interest payments due under the loans within these SPV trusts are divided up and paid out to the investors that have purchased mortgage-backed securities created by the pool of loans within the SPV trust.²⁸ Each investor of a mortgage-backed security owns an undivided interest in the mortgages securing the underlying notes making up the pool.²⁹ The SPV is a fictional entity with no physical location and no employees;³⁰ however, it will have a trustee, designated by a pooling and servicing agreement, who will “hold formal title to the loans for the benefit of [the mortgage-backed securities] investors...and [take other] certain specific actions on behalf of investors.”³¹

As with any trustee, this trustee has no beneficial, economic interest in the loans; the trustee merely acts on behalf of the investors of the mortgage-backed securities.³² The pooling and servicing

agreement will designate a loan servicer to manage the SPV trust, and usually provides the servicer with the power to foreclose when necessary.³³ The loan servicer is also the party who will physically hold the mortgage once it has been recorded in accordance with applicable recording law.³⁴ The note, on the other hand, will be in the physical possession of a document custodian as it is sold and resold throughout the securitization process.³⁵ While the note may be transferred several times, the mortgage, which is a recorded instrument, is not. The reason for this is simple: a person claiming the right to enforce the note may wish to have physical possession of it in order to assert “holder” status under UCC Article 3.³⁶ The same is not true for the mortgage, which only requires that it be recorded in the name of an applicable party (and assigned to the current owner of the loan).³⁷

III. UCC Article 3 and the Transferability of Negotiable Instruments

Negotiable instruments were developed and have been used by merchants throughout history because of their importance in business transactions as well as commercial and economic development.³⁸ In modern commerce, negotiable instruments are used in a variety of contexts. For example, without the laws governing negotiable instruments, “business trade receivables,” prevalently used by commercial businesses to fund sales to customers, would be much less

19. Various forms of securitization can take place, and will differ depending on the type of asset that is securitized. However, the form discussed in this article will be confined to that which securitizes mortgage loans, *i.e.*, loans that are secured by mortgages. When these loans are securitized, the product created is called a mortgage-backed security. These are securities in which investors may purchase undivided interests. For more in-depth information on this process, see *Mortgage-Backed Securities (MBS) and Collateralized Mortgage Obligation (CMOS)*, in SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION (last visited Jan. 25, 2013), available at www.rbcwm-usa.com/file-588373.pdf [hereinafter *MBS & CMOS*].

20. Problems in Mortgage Servicing from Modification to Foreclosure: Hearing Before the Comm. Banking, Hous., Urban Affairs, 111th Cong. 61 (2011) [hereinafter *Arnold Statement*] (“[T]he mortgage...establishes a lien against the property as collateral for the loan and allows the lender (or noteholder) to foreclose...if the borrower does not repay...The person who borrows the money is called the ‘mortgagor.’”).

21. *Id.*

22. See, e.g., Dale A. Whitman, *How Negotiability Has Fouled Up the Secondary Mortgage Market and What to Do About It*, 37 Pepp. L. Rev. 737, 738 (2010) (“In this era, it is a relatively rare mortgage that is held in portfolio for its full term by the originating lender.”). The practice of the lender retaining the loan in its own portfolio (portfolio lending), essentially died with the demise of the traditional savings and loan industry in the early 1990s. See, e.g., Harrell, *supra* note 3.

23. See, e.g., Derrick M. Land, *Residential Mortgage Securitization and Consumer Welfare*, 61 Consumer Fin. L.Q. Rep. 208 (2007).

24. See, e.g., Reginald T. O’Shields, *Reforming America’s Mortgage Market: What Comes After Fannie Mae and Freddie Mac?*, 16 N.C. Banking Inst. 99, 132 n. 11 (“Securitization of mortgage loans involves the sale of the mortgage loan made by a lender, called the originator, to a financial institution arranging, or sponsoring the securitization [called the sponsor].”).

25. *Id.* (“The sponsor then sells the loan to a special purpose entity that issues securities to investors backed by the loan.”).

26. Gary Gorton & Nicholas Souleles, *Special Purpose Vehicles and Securitization*, in *THE RISKS OF FINANCIAL INSTITUTIONS* 549, 555 (Mark Carey & Rene’ M. Stulz eds. 2005).

27. THE BOND MKT. ASS’N INT’L SWAPS & DERIVATIVES ASS’N SEC. INDUS. ASS’N, SPECIAL PURPOSE ENTITIES (SPEs) AND THE SECURITIZATION MARKETS 2 (2002), available at <http://www.isda.org/speeches/pdf/SPV-Discussion-Piece-Final-Feb01.pdf> (“[SPVs] are legal entities such as corporations, trusts, or partnerships established for a specific and limited purpose. An [SPV] essentially acts as a depository for a specific group of assets in a securitization, and in turn, issues securities to the marketplace for purchase by investors.”).

28. *Id.* at 8.

29. CORPORATE TRUST COMM., AM. BANKER’S ASS’N, THE TRUSTEE’S ROLE IN ASSET-BACKED SECURITIES 10 (2010) [hereinafter *TRUSTEE’S ROLE*] (“Although the trustee is the legal owner of record of the mortgage loans, the trustee does not own the loans for its own account or have an economic interest in the loans. The beneficial owners of these mortgage loans are investors in the MBS securities.”).

30. Gorton & Souleles, *supra* note 26, at 550.

31. *TRUSTEE’S ROLE*, *supra* note 29, at 10.

32. *Id.*

33. *Id.* “The trust instruments creating MBS securities and relevant law do not give the trustee any powers or duties with respect to foreclosure [or] maintenance...of properties that are collateral for the MBS securities. Those powers and duties are conferred exclusively on loan servicers who generally are appointed by the depositor or seller of the loans to the MBS trust.” *Id.*

34. *Arnold Statement*, *supra* note 20, at 61 (“The mortgage is recorded in the county land records...[and then] returned to the servicer.”).

35. *Id.* (“[After origination, t]he note is sent to a custodian (usually a regulated depository institution) and is typically bought and sold...in the normal course of financial activity.”).

36. See *infra* Part IV.A.

37. See, e.g., *supra* note 34.

38. See *infra* Part IV.B. & C.

marketable; as a consequence it would be much harder for businesses to purchase basic equipment, such as vehicles, without having other sources of cash up front.³⁹

In the secondary mortgage market, the use of negotiable instruments law is essential in providing access to funding for lending to parties who have low credit scores.⁴⁰ By allowing negotiable mortgage notes to be readily transferable, thus aiding their liquidity for purposes of sale in the secondary mortgage market, negotiable instruments law allows lenders to maintain their liquidity, replenish the funds needed for additional lending, and spread the risks associated with these loans.⁴¹ Otherwise, in the event of default, the lender would bear the entire loss, requiring a higher interest rate to compensate for this concentration of risk. Secondary market sales of these loans also provide the lender with the funding to continue lending operations. Mortgage-backed securities create immediate revenue from sales of the loans, which is poured back into the loan origination process, allowing lenders to originate more loans.⁴² Without this revenue, many mortgage lenders would not have the funding necessary to continue making loans.

IV. The Owner Versus the Holder of a Negotiable Instrument

A. The Role of Negotiable Instruments

A negotiable instrument is “an unconditional promise or order to pay a fixed amount of money” that meets certain other criteria.⁴³ For an instrument to qualify as a negotiable instrument, the promise or order must be written, for a fixed and certain amount, and it must be unconditional.⁴⁴ These criteria aid in the instrument’s transferability, or “negotiability,”⁴⁵ a characteristic essential in making negotiable instruments useful in credit transactions.⁴⁶

In dealing with negotiable instruments, it is imperative to understand the difference between being the holder⁴⁷ (or a holder in due course⁴⁸) – statuses governed by UCC Article 3 – versus having an ownership or other property interest in the negotiable instrument⁴⁹ -- a status governed by property law and UCC Article 9.⁵⁰ These terms (owner, holder, etc.) are sometimes used interchangeably and without precision, even in reported cases, which can prove confusing because the owner of the negotiable instrument does not necessarily enjoy

holder status, and vice versa; moreover, the legal distinctions can be important.⁵¹

For purposes of this discussion, the essential difference between holder and owner status is that the holder is *per se* a party entitled to enforce the instrument,⁵² even if not the owner. In contrast, in the event the owner is not the holder of the note, proving ownership status and a right to enforce the note may be more difficult.⁵³

To qualify as the holder of a negotiable instrument, a party must be in physical possession of a properly indorsed⁵⁴ or bearer note.⁵⁵ Another party with a right of enforcement, comparable to that of the holder for some purposes, is the “non-holder in possession with the rights of the holder.”⁵⁶ This is, *e.g.*, a party who is in physical possession of a negotiable instrument that has not been indorsed in such a way as to make that party a holder.⁵⁷

If possession of a negotiable instrument is transferred, which commonly occurs in a securitization, there must be a proper execution of the transfer to grant the transferee the right of enforcement, *e.g.*, as the holder or a “non-holder in possession with the rights of the holder.”⁵⁸ A transfer occurs when the previous holder delivers or assigns the negotiable instrument to the transferee for the purpose of giving the transferee the right to enforce it.⁵⁹ Proof of the status of a “non-holder in possession with the rights of the holder” requires more than simple production of the negotiable instrument, because “by

39. *MBS & CMOS*, *supra* note 17, at 3 (“Securitization provides funding and liquidity for...automobile loans, student loans,...business trade receivables...among others.”). While the primary repository for the law of negotiability today is UCC Article 3, it is found also in various guises in (sometimes surprising) other places, *e.g.*, UCC Article 9 (*see, e.g.*, §§ 9-330 - 9-332 and Article 9 pt. 5) and even federal law, *see, e.g.*, Truth in Lending Act § 131, 15 U.S.C. § 1641.

40. Edward J. Janger, *The Costs of Liquidity Enhancement: Transparency Cost, Risk Alteration, and Coordination Problems*, 4 *Brook. J. Corp. Fin. & Com. L.* 39, 44 (2009) (“[MBSs] are creatures of contract, transferring or parceling out the ownership of a single claim or a pool of claims. The...liquidity of small claims is enhanced by both the ability to spread risk among investors and the ability to pool the risk of various loans.”).

41. *Id.*

42. *MBS & CMOS*, *supra* note 19, at 4. Mortgage securities play a crucial role in the availability and cost of housing in the United States. The ability to securitize mortgage loans enables lenders and mortgage bankers to access a larger reservoir of capital, to make financing available to home buyers at lower costs and to spread the flow of funds to areas of the country where capital may be scarce. *Id.*

43. UCC § 3-104(a).

44. *Id.*

45. MILLER & HARRELL, *supra* note 15, at 39 - 40 (“[F]orm requirements induce[d] the prospective takers...to purchase...if the form of the contracts were uncertain it would be difficult to value the contract’s worth.”).

46. *See* Jane Kaufman Winn, *Couriers Without Luggage: Negotiable Instruments and Digital Signatures*, 49 *S.C. L. Rev.* 739, 741 - 42 (1998) (“For an earlier generation of commercial lawyers, negotiability was virtually synonymous with marketability[;]...attributes of negotiability [include]...free transferability, recognition of special rights for good faith purchasers for value, and certain procedural advantages of the obligation, such as a presumption of consideration.”).

47. *See* UCC § 3-301.

48. *Id.* § 3-302.

49. UCC § 9-109(a)(3).

50. In addition to being a contract, *e.g.*, creating an obligation to pay, an instrument reifies this obligation and therefore constitutes property. *See, e.g.*, Harrell Commentary, *supra* note 14, at 224 - 228. In addition to general property law, these issues are governed by Article 9. *See, e.g.*, Alvin C. Harrell, *Impact of Revised UCC Article 9 on Sales and Security Interests Involving Promissory Notes and Payment Intangibles*, 55 *Consumer Fin. L.Q. Rep.* 144 (2001).

51. MILLER & HARRELL, *supra* note 15, at 95 (“The holder of an instrument need not be the owner of it.”).

52. UCC § 3-301 (“Person entitled to enforce the instrument means (i) the holder of the instrument....”).

53. *Id.* (“A person may be the person entitled to enforce the instrument even though the person is not the owner of the instrument or is in wrongful possession of the instrument.”).

54. *Id.* § 3-204(a) (“Indorsement means a signature, other than that of a signer as a maker, drawer, or acceptor, that alone or accompanied by other words is made on an instrument for the purpose of negotiating the instrument.”).

55. *Id.* § 3-201(a).

56. *Id.* § 3-301(ii).

57. *Id.* The rights of a holder may be transferred to a non-holder in various ways under contract law, *e.g.*, by a separate assignment. *See, e.g.*, UCC § 3-203.

58. UCC § 3-301(ii). *See supra* note 57.

59. *See* UCC § 3-203, cmt. 2.

its terms [the instrument] is not payable to the transferee and the transferee must account for possession of the unindorsed instrument by proving the transaction through which the transferee acquired it.”⁶⁰ If the transferee can show that a prior holder transferred the instrument to him or her for the purpose of enforcement, this will be sufficient to establish the transferee as having the rights of the holder.⁶¹ However, absent the indorsement and other requirements of a negotiation under UCC section 3-201, this will not make the transferee a holder.

Putting these terms in the context of a securitization will illustrate the point: Bank X originates a home loan, and proceeds to sell and assign the note⁶² to Bank Y to be pooled, but physically transfers the note to a servicer, Bank Z. Bank X no longer possesses any rights in the note or in the underlying mortgage securing it. The status of note owner and the status of holder have now been separated and are embodied in two different parties: Bank Y as note owner (assuming all requirements of property and contract law, as well as UCC Article 9, are satisfied) and Bank Z as holder of the note (assuming the note was properly indorsed).

B. History of Negotiable Instruments

As noted, negotiable instruments have been utilized in commercial practice since at least the Middle Ages;⁶³ as one writer put it, the law of negotiable instruments “is not so much a product of human ingenuity as of common sense and experience...this is the reason why it has been found so durable and permanent.”⁶⁴ The Law Merchant (or “law of merchants”) was a well-established body

of law created through mercantile business custom, and it is the source of our negotiable instrument law.⁶⁵ It was the Law Merchant that formalized the bill of exchange (English precursor to a modern negotiable instrument), which allowed the ready transfer of an order to pay money.⁶⁶ The bill of exchange was a tool of expedience, and was needed because of the dangers posed if a merchant were to carry or send tangible money (*e.g.*, coins) across the ocean as a means to conduct business. To facilitate this, the Law Merchant recognized the assignability of debt simply through transfer of an instrument and a signature.⁶⁷ The common law did not initially recognize these concepts or forms of contract, so they could only be enforced in merchant courts recognizing the Law Merchant.⁶⁸ Ultimately, however, and due in significant part to Lord Mansfield, the Law Merchant was grafted into the common law of England.⁶⁹

C. Negotiable Instruments and Commerce

The recognition of negotiable instruments did not have an easy history as it made its way into the common law, but it endured because of the persistence of merchants and jurists who saw its worth.⁷⁰ The characteristic that made negotiable instruments so attractive in commercial transactions was the ease of their transferability, hence their acceptability as a substitute for cash. The formal requirements, including necessary specific terms, a lack of conditions upon the obligation to pay, and the tangible written form, allowed parties to transfer debts to remote parties, even across oceans.⁷¹ For example, if X needed credit to purchase goods overseas, carrying coinage was far too risky; however, if Y were willing to promise credit or payment on behalf of X in the form of a note or draft issued for a fee, X could carry the newly acquired note or draft obtained from Y to a distant country and could transfer it to Z as payment for whatever goods X wanted to purchase.

Of course, Z could not know what terms and conditions took place between X and Y, and the note would have little or no value to Z if there were a need to inquire into or enforce such conditions or terms. So, before negotiable instruments were recognized as part of the English common law, this transaction was dependent on the world-wide reputation and credibility of Y. Y’s reputation for paying

60. *Id.*

61. *Id.*

62. JAMES STEVEN ROGERS, THE END OF NEGOTIABLE INSTRUMENTS 55 (2012) (noting that it is common for mortgage notes to be drafted so that they meet the UCC requirements for negotiability).

63. *See, e.g.*, Roy A. Redfield, *The Law of Negotiable Instruments*, 43 *Banking L. J.* 841, 841 (1926); *see also supra* note 12.

64. Redfield, *supra* note 63.

65. *See, e.g., id.*; *see also* Holdsworth, *supra* note 1, at 12 - 13 (“These documents came from a very early period in the history of law, and were not necessarily confined to mercantile transactions. But, with the development of commerce, they necessarily came to be used most frequently in these transactions.”).

66. *See* Holdsworth, *supra* note 1, at 13 (“This expedient was found in the adaptation of another kind of instrument which, in the late thirteenth and early fourteenth centuries, had been invented for the purpose of effecting an exchange of money without incurring the risks of its physical transportation. This instrument was the Bill of Exchange.”).

67. *See* W.S. Holdsworth, *The Origins and Early History of Negotiable Instruments II*, 31 *L.Q. Rev.* 173, 184 - 85 (1915):

It seems to have been settled in the...[17th] century that [defenses were not good] if the person entitled under the bill took in good faith; and good faith was always presumed...It was thought that, by accepting, he personally promised to pay the payee or anyone who appeared as indorsee. His contract was therefore with the indorsee who appeared with the bill.

68. W.S. Holdsworth, *The Origins and Early History of negotiable Instruments IV*, 32 *L.Q. Rev.* 20, 30 (1916):

In England, as abroad, the development of the negotiable character of the bill of exchange reacted upon the legal position of the note or bill obligatory payable to bearer...[T]he common law in the sixteenth and early part of the seventeenth century did not recognize the assignability which these instruments possessed according to the customs prevailing amongst the merchants.

69. William Murray became Lord Mansfield upon his appointment as Chief Justice of the King’s Bench in 1756. He proceeded to implement 150 years of aspirations regarding contract law, *e.g.*, as illustrated in *Slades Case*, 4 *Coke* 926 (1602), and *Woodward v. Rowe*, 2 *Keb.* 132, 84 *Eng. Rep.* 84 (1666). *See, e.g.*, Lord Mansfield’s opinion in *Miller v. Race*, 97 *Eng. Rep.* 398 (K.B. 1758). As a result, Lord Mansfield is considered (among other accomplishments) to be the father of modern commercial law (including the law of negotiable instruments).

70. The Statute of Staples was a significant development for merchants, because the courts were administered and the cases decided by merchants who understood and were enforcing the law of merchants. *See, e.g.*, *The Development of Negotiable Instruments in Early English Law*, 51 *Harv. L. Rev.* 813, 827 - 29 (1938). However, when it ended, and after a stint in the courts of admiralty (which also inevitably ceased), the merchants were forced to bring their claims to the common law courts. *Id.* at 833 - 37. The common law courts did not immediately recognize the law of merchants and the reception of it was arduous at best. *Id.* at 837 - 41. While there is much to this tumultuous history, a turning point seemed to come in 1704. At the time, promissory notes were being treated interchangeably as if they were bills of exchange, and Lord Holt decided that promissory notes were, in fact, not negotiable. *Id.* at 842 - 43. Because of this holding, and others that affirmed it, the merchants petitioned for reform, and the Statute of Anne was passed. *Id.* It provided that promissory notes, meeting particular criteria, were to be treated and enforced as fully negotiable, just like the bills of exchange. *Id.* But it remained for Lord Mansfield, a half-century later, to fully effectuate this change. *See supra* note 69.

71. *See* Holdsworth, *supra* note 67, at 177.

his debt, expressed as an unconditional obligation to pay the holder, based on the Law Merchant, became acceptable as currency in the form of the note or draft.⁷²

“[T]he piece of paper...itself [was] the claim or debt [that] it evidenced. This idea came to be known as the doctrine of merger – the debt was merged in the instrument.”⁷³ For those who do not have the funds to accomplish the business transaction they want to conduct, this ability to create “private money”⁷⁴ is one of the most important innovations “in history [and]...civilization.”⁷⁵ When the Law Merchant became part of the English common law in the mid-to-late-eighteenth century, this innovation and opportunity became widely available to the broader public for the first time. The industrial revolution, and the end of serfdom in Britain, soon followed.

During the industrial revolution, when mobile, creative funding became crucial to the growth of economic society,⁷⁶ negotiable instruments law became increasingly beneficial, and essential, for commerce. As Judge Story recognized, though the history and the development of negotiable instruments law is lengthy and full of contention, it was undeniably aided by the needs and “exigencies of commercial life.”⁷⁷ However, with this expansion of mobile debt came a recognition of the need for established, clear rules; clear rules would ease enforceability, which would aid in negotiable instru-

ments’ use and marketability.⁷⁸ Unless the parties dealing with negotiable instruments know that these instruments will be enforceable, parties will not risk dealing with them as a substitute for cash. This fundamental principle has not changed.

Just as eighth century merchants had their commercial needs, as recognized by Lord Mansfield 1,000 years later, the business needs of today require courts to recognize and enforce the concise rules of negotiable instruments law as codified in UCC Article 3. As noted below, these lessons have been illustrated again in the twenty-first century, in the context of secondary market transactions involving home mortgage loans.

V. Agency Law: A Primer

Since negotiable instruments law first took root, agency law has heavily influenced and been a part of it;⁷⁹ today, agency law continues to be expressly recognized in the UCC and to supplement it as needed.⁸⁰ Therefore, in order to give UCC Article 3 its full force and effect, it is essential to understand how agency law and an agency relationship works.

An agency relationship is formed when one party, the principal, agrees to have another party, the agent, “act on the principal’s behalf and subject to the principal’s control.”⁸¹ Agency looks at

the facts of a relationship;⁸² so, while the titles of the parties are relevant, they are not dispositive.⁸³ Further, the parties may not know they are creating an agency relationship, but if they intend to act in such a way that qualifies as an agency relationship, and do so act, agency law applies.⁸⁴

An agency relationship is a consensual one.⁸⁵ Manifestation by the principal is required so that a reasonable person would understand that the principal desires the potential agent to act on the principal’s behalf.⁸⁶ Further, the potential agent must manifest consent to be the agent of the principal.⁸⁷ Agency also requires the agent act on behalf of the principal and the principal maintain the right of control over the agent.⁸⁸

Whenever an agency relationship is formed, there will be a scope of authority conferred to the agent by the

72. *Id.* The lack of an enforcement mechanism, outside the community of merchants, essentially meant that only those born to an established merchant family could conduct these transactions.

73. Grant Gilmore, *Formalism and the Law of Negotiable Instruments*, 13 *Creighton L. Rev.* 441, 449 (1979).

74. *See* Harrell Commentary, *supra* note 14, at 98 n. 537.

75. *Id.*

76. *See* Gilmore, *supra* note 73 at 446 - 47:

There was a flurry of litigation about promissory notes in England at the end of the seventeenth century...Lord Mansfield and his colleagues in the late eighteenth century were faced with radically new problems for which they devised radically new solutions....The radically new problems all stemmed from the industrial revolution and the vastly increased number of commercial transactions which it spawned...When goods were shipped, they had to be paid for.

77. *Id.* at 454.

78. *See id.* at 449 (“The courts also worked out an elaborate set of rules on when the transferor was required to endorse, as well as deliver, the bill and on what liabilities to subsequent parties he assumed by endorsing.”).

79. *See* W.S. Holdsworth, *The Origins and Early History of negotiable Instruments III*, 31 *L.Q. Rev.* 376, 384 (1915) (“The merchants in their efforts to find some more convenient methods were accustomed either to send letters of credit, or bills with the names left blank to be filled up by their foreign agent, or to make the bill payable to the payee or the bringer thereof.”).

80. In order to enforce the UCC according to its “purpose and policies,” other areas of law, such as agency law, supplement the UCC where it is silent. *See* UCC § 1-103.

81. RESTATEMENT (THIRD) OF AGENCY § 1.01 (2006) (“Agency is the fiduciary relationship that arises when one person (a ‘principal’) manifests assent to another person (an ‘agent’) that the agent shall act on the principal’s behalf and subject to the principal’s control, and the agent manifests assent or otherwise consents to so act.”).

82. RESTATEMENT (THIRD) OF AGENCY § 1.02, cmt. a (2006):

Whether a relationship is one of agency is a legal conclusion made after an assessment of the facts of the relationship and the application of the law of agency to those facts. Although agency is a consensual relationship, how the parties to any given relationship label it is not dispositive. Nor does party characterization or nonlegal usage control whether an agent has an agency relationship with a particular person as principal. The parties’ references to functional characteristics may, however, be relevant to determining whether a relationship of agency exists.

83. *See id.*; *see also* RESTATEMENT (FIRST) OF AGENCY § 1, cmt. b (1933) (“There is not necessarily an agency relationship because the parties to a transaction say that there is, or contract that the relationship shall exist, or believe it does exist.”).

84. *Id.* (“It is not necessary that the parties intend to create the legal relationship or to subject themselves to the liabilities the law imposes upon them as a result of it...Agency results only if there is an agreement for the creation of a fiduciary relationship with control by the beneficiary.”).

85. RESTATEMENT (THIRD) OF AGENCY § 1.01, cmt. c (“As defined by the common law, the concept of agency posits a consensual relationship in which one person,...acts as a representative of or otherwise acts on behalf of another person with power to affect the legal rights and duties of the other person.”).

86. *Id.* § 1.03, cmt. e (“A manifestation does not occur in a vacuum, and the meaning that may reasonably be inferred from it will reflect the context in which the manifestation is made. Assent and intention may be expressed explicitly, but often they are inferred from surrounding facts and circumstances.”).

87. *Id.* §1.01, cmt. d (“[I]t is not necessary to the formation of a relationship of agency that the agent manifest assent to the principal, as when the agent performs the service requested by the principal following the principal’s manifestation...it is a question of fact whether the agent has agreed.”).

88. *Id.* cmt. f (“An essential element of agency is the principal’s right to control the agent’s actions. Control is a concept that embraces a wide spectrum of meanings, but within any relationship of agency the principal initially states what the agent shall and shall not do, in specific or general terms.”).

principal.⁸⁹ This authority may be broad or confined,⁹⁰ but it is essential to the relationship; the authority determines to what extent an agent may act on behalf of the principal and consequently bind the principal to a contract.⁹¹ When the principal manifests assent to the agent that the agent is to act on his or her behalf, actual authority is conferred.⁹² If the principal's manifestation reaches a third party, so that the third party reasonably believes the agent possesses authority, apparent authority is conferred.⁹³ Apparent authority can occur on its own or concurrently with actual authority. The two authorities are not mutually exclusive. The moment the authority is conferred, an agency relationship exists, and the agent possesses the power to act on behalf of the principal within the scope of that authority as reasonably interpreted by the agent⁹⁴ or the third parties.⁹⁵

A driving principle behind agency law is to encourage the use of agents by allowing the benefits and burdens to fall on those who voluntarily choose to use agents.⁹⁶ Concurrently, agency

law protects members of the public coming into contact with agents who are acting subject to another's purpose and will.⁹⁷ Therefore, for example, if an agent's apparent authority enables the agent to commit a tort, the principle will be vicariously liable for that tort.⁹⁸

VI. What is "MERS?"

A. Introduction

As indicated above, agency and negotiable instruments are tools essential to modern business transactions. "Commerce requires the use of agents, and the use of agents requires that third parties be willing to rely on them."⁹⁹ Similarly, the history of negotiable instruments, within a mobile society, makes it clear that they are essential to commerce.¹⁰⁰ Nowhere do these two areas of law work more harmoniously than in the context of MERS.

B. Structure of MERS

For ease of reading, Mortgage Electronic Registration System, Inc., hereinafter will be referred to as MERS Sub, and MERSCORP, Inc. hereinafter will be referred to as MERS Parent. These two corporations work toward the same goals, namely to: streamline the securitization process; cut costs within the mortgage business; and increase ef-

iciency by tracking the parties involved in each stage of private transfers.¹⁰¹

MERS Parent is a corporation privately held by the mortgage industry.¹⁰² MERS Parent owns and operates the MERS System, a database that tracks note servicing and beneficial ownership rights.¹⁰³ MERS Sub, on the other hand, is wholly owned by MERS Parent.¹⁰⁴ Banks that choose to become a member of MERS Parent sign a member agreement and pay a designated member fee. After doing so, when the MERS Parent member bank (the lender) originates a home loan, MERS Sub generally is designated the mortgagee of record.¹⁰⁵ These two companies have become entwined within the minds of the general public; however, the two companies serve different purposes, and have different powers.¹⁰⁶

C. "MERS" as the Agent

As noted above, when a home loan is first created between a mortgagor and

89. *Id.* §§ 3.01 - 3.03 (defining actual and apparent authority within an agency relationship).

90. *See id.* § 2.01 (explaining the differences in scope of authority conferred between special and general agents).

91. WARREN A. SEAVEY, *HANDBOOK OF THE LAW OF AGENCY* 11 (1964) ("The power of an agent to create legal relations between the principal and third persons is a characteristic element of the agency relation. It is based upon the principal's consent or apparent consent to the relation.")

92. RESTATEMENT (THIRD) OF AGENCY § 2.01, cmt. C. & § 2.02 ("Actual authority is a consequence of a principle's expressive conduct toward agent, through which the principle manifests assent to be affected by the agent's action, and the agent's reasonable understanding of the principal's manifestation"). The focal point for determining whether an agent acted with actual authority is the agent's reasonable understanding at the time the agent takes action. Although it is commonly said that a principal grants or confers actual authority, the principal's initial manifestation to the agent may often be modified or supplemented by subsequent manifestations from the principal and by other developments that the agent should reasonably consider in determining what the principal wishes to be done.

93. *Id.* at § 2.03.

94. *Id.* §§ 2.01 & 2.02.

95. *Id.* § 2.03.

96. *See, e.g.,* Paula J. Dalley, *A Theory of Agency Law*, 72 U. Pitt. L. Rev. 495, 497 (2011):

Stated briefly, the purpose of agency law is to restore the status quo after a person chooses to use an agent. The foundational principle of agency law is that the principal, who has chosen to conduct her business through an agent, must
(Continued in next column)

96. (Continued from previous column)

bear the foreseeable consequences created by that choice. Conversely, as bearer of the risks the principal is entitled to receive the benefits created by the agency relationship.

97. *Id.*

98. RESTATEMENT (THIRD) OF AGENCY § 7.08 ("A principal is subject to vicarious liability for a tort committed by an agent in dealing or communicating with a third party on or purportedly on behalf of the principal when actions taken by the agent with apparent authority constitute the tort or enable the agent to conceal its commission.")

99. Dalley, *supra* note 96, at 515.

100. *See* SEAVEY, *supra* note 91, at 21 ("[The agent] was created at the beginning of the eighteenth century in order to avoid the then existing rule that contracts were not assignable."); *id.* at 2:

The agency relation exists in order to enable a person to utilize the services of others and thereby to accomplish what he could not achieve alone. Business is today almost wholly conducted by agents...in many cases partnerships and corporations, acting on behalf of principals who are usually corporations and partnerships.

101. *See* Andrew Lipton, *Mortgage Electronic Registration Systems, Inc. (MERS): Its Impact on the Credit Quality of First-Mortgage Jumbo MBS Transactions*, STRUCTURED FINANCE 1 (Apr. 20, 1999), at 2:

[MERS Parent and MERS Sub bring] the following benefits to the mortgage industry:...The assignment of mortgage recording fee can range from \$25-50 per loan. Registering a loan with MERS will cost \$3.50.... A second initial purpose of [MERS Parent] was to help facilitate recordation, which will benefit warehouse lenders, many of whom do not currently have their assignments recorded...[and] [e]fficiency for [p]roviding and [r]ecording [r]eleases;

See also Arnold Statement, *supra* note 20, at 60:

[MERS System and MERS Sub serve] two important functions. First, [MERS System] maintains a database or registry of mortgage loans, keeping track of changes in servicing rights and beneficial ownership interests over the life of the loan. Second, [MERS Sub] can be designated by its members to serve as mortgagee...in the public land records.

102. Arnold Statement, *supra* note 20, at 60 n. 1 ("[MERS Parent] is structured as a privately held stock company. Its principal owners are the Mortgage Bankers Association, Fannie Mae, Freddie Mac, Bank of America, Chase, HSBC, CitiMortgage, GMAC, American Land Title Association, and Wells Fargo.")

103. *Id.* at 61 ("Every time a note or servicer changes hands, a notation of that change is made (electronically) on the MERS System by the members involved in the sale. In this way, changes in servicing rights and beneficial ownership interest in the promissory note are tracked over the life of the loan.")

104. *Id.* at 61 n. 8 ("The MERS System is the database; [MERS Parent] is the operating company that owns the database; and [MERS Sub] a subsidiary of [MERS Parent], which will serve as mortgagee in the land records for loans registered on the MERS System.")

105. *See infra* this text Part VI.C.

106. *Compare* discussion *infra* this text Part VI.C. & D.

the lender, MERS Parent and MERS Sub are often involved from the beginning.¹⁰⁷ In such cases, the mortgage executed between the mortgagor and the lender will name MERS Sub as the mortgagee of record and state that MERS Sub is serving as the “nominee for Lender and Lender’s successors and assign[s].”¹⁰⁸ Before MERS Sub can serve as the mortgagee of record for a loan, the lender must become a member of MERS Parent.¹⁰⁹ As a part of this process, the lender will agree that MERS Sub will act as its agent by serving as the mortgagee of record on all current and future loans that are, or will be, registered in the MERS System.¹¹⁰ Specifically, Rule 2, section 5(a) of the MERS Parent Rules of Membership states:

Each Member,¹¹¹ at its own expense,¹¹² shall cause [MERS Sub], to appear in the appropriate public records as the mortgagee of record with respect to each mortgage loan that the Member registers on the MERS System.

Further, in accordance with the MERS Parent Rules of Membership, MERS Sub agrees to serve as the lender’s agent. The lender’s control, as principal, over MERS Sub as agent, is shown in Rule 2, section 6 which states:

MERS shall at all times comply with the instructions of the holder of the mortgage loan promissory notes. In the absence of contrary instructions from the beneficial owner, MERS [Parent] and [MERS Sub] may rely on instructions from the servicer shown on the MERS System in accordance with these Rules and the procedures with respect to transfers of beneficial ownership, transfers of servicing rights, and releases of security interests applicable to such mortgage loan.¹¹³

When MERS Sub becomes the mortgagee of record on a home loan, one grant of actual authority given by the member is that of receiving information on behalf of the lender and the lender’s assigns and successors with regard to that loan. Rule 3, section 1 states:

MERS [Parent] shall within two (2) business days forward to the appropriate Member or Members, in the form prescribed by and otherwise in accordance with the Procedures, all properly identified notices, payments, and other correspondence received by MERS [Parent] with respect to mortgage loans registered on the MERS System for which [MERS Sub] serves as the mortgagee of record.¹¹⁴

Also, MERS Sub, as a company, must act through its own agents to carry out duties and needs required by the principals. The Rules of Membership create authority for agents called “certifying officers”: (1) to release the lien of any mortgage

loan registered on the MERS System to such Member; (2) assign the lien of any mortgage naming MERS Sub as the mortgagee when the Member is also the current promissory note-holder, or if the mortgage is registered on the MERS System, is shown to be registered to the member; (3) to foreclose upon the property securing any mortgage loan registered on the MERS System to such Member; (4) to take any and all actions necessary to protect the interest of the member or the beneficial owner of a mortgage loan in any bankruptcy proceeding regarding a loan registered on the MERS System that is shown to be registered to the member; (5) to take such actions as may be necessary to fulfill such member’s servicing obligations to the beneficial owner of such mortgage loans (including mortgage loans that are removed from the MERS System as a result of the transfer thereof to a non-member); and (6) to take action and execute all documents necessary to refinance, amend or modify any mortgage loan registered on the MERS System to such member.¹¹⁵

This authority is conferred by member banks to MERS Sub, empowering MERS Sub to carry out various duties through its agents on behalf of its principals, the member banks. Notably, the duties include the authority to foreclose upon the property securing any mortgage loan registered on the MERS System to such member as well as the authority “to take such actions as may be necessary to fulfill such Member’s servicing obligation to the beneficial owner of such mortgage loans.” These two grants of authority are notable for two reasons: (1) they illustrate the intent of the members that MERS Sub will have authority to execute any necessary paperwork or complete any action linked to a foreclosure -- a foreclosure necessarily includes the authority to handle the note as well as the mortgage as both are necessary to foreclose; and (2) these grants of authorities also evidence the intent of the members to

107. See discussion immediately below; see also Rule 2, § 5(a), MERSCORP, Inc., Rules of Membership 12 (2012), available at www.infomaxx.com/RULES/February2012.pdf [hereinafter Rules of Membership].

At or prior to the time a Member registers a mortgage loan on the MERS System, such Member shall provide evidence reasonably satisfactory to MERS demonstrating that Mortgage Electronic Registration System, Inc. is, or as soon as practicable shall be, properly recorded as mortgagee of record in the appropriate public records with respect to such mortgage loan.

108. MERSCORP HOLDINGS, INC., MORTGAGE ELECTRONIC REGISTRATION SYSTEMS, INC. SIGNING OFFICER PRIMER 5 (March 2012) (on file with author) [hereinafter MERSCORP HOLDINGS].

109. See discussion immediately below; see also Rules of Membership, *supra* note 107, Rule 1, § 1:

MERSCORP, Inc. (“MERS”) shall make the services of its mortgage electronic registration system (the “MERS® System”) available to any Member of MERS. A Member is defined as an organization or natural person who has signed a Membership Agreement and is not more than 60 days past due as to the payment of any fees due and owing to MERS.

110. See: Rules of Membership, *supra* note 107, at 12 (noting Rule 2, § 5(a)).

111. *Id.* at 2 (“A Member is defined as an organization or natural person who has signed a Membership Agreement [MERSCORP, Inc. Rules of Membership] and is not more than 60 days past due as to the payment of any fees due and owing to MERS[CORP, Inc.]”).

112. This requirement is consistent with Agency since the principal, in an agency relationship is required to indemnify the agent from expenses relating to accomplishment of the principal’s objectives. For more information on this, see RESTATEMENT (THIRD) OF AGENCY § 8.14.

113. Rules of Membership, *supra* note 107, at 13 (emphasis added).

114. *Id.* at 15.

115. See Rules of Membership, *supra* note 107, at 15 (format edited and emphasis added).

include MERS Sub in current and future loans. When banks become members of MERS Parent, they do so with the intent that their loans will be sold and probably will be owned by an SPV Trust, which will require a trustee and servicer to carry out necessary paperwork on the trust's behalf. If this were not the intent, MERS Sub would serve little purpose. Further, the effect of the Rules of Membership's wording allowing MERS Sub's agents to "take such actions as may be necessary" is to assist the servicer in performing its duties with respect "to the beneficial owner of the mortgage loans."¹¹⁶ The above rule creates an agency authority for MERS Sub, granted by the members, and includes the authority for MERS Sub to carry out its duties through agents designated by MERS Sub.

When one considers the language of a typical mortgage designating MERS Sub as the nominee, paired with the language within the MERS Parent Rules of Membership, it is clear that the MERS Parent business structure essentially creates an agency relationship. Membership is voluntary, and is not utilized unless the lender anticipates selling the loan.¹¹⁷ Accordingly, each member agrees that MERS Sub will be its nominee for the initial creation of the loan, as well as its nominee in the event the member bank sells the loan or purchases and is, consequently, assigned a new loan from another MERS member bank.¹¹⁸ For loans that remain in the MERS System, the note may be transferred from party to party (physically or otherwise, *e.g.*, by assignment) because of the securitization process, while the mortgage, rather than moving through the chain of parties with the note – which would require constant re-recording of assignments of the mortgage – remains in the name of MERS Sub, which has the authority to act on the behalf of

whoever holds the note at the time in accordance with its agency authority.¹¹⁹

This consensual element of the agency relationship between MERS Sub and the Members is never broken since the Rules of Membership state that MERS Sub will be designated the nominee on each mortgage affiliated with any loan registered on the MERS System by a MERS member bank. If, at any time, a MERS member sells a loan to a non-member, the member must notify MERS Sub, thus indicating the need to assign the mortgage so that a new party may become the mortgagee of record. Further, any documentation that needs to be assigned to the non-member party is to be assigned by an agent of MERS Sub, as stated in the Rules of Membership at Rule 3, section 3 in which the MERS member banks grant MERS Sub the authority to do anything necessary to assist the servicer in completing an obligation on behalf of the loan owner; this includes "mortgage loans that are removed from the MERS System as a result of the transfer to a non-member."

This requirement works to the benefit of the lender, borrower, and investors, since the mortgage loan can be sold and transferred with ease from member to member without the necessary re-documenting, recording, delays, and fees usually associated with the recording statutes.¹²⁰ This translates to reduced costs and increased efficiencies throughout the loan origination and securitization process. Ultimately, this benefits borrowers, who bear the costs of lending, funding, recording, and title searching. The disclosure requirement¹²¹ between MERS Sub and the members

also works to the benefit of the lender and the public that must deal with MERS Sub. The member knows that MERS Sub will receive information on its behalf on all loans for which MERS Sub is the mortgagee of record. Therefore, the member can have confidence it will receive all relevant information concerning the loan.

Some have criticized the corporate structure and concept of MERS Sub as being a hindrance for the homeowner facing the threat of foreclosure, because of an alleged inability of the borrower to talk to the lender or owner of the note about restructuring the payments on the loan.¹²² However, when the scope of the agency relationship includes the agent receiving information on behalf of the principal, a principal is deemed to have received notice once the agent has been notified.¹²³

This is efficient and cost-effective for the business and customer. Once a loan has entered the securitization process, the homeowner likely will not know who the owner of his or her home loan is and, as a result, who to contact. So, the homeowner simply notifies MERS Sub who is required to forward the correspondence to the correct party. This encourages MERS Sub to ensure that information gets to the correct party so that its fiduciary duty is not breached. This also encourages the beneficial owner of the loan to act upon the information since the owner has been imputed with notice through an agent. In the event MERS Sub fails to notify the holder, the member and MERS Sub bear the loss, not the homeowner.

D. MERS as the Principal

Typically, the mortgage loans in the MERS System are involved in a securitization process and, consequently, the ownership will go through various stages and transfers. Also, as noted above, the loan balance (loan principal) will change as payments are made while the note (or the right to enforce it) is transferred

116. *Id.*

117. Arnold Statement, *supra* note 20, at 60 n. 2 ("Members tend to register only loans they plan to sell.")

118. *Id.* at 62 ("Thus, the language of the recorded mortgage authorizes MERS to act on behalf of the lender in serving as the legal titleholder under the mortgage and exercising any of the rights granted to the lender there under.")

119. See *supra* Parts III. & VLC.

120. See Peterson, *supra* note 17, at 115 ("To facilitate their service, county recorders charge modest fees on documents they record. Although the amount and method of calculating these fees varies considerably, a charge of about thirty-five dollars for a mortgage is typical.")

121. THE RESTATEMENT (THIRD) OF AGENCY § 5.03 provides as follows:

For purposes of determining a principal's legal relations with a third party, notice of a fact that an agent knows or has reason to know is imputed to the principal if knowledge of the fact is material to the agent's duties to the principal, unless the agent: (a) acts adversely to the principal as stated in § 5.04, or (b) is subject to a duty to another not to disclose the fact to the principal.

122. See Harrell, *supra* note 17, at 14 (quoting Professor Chris Peterson's suggestion that MERS masks the parties involved in the mortgage transaction "like a masked executioner").

123. RESTATEMENT (THIRD) AT AGENCY §§ 5.03 & 8.11 (2006).

throughout the securitization process;¹²⁴ but, all the while, with regard to a mortgage loan the basic servicing objective remains the same: collect the payments as they become due. When a note falls into serious delinquency, a party acting on behalf of the person who owns the loan or holds the note will find it necessary to foreclose on the mortgage so the beneficial owner of the note may recover as much of the debt owed as possible. All of this requires extensive recordkeeping, legal compliance, and customer relations.¹²⁵ Rather than employ a host of clerks at MERS Sub, MERS Parent has instructed its members to designate particular officers within the members' organizations to undergo training, certification, and an approval process to become agents of MERS Sub.¹²⁶ These agents act on behalf of MERS Sub and assist members, *i.e.*, the principles of MERS Sub.

Such an agent, once approved and certified by MERS Sub, is called a "MERS Certifying Officer, also known as a 'Signing Officer'"¹²⁷ and has the power and au-

thority to execute certain documentation on behalf of MERS Sub in order to carry out the objectives of the members.¹²⁸ There are certain actions and documents that can only be accomplished by MERS Sub since it is the mortgagee of record; these actions and documents are within the scope of MERS Sub's authority to act on behalf of the member as needed within the securitization process.¹²⁹ Since these processes usually require documentation to be created and signed, the Signing Officer accomplishes this on behalf of MERS Sub. Accordingly, these officers are agents of MERS Sub.

The scope of a Signing Officer's authority, however, only extends to those duties MERS Sub has been empowered to perform on behalf of the member, and is restricted to those loans in the MERS System that are registered to the member who designated the Signing Officer.¹³⁰ Even though agency law does not require documentation in order to create an agency relationship, MERS Sub executes a Corporate Resolution for any Signing Officer that it authorizes to act on behalf.¹³¹ The Signing Officer does not have authority to act on behalf of MERS Sub until the Corporate Resolution is executed, naming the party as a Signing Officer. Before a person is appointed as a Signing Officer, that individual must

complete a certification exam.¹³² The certification exam tests the potential Signing Officer's knowledge on the limitations of his or her authority,¹³³ in an effort to ensure that MERS Sub will not be held liable for an agent acting beyond the scope of the intended authority.¹³⁴ Practically speaking, this makes sense; the Signing Officers designated will be familiar with each loan because they work with the member in buying and selling the home loans. However, as agents of MERS Sub, Signing Officers remain controlled by MERS Sub with regard to the procedures and duties they carry out on its behalf.

When MERS Sub is the mortgagee of record for a loan that goes into serious default, the holder of the note will notify MERS Sub when the time comes to initiate foreclosure, thus granting MERS Sub the actual authority to initiate foreclosure.¹³⁵ If a note holder determines that MERS Sub will initiate foreclosure, there must be a party who can act on behalf of MERS Sub.¹³⁶ This was another task that had been designated

124. See Arnold Statement, *supra* note 20, at 61:

A fundamental legal principle is that the mortgage follows the note, which means that as the note changes hands, the mortgage remains connected to it legally even though it is not physically attached...This principle is not changed when MERS is the mortgagee because of the agency relationship between MERS and the lender.

125. See *supra* Part V.LC. See also discussion below in this Part V.LD.

126. Rules of Membership, *supra* note 107, at 15 - 16:

Upon request from the Member, Mortgage Electronic Registration System, Inc. shall promptly furnish to the Member, in accordance with the Procedures, a corporate resolution designating one or more officers of such Member, selected by such member as "certifying officers" of Mortgage Electronic Registration System, Inc. to permit such Member to [carry out particular actions]...the Member shall deliver to Mortgage Electronic Registration System, Inc. a corporate resolution naming the Corporate Secretary of Mortgage Electronic Registration System, Inc. as a "certifying officer" of the Member solely for the purpose of installing Mortgage Electronic Registration System, Inc. as mortgagee of record on mortgage loans which have been registered on the MERS System by the Member;

MERSCORP HOLDINGS, INC., *supra* note 108 at 9:

[a Signing Officer] may only take action in the name of MERS once [the Signing Officer has] been appointed as a MERS Signing Officer pursuant to a MERS Corporate Resolution issued by MERS. Successfully completing the Certification exam does not [alone] appoint you as a MERS Signing officer.

127. See *supra* this text and note 115. While the Signing Officer can be referred to as both a "Signing Officer" and a "Certifying Officer," for clarity, the remainder of this article refers to these officers as "Signing Officers."

128. Rules of Membership, Inc. *supra* note 107, at 17:

[A]ny action required or permitted to be taken by...Mortgage Electronic Registration System, Inc. pursuant to these Rules shall be taken on behalf of MERS by such person as may from time to time be designated by the respective Boards of Directors of MERS and Mortgage Electronic Registration System.

129. See *supra* this text Part V.LC.

130. The Corporate Resolution that names the Signing Officers will state that the Signing Officer is to carry out the duties designated by the MERSCORP, Inc. Rules of Membership on behalf of Mortgage Electronic Registration System, Inc. for the Member bank designating the Signing Officer. Therefore, it follows that the Signing Officer will only be acting on the loans associated with the Member bank that appoints him or her:

Now, Therefore,... the Signing Officers set forth on the attached list of candidates, at the request of [insert Member Bank] are officers of the Member, which is a member of the MERS System, and that each such individual be, and he or she, as the case may be, hereby is, appointed as an assistant secretary and vice president of MERS...

Corporate Resolution of Mort. Elec. Reg. Sys., Inc., to Member Bank (July, 27, 2011) (on file with author).

131. *Id.*

132. MERSCORP HOLDINGS, INC., *supra* note 108, at 2 ("[Signing Officer] must successfully complete the Certification Exam.").

133. Some of the questions posed are: "[W]hat title should a MERS Signing Officer use when executing documents in the name of MERS?"; and "[M]ay I continue to sign or act as a MERS Signing Officer for my organization even after I am no longer an officer of the organization?" This last question is an example of one in which MERS Sub is attempting to enforce the limitations on any danger of becoming bound by apparent authority. For more examples of the Corporate Resolution Exam for potential Signing Officers, see Signing Officer Exam, MERSCORP Holdings, Inc. (May 2012) (on file with author).

134. By reason of their taking the exam, it would be unreasonable for the agents to believe that their duties included anything specified on the exam as being outside the scope of an agent's authority, particularly an activity that the agent who took the exam expressly acknowledged was not allowed. Therefore, the agent could not reasonably interpret anything that could fall into those excluded categories in such a way as to authorize binding the principal through the agent's actual authority. There would still be possibility of apparent authority, but these exams also could limit rogue actions by the Signing Officers' for the most part. See *generally supra* this text Part V.

135. Arnold Statement, *supra* note 20, at 64 ("It is important to note that Mortgage Electronic Registration System, Inc. only initiates foreclosure when it has been instructed to do so by the servicer acting on behalf of the note owner.").

136. *Id.* at 63:

In the white paper calling for the creation of MERS...it was recognized that members would need to have a form of authority to act on behalf of MERS when MERS is the mortgagee on their behalf. That authority took the form of electing persons (designated by the member) as officers with limited authority to take certain actions.

to the Signing Officers to perform on behalf of MERS Sub. However, as more fully discussed below, MERS Sub rescinded this particular authority.¹³⁷

On February 16, 2011, MERS Parent issued a statement of proposed amendment to its members stating that MERS Signing Officers would no longer be allowed to foreclose in the name of MERS Sub.¹³⁸ This occurred after allegations of “robo-signers” came to light.¹³⁹ Robo-signers purportedly executed required foreclosure documentation without thorough review in an attempt to effectuate as many foreclosures as possible.¹⁴⁰ MERS Sub responded by limiting the documentation that Signing Officers are allowed to execute in foreclosure cases throughout the United States.¹⁴¹

Nonetheless, under agency law, if a Signing Officer utilized this practice in the name of MERS Sub, MERS Sub could be liable for any tortious conduct arising out of “robo-signing,” on the basis of Signing Officers’ apparent authority. Thus, MERS Parent issued its announcement of the amendment, which completely cut off Signing Officers’ authority to effectuate foreclosure proceedings, in order to limit its liability as the principal.¹⁴² Assuming that the general public, or at least those affiliated with the mortgage foreclosure industry, know that this authority has been eliminated by MERS Sub, apparent authority would be a hard sell in court.

VII. MERS Sub in Court

A. Introduction

In recent years, reflecting the upsurge in mortgage loan defaults and foreclosures, MERS Sub has been involved in countless foreclosures and other lawsuits stemming from its role as mortgagee of record. While many courts have recognized MERS Sub’s authority,¹⁴³ some have denied MERS Sub’s authority to do the most basic of tasks.¹⁴⁴ In almost all of the latter cases, the courts failed to properly apply agency law.

B. Authority to Transfer the Promissory Note

One of the most popular topics the courts have grappled with is whether MERS Sub has the authority to transfer or assign a promissory note. Because some courts rely on *Black’s Law Dictionary* for its definition of “nominee,” the courts fail to recognize MERS Sub’s authority.¹⁴⁵ For example, the Oklahoma Supreme Court considered this issue and concluded that MERS Sub does not have the authority to transfer or assign a promissory note.¹⁴⁶

In *CPT Asset Backed Certificates, Series 2004-EC1 v. Cin Kham*,¹⁴⁷ the trustee was foreclosing on behalf of an SPV trust. The note, secured by a mortgage, was indorsed in blank, but the SPV trustee did not demonstrate that it was the

holder, so the SPV trustee had to prove it was a “non-holder in possession with the rights of the holder.”¹⁴⁸ MERS Sub had assigned the mortgage “together with the note, debts and claims thereby secured” to the SPV trustee.¹⁴⁹ However, the Oklahoma Supreme Court ruled that MERS Sub lacked authority to transfer the note along with the mortgage.¹⁵⁰

The *Cin Kham* Court, in interpreting the term, “nominee,” stated that “[i]n the absence of a contractual definition, the parties leave the definition to judicial interpretation.”¹⁵¹ It defined a nominee based on the definition in *Black’s Law Dictionary*, which states that a nominee is “[a] person designated to act in place of another usually in a very limited way.”¹⁵² The Court recognized that the “‘nominee’ is substantially the same as the definition of an agent” and that the “legal status of a nominee/agent depends on the context of the relationship of the nominee/agent to its principal.”¹⁵³ However, the Court focused only on the relationship between the prior note owner and MERS Sub with regard to the mortgage, concluding that MERS Sub had no authority to also assign the note.¹⁵⁴

The *Cin Kham* Court incorrectly construed MERS Sub’s authority when it relied on the definition in *Black’s Law Dictionary* and focused on the MERS Sub position within the narrow context of its status as nominee on the mortgage.¹⁵⁵ If CPT were a MERS Member, then, as explained above, MERS Sub had given actual authority to assist the Member in foreclosing “upon the property securing any mortgage loan registered on the

137. MERSCORP, Inc., Announcement—Foreclosure Processing and CRMS Scheduling, to All MERS Members (Feb. 16, 2011) (“The proposed amendment will require Members to not foreclose in MERS’ name.”).

138. *Id.*

139. Matt Gutman, *Foreclosure Crisis: 23 States Halt Foreclosure as Officials Review Bank Practices*, ABCNews (Oct. 4, 2010):

Officials of some big banks now admit that so-called “robo-signers” were signing off on thousands of foreclosures a day without actually looking at the details of any of the cases. [One robo-signer] had a day job in the Florida Attorney General’s office, [sic] she somehow managed to vet some 150,000 mortgages in three years. If she worked every day of every year, that would amount to over 130 mortgages a day.

140. *Id.* (“[Banks had] been overwhelmed by the foreclosed properties, and this was their way of trying to get through those problems as fast as they could.”).

141. *Id.*

142. See *supra* note 137 and accompanying text.

143. See, e.g.: Citimortgage, Inc. v. Barabas, 975 N.E.2d 805, 815-16 (2012) (holding that the relationship between MERS and its members was a conferral of power to pass the mortgage to Citimortgage with all rights of the prior lender.); Deutsche Bank Nat. Trust Co. v. Pietranico, 928 N.Y.S.2d 818 (N.Y. Sup. Ct. 2011) (holding that MERS had the authority to negotiate the note); Santarose v. Aurora Bank FSB, No. H-10-720, slip op. (S.D. Tex. 2010) (holding that the plain language of the relationship gave MERS authority to foreclose).

144. See, e.g.: CPT Asset Backed Cert’f Series 2004-EC1 v. Cin Kham, 2012 OK 22, 278 P.3d 586, 592 (2012) (holding that MERS’ authority was confined (at most) to dealing only with the mortgage and did not extend to the promissory note); Mort. Elec. Reg. Sys. v. Saunders, 2010 ME 79, 15, 2 A.3d 289, 297 (2010) (“The only right MERS has in the . . . mortgage and note is the right to record the mortgage.”); Landmark Nat. Bank v. Kesler, 192 P.3d 177, 180 (Kan. App. 2008) (“There is no express right to MERS to transfer or sell the mortgage or even to assign duties.”).

145. See *supra* note 143 and cases cited therein.

146. *Cin Kham*, 2012 OK 22 278 P.3d at 592.

147. *Id.* 2, at 587.

148. *Id.* ¶¶ 20 - 22, at 591 - 92.

149. *Id.* ¶ 23, at 592.

150. *Id.* ¶ 24.

151. *Id.*

152. *Id.* This is a long-standing definition. See, e.g., BLACK’S LAW DICTIONARY at 1200 (4th ed. 1951) (“One designated to act for another as his representative in a rather limited sense.”) (citing *Schuh Trading Co. v. Commissioner of Internal Revenue*, 95 F.2d 404, 411 (7th Cir. 1938)). See also *infra* note 167 and accompanying text.

153. *Cin Kham*, 2012 OK 22, ¶ 24.

154. *Id.*

155. *Id.* at 592.

MERS System to such member.”¹⁵⁶ Alternatively, if CPT was not a member, then CPT, as a trustee, was designated by the “beneficial owner of the mortgage loan or any designee thereof” to receive and enforce the promissory note by reason of its pooling and servicing agreement.¹⁵⁷ Either way, as explained above, MERS Sub had actual authority to exercise the rights derived from an “assignment for such mortgage loan,” which would include a note since a mortgage loan necessarily compromises both a mortgage and a note.

The *Cin Kham* Court further held that the transfer of the mortgage was not supportive to show that the trustee was the “non-holder in possession with the rights of the holder.”¹⁵⁸ This holding is inconsistent with the law of property and UCC Article 3, as well as with the Court’s previous holding in *Deutsche Bank Nat’l Trust Co. v. Byrams*.¹⁵⁹ In *Byrams*, the Oklahoma Supreme Court acknowledged that a mortgage transfer could, with the correct language, also transfer the mortgage note, thereby satisfying the evidentiary requirements necessary when one must prove the transaction in which one obtained the note, and establishing the rights of the holder.¹⁶⁰ In *Cin Kham*, the broad language in the assignment should have been sufficient for this purpose.

This position is consistent with the *Restatement of Property*, which states that a transfer of a mortgage is generally intended to assist in keeping the note and the mortgage together:

Ideally a transferring mortgagee will make that intent plain by executing to the transferee both an assignment of the mortgage and an assignment, indorsement, or

other appropriate transfer of the [promissory note]. But experience suggests that, with fair frequency, mortgagees fail to document their transfers so carefully. This section’s purpose is generally to achieve the same result even if one of the two aspects of the transfer is omitted.¹⁶¹

UCC Article 3 is consistent with this position, stating that a transferee must prove “the transaction through which the transferee acquired [the note]” when the transferee acquires it without the right of holder, or holder in due course status.¹⁶² UCC section 1-103 emphasizes that, in making such a determination, the UCC is to be interpreted liberally in order to effectuate the intent of the parties. This is not a context in which the statute mandates a strict construction in order to frustrate the obvious intent of the parties. One way to show why someone is in possession of an unindorsed note, and the mortgage that secures it, is to show that the broad language of the assignment of the mortgage loan to the transferee encompasses both the note and the mortgage.¹⁶³

C. Authority to Transfer the Mortgage

Surprisingly, MERS Sub’s authority to transfer the mortgage has also been rejected, though in a case that itself has been heavily criticized.¹⁶⁴ In this

infamous Kansas appellate court case, *Landmark National Bank v. Kesler*,¹⁶⁵ the Supreme Court of Kansas discussed MERS Sub’s title and role in the disputed transaction.¹⁶⁶ It defined the term “nominee” by reference to *Black’s Law Dictionary*, and then stated that this had been interpreted to mean anything from a “straw man or a limited agent to one who has broader authority.”¹⁶⁷ The Court continued by stating: “[I]n its ordinary meaning, a nominee represents the principal in only a nominal capacity and does not receive any property or ownership rights.”¹⁶⁸ This, of course, is either false or entirely beside the point, since by definition an agent has potential authority to transfer such rights on behalf of the principal. Further, the *Landmark* Court concluded that the original mortgage between Millennia and MERS Sub didn’t give MERS Sub any authority “to transfer or sell the mortgage or even to assign its duties as nominee.”¹⁶⁹

The *Landmark* Court treated the title of “nominee” as a distinct type of agent whose powers and authority are identifiable and strictly limited by the name. However, from the inception of the mortgage loan in question, Millennia understood it would sell, assign, and transfer the promissory note and mortgage so that the loan could undergo securitization.¹⁷⁰ As a MERS Member, Sovereign intended MERS Sub to act as its agent

156. See *supra* this text Part VI.C.

157. Rules of Membership, *supra* note 107, at 16 - 17 (“At the request of the beneficial owner of the mortgage loan, or any designee thereof...[MERS Sub] shall provide to such beneficial owner or designee a recordable assignment for such mortgage loan to another party designated by the beneficial interest or designee.”).

158. *Cin Kham*, 2012 OK ¶ 25, 278 P.3d at 593.

159. *Deutsche Bank Nat’l Trust Co. v. Byrams*, 2012 OK 4, 275 P.3d 129 (2012).

160. *Id.*, 275 P.3d 129, at 132, ¶ 9.

161. RESTATEMENT (THIRD) OF PROP. § 5.4 cmt. a.

162. See *supra* this text Part IV.

163. *Wells Fargo Bank, N.A. v. Heath*, 2012 OK 54, ¶ 5, 280 P.3d 328, 337 (2012) (Gurich, J., dissenting):

The assignment of the mortgage was proof of the purpose of the transfer of the note. There is no indication in the assignment of the mortgage that the parties intended anything other than to transfer both the mortgage and the note...The assignment of the mortgage was proof of the transaction through which the plaintiff acquired the rights of the holder.

164. The New York Supreme Court correctly noted the reasoning to be strived for when dealing within the realm of Agency and Article 3. It noted that to make any other ruling besides finding MERS was the agent and acting within its duties when it transferred the note and when it transfers mortgages:

would ignore the fact that the negotiability of notes is in the national interest, that courts should encourage beneficial commercial transactions that keep commercial paper flowing and the law of secured transactions which encourage the purchase of notes on the secondary mortgage market.

(Continued in next column)

164. (Continued from previous column)

The growing trend of cases that argue for the splitting of the right of enforcement of the note from the mortgage, due to purported defective assignments, in essence, leaves the note unsecured and confers an unwarranted windfall on the mortgagor...Without the agency relationship, the note holder is left without the power to foreclose in the event of a default.

Deutsche Bank Nat. Trust Co. v. Pietranica, 928 N.Y.S. 2d 818, 836 (N.Y. Sup. Ct. 2011). This same reasoning, unfortunately, is not followed in the *Landmark* case, as noted below.

165. *Landmark Nat. Bank v. Kesler*, 192 P.3d 177 (Kan. App. 2008).

166. *Id.* at 178.

167. *Id.* at 180. See also *supra* note 152.

168. *Landmark*, 192 P.3d at 180.

169. *Id.*

170. *Arnold Statement*, *supra* note 20, at 60 n. 2 (“Members that to register any location plan to sell.”).

in the transfer of the loan. Also, as part of Millennia and Sovereign's membership, both expressly authorized MERS Sub to transfer and assign mortgages held by MERS Sub on their behalf.¹⁷¹

When the *Landmark* Court stated that MERS Sub did not receive "property or ownership rights,"¹⁷² the Court's meaning is dubious; but if the rights referred to by the Court included issuing or creating documents that would alter or affect the principal's interest in property or ownership, then this statement does not comport with the law of the agency. Agents are consistently given rights of transfer in property for the purpose of acting on behalf of the principal, thus affecting the principal's rights in property or contractual obligations.¹⁷³ Whatever rights the MERS Member has when it is the principal, so too does MERS Sub have when it is acting on behalf of the member within the scope of its authority.

MERS Sub's authority to act on behalf of MERS members is analogous to the common authority of a homeowners' association, as recognized in *Neponsit Property Owners' Ass'n, Inc. v. Emigrant*.¹⁷⁴ In *Neponsit*, the homeowners association sought to enforce a covenant that ran with a tract of land.¹⁷⁵ The court discussed whether it, solely as a homeowners association, had the right to enforce the covenant running with the land, considering that the association: never owned the land; never had any enjoyment in the land; and never had any interest in the land or the place to which the covenant's charges would be expended.¹⁷⁶ The court concluded, however, that: "in substance, if not in form, there is privity of estate between

the [association] and the defendant."¹⁷⁷ The court reasoned that the association was a tool of convenience, created so the "property owners may advance their common interests." While the court recognized that the association was not one of the property owners, the property owners had given it the right to enforce the covenants possessed by them.¹⁷⁸

The homeowners association provided a way for the homeowners to collectively effectuate their common interests.¹⁷⁹ So too is MERS Sub a tool of convenience to effectuate various purposes that will directly benefit the beneficial owners within an SPV trust. MERS Sub's actions also indirectly benefits the mortgage business, and, as a result, private parties who hope to one day own a home:

Only blind adherence to an ancient formula devised to meet entirely different conditions could constrain the court to hold that a corporation formed as a medium for the enjoyment of common rights of property owners owns no property which would benefit by enforcement of common rights....¹⁸⁰

The Supreme Court of Indiana issued a decision in *Citimortgage, Inc. v. Barabas*¹⁸¹ that contrasts dramatically with the Kansas Court's analysis in *Landmark*. The issue before the Indiana Court was whether Citimortgage could intervene.¹⁸² Barabas, the borrower/defendant, had taken out a mortgage loan with Irwin. Subsequently, Irwin sold the loan and MERS negotiated the promissory note to Citimortgage.¹⁸³ Both Irwin and Citimortgage were Members of MERS Parent.¹⁸⁴ Barabas obtained

a second mortgage loan from ReCasa; ReCasa was not a MERS Member.¹⁸⁵

Barabas fell behind on the second mortgage payment and ReCasa initiated foreclosure proceedings.¹⁸⁶ Irwin was notified, but Citimortgage and MERS Sub were not.¹⁸⁷ Irwin had disclaimed any interest in the mortgage when it was notified of the ReCasa foreclosure, so summary judgment was granted in favor of ReCasa.¹⁸⁸ Citimortgage, as assignee of the mortgage from MERS Sub, filed a motion seeking to intervene in the ReCasa foreclosure suit, noting that it had a security interest in the property.¹⁸⁹ While the court recognized that MERS Sub had indeed been the agent of Irwin, Irwin had disclaimed its interest. Therefore, Citimortgage had to prove that it had an interest in the property as a basis for its right to intervene, and proof was contingent on MERS Sub having had an interest in the property as well as the power to assign that interest to Citimortgage.¹⁹⁰

The *Barabas* Court concluded that MERS Sub was not only the agent of Irwin, it was also the agent of all MERS member banks, including Citimortgage.¹⁹¹ So, unless the opposing party proved that ownership of the promissory note, and thus ownership of the underlying mortgage, had passed to a non-member (and thus was outside the scope of MERS Sub's authority as agent) at any point *before* the assignment of the mortgage to Citimortgage, the assignment to Citimortgage was effective to give it the interest in the real property necessary for it to intervene.¹⁹² This directly contradicts the controversial analysis in *Landmark*.¹⁹³

171. See *supra* Part VI.C.

172. *Landmark*, 192 P.3d at 178.

173. See SEAVEY, *supra* note 91, at 116-17 (explaining the authority and power for an agent to bind a principal to a contract, and enlarge or diminish the principal's ownership rights with regard to mortgages, negotiable instruments, and chattel).

174. *Neponsit Property Owners' Ass'n, Inc. v. Emigrant*, 15 N.E.2d 793 (1938).

175. *Id.* at 793 - 94.

176. *Id.* at 797.

177. *Id.* at 798.

178. *Id.*

179. *Id.*

180. *Id.*

181. *Citimortgage, Inc. v. Barabas*, 975 N.E.2d 805 (2012).

182. *Id.* at 811 - 12.

183. *Id.* at 811.

184. See *id.* at 809 - 811.

185. *Id.* at 810.

186. *Id.*

187. *Id.*

188. *Id.*

189. *Id.* at 811.

190. *Id.*

191. *Id.* at 814 - 15.

192. *Id.* at 815.

193. See discussion of *Landmark*, 192 P.3d 177, *supra* this text at notes 164 - 173.

Another controversial case cited and referenced in discussions regarding MERS Sub's authority to assign a mortgage is *U.S. Bank Nat'l Ass'n v. Ibanez*.¹⁹⁴ In *Ibanez*, the Supreme Judicial Court of Massachusetts held that, if the status of a mortgage holder is challenged, the mortgage holder must prove that it is either the original mortgagee or that "they claimed the authority to foreclose as the eventual assignees of the original mortgagees."¹⁹⁵ According to *Ibanez*, the holder can make the necessary showing in either of two ways: (1) "A foreclosing entity may provide a complete chain of assignments linking it to the record holder of the mortgage, or a single assignment from the record holder of the mortgage"; or (2) if the foreclosing party obtained an assignment from the original lender, it can show proof of that transfer.¹⁹⁶ The *Ibanez* Court indicated that recording the assignment is of no consequence to determining ownership of the mortgage, and "[t]he key in either case is that the foreclosing entity must hold the mortgage at the time of the notice and sale...to have the authority to foreclose under the power of sale."¹⁹⁷

While this language is somewhat muddled (indicating that the mortgagee "must hold the mortgage"), the holding in *Ibanez* did not purport to invalidate MERS Sub's ability to act within its authority, which includes the transfer of any necessary documentation to effectuate a foreclosure.¹⁹⁸ A recent law review note applied this reasoning in a hypothetical representing what would

be a typical transaction involving MERS Sub:¹⁹⁹ The originator of the loan transfers the promissory note to member A; MERS Sub is already the mortgagee of record, so no transfer or recording of the mortgage occurs. The note is sold and transferred a couple of times and, eventually, member E, the trustee for a SPV trust that came to own the loan, becomes the holder. Applying the holding of *Ibanez*, the author questions whether MERS Sub would have the authority to transfer the mortgage to member E.²⁰⁰

However, applying the reasoning of *Ibanez*, which specifically states that the mortgage assignment need not be recorded at the time of foreclosure,²⁰¹ in this hypothetical, both MERS Sub and member E would be able to prove the necessary chain of title from which they received the mortgage, and thus either could initiate foreclosure. In the hypothetical, "the chain of title starts and stops with [MERS Sub]."²⁰² Once member E shows that it has been assigned the mortgage from MERS Sub, the mortgagee of record, it has met its burden according to *Ibanez*.²⁰³ Also, since MERS Sub would have no chain of title to prove, MERS Sub would have no issue proving itself the mortgagee of record under the holding of *Ibanez*. Further, *Ibanez* does not purport to invalidate the law of agency; as a valid agent of all MERS Members in the hypothetical, MERS Sub would have held

the mortgage as the mortgagee of record on behalf of all members as principals.

D. Authority to Foreclose

MERS Sub's authority to foreclose also has been hotly contested. In response, MERS Sub revoked its agents' authority to foreclose on its behalf, and MERS Parent revised its Rules of Membership to eliminate the option that members may elect to have MERS Sub foreclose on their behalf.²⁰⁴ However, the issue is still instructive in illustrating any disconnect between the cases and a correct analysis of the relationship between MERS Sub, the members, and the Signing Officers.

In *Mortgage Electronic Registration Systems, Inc. v. Johnston*,²⁰⁵ the Rutland Superior Court held that MERS Sub did not have authority to foreclose on behalf of the lender. The Johnstons executed a note naming WMC Mortgage Corporation as the payee, and the note was secured by a mortgage executed in the name of MERS Sub as nominee for the lender.²⁰⁶ Less than a year later, the Johnstons defaulted and MERS Sub initiated foreclosure on behalf of WMC.²⁰⁷ The Rutland Superior Court initially granted default judgment in favor of MERS Sub due to the Johnstons' failure to answer, but then it raised the issue *sua sponte* as to whether MERS Sub had standing to initiate the foreclosure.²⁰⁸

Relying on the now largely-discredited decision of the Kansas Court of Appeals in *Landmark*,²⁰⁹ the trial court emphasized MERS Sub's title as "nominee;" it also noted the lack of a definition for the term "nominee" within "the mortgage

194. *U.S. Bank Nat'l Ass'n v. Ibanez*, 941 N.E.2d 40, 52 (2011). *Ibanez* did not deal directly with MERS Sub, but a recent article challenged MERS Sub's authority based on this holding and agency. See Robinson, *supra* note 17, at 119 - 24. On *Ibanez* and its progeny, see also: Arthur B. Axelson, Heather C. Hutchings & Alvin C. Harrell, *Update on Mortgage Foreclosure Litigation: MERS, Standing to Sue and "Show Me the Note" as Defenses*, 67 Consumer Fin. L.Q. Rep. 155, 159 (2013); Claire Alexis Ward, *Throw the Book at Them: Testing Mortgagor Remedies in Foreclosure*, 66 Consumer Fin. L.Q. Rep. 269 (2012); Scott D. Samlin & Rinaldo Martinez, Case Note: *Massachusetts Supreme Judicial Court Decision in Bevilacqua v. Rodriguez*, 65 Consumer Fin. L.Q. Rep. 348 (2011).

195. *Ibanez*, 941 N.E.2d at 52.

196. *Id.* at 53.

197. *Id.*

198. See *supra* this text Part VI.B.

199. See Robinson, *supra* note 17, at 123. The author of the note reasons as follows:

In the *Ibanez* scenario, when MERS originally records the mortgage, it does so "solely as nominee for Lender B and Lender B's successors and assigns." According to *Ibanez*, a lender does not become the assignee of a mortgage unless it holds a recordable assignment of the mortgage, meaning that Bank E is not legally Lender B's "successor" or "assign"...It is a well-settled legal principle that an agent cannot augment or reduce the legal rights of its principal. Therefore, if Bank E does not have standing to foreclose in this scenario, it necessarily follows that Bank E's agent does not have the power to do so either.

Id.

200. See *id.*

201. *Ibanez*, 941 N.E.2d at 53.

202. *Deutsche Bank Nat. Trust Co. v. Pietranica*, 928 N.Y.S.2d 818, 830 (N.Y. Sup. Ct. 2011).

203. *Ibanez*, 941 N.E.2d at 53 ("If the claimant acquired the note and mortgage from the original lender or from another party who acquired it from the original lender, the claimant can meet its burden.")

204. See *supra* note 133.

205. *Mortg. Elec. Reg. Sys., Inc. v. Johnston*, No. 420-6-0, slip op. at 19 (Rutland Sup. Ct. 2009).

206. *Id.* at 2.

207. *Id.*

208. *Id.* at 2 - 3.

209. 192 P.3d 177. See *supra* notes 164 - 173 and accompanying text.

deed, and the functional relationship between MERS and the lender, WMC.”²¹⁰

After defining and interpreting the term “nominee” according to *Black’s Law Dictionary*, the *Johnston* court stated that the mortgage deed “purported to expand the authority of MERS as a ‘nominee’ to act as...an agent or as a power of attorney to carry out the rights of the lender.”²¹¹ The court then stated that: “importantly,...MERS and the lender...purposely chose...‘nominee’ and *not* ‘agent’ or ‘power of attorney.’”²¹² The court held that MERS Sub was not entitled to enforce the instrument under UCC section 3-301, 3-418²¹³ or 3-309.²¹⁴ Finally, MERS Sub’s attempt to act on behalf of the lender as an assignee was rejected because it did not possess the right of enforcement because of a failure to use the word “agent.”²¹⁵ Therefore, pursuant to “black letter mortgage law...[the] mortgage is unenforceable if it is held by one who has no right to enforce the secured obligation.”²¹⁶

This reflects a virtual cascade of errors. First, mortgage law is not determinative to ascertain who has the right to enforce a negotiable instrument (“the secured obligation”); the applicable law is UCC Article 3, which states that one need only be the person entitled to enforce the instrument, *e.g.*, the holder, holder in due course, or a “non-holder in possession with the rights of the holder.”²¹⁷ Moreover, as noted previously, UCC Article 3 is supplemented by agency law. So, as long as MERS Sub, or its principal, was the holder, or a holder in due course, of

the note (or was otherwise entitled to enforce it) at the time the foreclosure proceedings began, MERS Sub had the necessary authority under UCC Article 3 to enforce the note in a mortgage foreclosure or otherwise; thus, it had standing.

Clearly, a determination of MERS Sub’s authority to foreclose cannot be confined to the label given it within the mortgage.²¹⁸ The ability for bodies of well-developed law to fill-in gaps of information, and to answer questions otherwise left wanting after a reference to *Black’s Law Dictionary*, is significant. Agency law accomplishes this task with regard to defining MERS Sub’s authority in the context of its relationship with MERS Members. While the *Johnston* court repeated numerous arguments against MERS Sub’s authority to foreclose, the crux of its decision hinged on a disregard of agency law and how it applies to UCC Article 3.

MERS Sub’s actual authority is defined by the member’s contracts with MERS Sub, as reasonably interpreted by MERS Sub, the agent; agency law does not require that these agreements be interpreted or approved in advance by a court, or an attorney, in order to create the agency relationship.²¹⁹ While, inevitably, courts and attorneys may need to delve into the facts of a case to determine if the agent’s, or the third party’s interpretation of the principal’s manifestations were reasonable, one of the purposes behind agency law is to encourage the use of agents as well as protect third parties who must deal with these agents.²²⁰ This is consistent with the mandate in UCC section 1-103, for a liberal interpretation designed to effectuate the intent of the parties. If this purpose is to be realized, the intent of the parties involved with the disputed transaction must be recognized and effectuated; a court

should not be looking for technicalities by which that intent can be frustrated.²²¹

Compare the *Johnston* holding to that of *Santarose v. Aurora Bank FSB*,²²² in which the Texas trial court held that MERS Sub, “[b]y the plain language of the Deed of Trust,...had the right to foreclose.”²²³ The facts were nearly identical to that of *Johnston* except that the payee bank had been previously named “Lehman Bank” and then “changed its name to Aurora.”²²⁴ MERS Sub, acting on behalf of the newly named payee bank, initiated foreclosure on the defaulted note.²²⁵ The mortgagors claimed that MERS Sub did not have standing to foreclose.²²⁶ The trial court rejected this argument in a brief statement, as follows:

The Deed of Trust expressly provides that MERS has the right: to exercise any or all of those interests [granted to Lender by Borrower], including, but not limited to, the right to foreclose and sell the [real property.] The uncontradicted evidence establishes that Aurora authorized foreclosure of the subject property by, through, and in the name of its nominee, [MERS Sub] [internal quotation marks omitted].²²⁷

E. Why MERS Sub’s Authority Makes Sense

The *Pietranico* opinion discussed immediately below illustrates the role of agency law and UCC Article 3. By acknowledging what the parties intended at the inception of their relationship, the court enforced the allocation of risks the principal assumed with regard to the loan principle, and allowed any attendant

210. *Johnston*, No. 420-6-0, slip op. at 6.

211. *Id.* at 7.

212. *Id.*

213. This section applies only to drafts (the court referenced 9A Vt. Stat. Ann. § 3-418 (2002) (UCC § 3-418)). Pursuant to the UCC, “[a]n instrument is a ‘note’ if it is a promise and is a ‘draft’ if it is an order.” Therefore, § 3-418 would not be applicable here. See 9A Vt. Stat. Ann. § 3-104(e) (UCC § 3-104(e)).

214. *Johnston*, No. 420-6-0, slip op. at 8.

215. *Id.* at 15.

216. *Id.* at 16.

217. See UCC §§ 3-102 & 3-301.

218. See *supra* this text Part V.

219. See *id.*; see also RESTATEMENT (THIRD) OF AGENCY § 1.01(c) (“Agency thus entails inward-looking consequences, operative as between the agent and the principal, as well as outward-looking consequences, operative as among the agent, the principal, and third parties with whom the agent interacts.”).

220. See, *e.g.*, Dalley, *supra* note 96 and accompanying text.

221. See *supra* this text Part V.

222. *Santarose v. Aurora Bank FSB*, No. H-10-720, slip op. at *5 (S.D. Tex 2010).

223. *Id.*

224. *Id.* at *1.

225. *Id.*

226. *Id.* at *2.

227. *Id.* at *5.

benefit earned as a result of using the agent to also accrue to the principal.²²⁸ It also allowed for the negotiability of the promissory note to be recognized and effective.²²⁹ All of this effectuated the rights and intent of the parties in each transaction. Without the use of agents and negotiable instruments law, the transfer of promissory notes and mortgages as needed for securitization purposes would be unduly burdensome and costly. Also, with so many transfers, it is beneficial to have a private party who is able to track the ownership of the mortgage so that, in the event of a serious default on the loan, MERS is able to notify the correct party,²³⁰ and MERS Sub is able to transfer the necessary documents to the applicable party so that the foreclosure process can be carried out.²³¹ As discussed previously, it is not always the owner of the loan that will foreclose, but rather another party, such as a servicer or a trustee, who is acting as agent on behalf of the owner or mortgagee.²³²

The *Pietranico* court noted that, “while the use of a nominee as the equivalent of an agent for the lender is not unusual, what is unusual is the extent various courts will go to limit the contractual role of MERS as a nominee.”²³³ What is also unusual in some of the case law is a seemingly determined refusal to give full recognition to the law of agency. This poses obvious risks for a broad range of commercial transactions. If principals lose confidence that the judicial system will enforce the authority they grant to their agents, they won’t use them. If third parties don’t believe courts will recognize the authority agents have been given, they won’t risk dealing with them. Ramifications of this in the secondary mortgage

market, and in any area of business that makes use of agents, could be widespread.

Finally, if the courts fail to recognize valid transfers of negotiable instruments, and the right of a non-holder to enforce the instrument pursuant to section 3-301, investors and the commercial financing industry will be less willing to deal with negotiable instruments.²³⁴ If negotiable instruments lose the assurance of enforceability that comes from the concise rules and liquidity provided by the UCC, then, at the very least, home loans will be harder to come by. In a real sense, this has been empirically demonstrated by the collapse in availability of private mortgage credit since the foreclosure crisis began to produce cases like some of those noted in this article.

Apparently, one of the reasons some courts have been unwilling to acknowledge MERS Sub’s authority to assign the mortgage or the note is the court’s unfamiliarity with the creation and development of the MERS Sub concept. However, the idea behind the function of MERS Sub is not new, nor is it novel in our law. R.K. Arnold analogized its purpose to that of Depository Trust and Clearing Corporation (DTCC),²³⁵ which was created for the efficient transfer and sale of stock certificates.²³⁶

The DTCC began in 1973 and has since been used to streamline millions of daily stock transfers on the New York stock exchange.²³⁷ Without the DTCC, the fees associated with buying and selling stock would skyrocket and the sheer number of stock shares being traded in a day would require so many transfers that errors and delays would be unacceptably

widespread.²³⁸ This would likely necessitate undesirable trading restrictions, and perhaps require stock exchange hours to be shortened and the number of days for trading to be decreased.²³⁹ These repercussions would be bad for business and investors and could further depress an already struggling economy. All of the same things can be said about the role of MERS in the home mortgage market. MERS utilizes the same concept for the home loan industry in the MERS Sub concept. Perhaps those unfamiliar with the term “nominee” may find the fact that the DTCC utilizes this same term, for much the same purpose as MERS Sub, to be a helpful parallel.²⁴⁰

Also, the *Barabas* decision is an example of how it is imperative to effectuate the intent of the parties within an agency relationship. In that case, the prior holder of the note disclaimed any interest in the mortgage loan after it was sold. If the court had held that MERS Sub did not possess any authority to transfer the mortgage as needed for foreclosure, the mortgage and the note would have been effectively bifurcated, and the party holding the unsecured note would have had no means to enforce the mortgage lien. Such an outcome would cause businesses and investors to fund fewer mortgage loans, for fear they would be unable to enforce the mortgage upon default. Further, this would leave mortgage debts unsecured and investors bearing inappropriate and unnecessary losses on defaulted home loans. Again, this is apparently what has happened over the past five years in some jurisdictions that have been vigorous in erecting unnecessary barriers to mortgage loan foreclosure.

One may ask why more originating lenders do not simply retain the notes and mortgages they originate. A significant reason is the need for banks and

228. *Deutsche Bank Nat. Trust Co. v. Pietranico*, 928 N.Y.S.2d 818, 831 (N.Y. Sup. Ct. 2011). See also *supra* note 96 and accompanying text.

229. See *supra* this text Part IV.C.

230. See *supra* Part VI.C.

231. *Id.*

232. See *supra* this text Parts II. & IV.

233. *Pietranico*, 928 N.Y.S.2d at 831.

234. See Dalley, *supra* note 96, at 499:

Without the restoration of the status quo provided by agency law, the use of agents would be either pointless or extremely expensive: principals would not have any assurance that they would receive the benefits of their agent’s actions, and third parties would be unwilling to deal with anyone other than someone who was provably a principal. (footnote omitted).

235. Arnold Statement, *supra* note 20, at 63.

236. *Responding to Wall Street’s Paperwork Crisis*, DTCC (last visited Jan. 27, 2013), <http://www.dtcc.com/about/history/>.

237. *Id.*

238. *Id.*

239. *Id.*

240. See DTCC, A Proposal to Fully Dematerialize Physical Securities, Eliminating the Costs and Risks They Incur 3 (2012) (“To tackle the mounting backlog, the New York Stock Exchange (NYSE) and its Central Certificate Service ‘immobilized’ stock certificates by maintaining them in a central location, registered in a nominee name.”).

other lenders to spread their risks so that they may remain financially sound and able to continue lending to those who otherwise might not be able to obtain a home loan.²⁴¹ Further, moving home loans into pools of mortgage-backed securities is needed to entice investors to capitalize the mortgage market.²⁴²

If there is agreement that what is needed today is more private funding to expand the availability of mortgage credit, so people can buy and sell homes and [refinance] mortgages, then Article 3 and the law of negotiability are obviously quite relevant (and likely essential) as a means to help entice that capital back into the mortgage markets.²⁴³

Another point for the courts to consider is that MERS Sub serving as the mortgagee of record is directly beneficial for borrowers and homeowners. Recording statutes allow for any change in the mortgagee to be recorded with the local clerk in the public records,²⁴⁴ however, this requires a (sometimes significant) recording fee.²⁴⁵ Because of the sheer number of transfers required for securitization, recording so many assignments for each mortgage would entail substantial costs, (not to mention error risks),²⁴⁶ and delays, which would be imposed on consumers. Every borrower and homeowner has an interest in the smooth and efficient functioning of the mortgage markets, *e.g.*, when buying or selling a home or refinancing a mortgage loan. While some commentators have

disparaged the practice of MERS Sub taking income from the county clerks,²⁴⁷ this income is not the purpose of the recording acts; MERS has made home loans cheaper and streamlined mortgage loan processing. Further, if the services of the county clerks are not required, then money has not been wrongfully taken, as this is money that has not been earned and is, therefore, not due.

Apparently, there has been some confusion as to the purpose and intent behind the recording statutes.²⁴⁸ They have never been intended to be a public source of information on all transfers of ownership that occur with regard to a mortgage or a loan, nor have they ever been intended as a means of information for mortgagors to ascertain the identity of their note holder so they may renegotiate their loan payments. Instead, the recording statutes have always been intended to effectuate notice for purposes of allocating the priorities of competing claims, *e.g.*, to provide notice of prior ownership or liens to a party seeking to purchase the real property; or notice to subsequent creditors so as to protect them and the party who has duly recorded his or her prior interest in real property.²⁴⁹ MERS Sub serves this purpose efficiently by serving as the nominal mortgagee in

the public land records.²⁵⁰ If one wants to purchase real property, and MERS Sub is recorded as the mortgagee, the purchaser will be on notice, as the recording statute intended, and he or she will know whom to contact about any possible liens or interests on the real property in question.

VIII. How MERS Sub's Authority Should Be Interpreted

A. Introduction

Since MERS Parent's decision to terminate members' option of foreclosing in the name of MERS Sub,²⁵¹ it is now unnecessary to discuss how MERS Sub's authority to foreclose should be interpreted in future transactions. However, because this option will not be available, it will be imperative for courts to recognize the other essential authorities that members have granted to MERS Sub in order to carry out future transactions.

B. Transferring the Mortgage

All members of MERS Parent have given actual authority to MERS Sub to act as the mortgagee of record for home loans registered in the MERS System database.²⁵² However, because of the language in the MERS Parent Member By-Laws,²⁵³ as well as the broad language found in any mortgage in which MERS Sub is named the original mortgagee of record,²⁵⁴ MERS Sub also has been granted actual authority to act on behalf of the members in many other capacities.²⁵⁵ At the heart of MERS Sub's authority is the oft-quoted holding of the United States

241. See *supra* this text Part III.

242. *Id.*

243. See Harrell Commentary, *supra* note 14, at 15.

244. SHELDON F. KURTZ & HERBERT HAVEN KAMP, CASES AND MATERIALS ON AMERICAN PROPERTY LAW 1167 (4th ed. 2003) ("As a general rule, the only penalty for failure to record is possible subsequent loss of interest. Most states proscribe by statute the documents that are entitled to be recorded.")

245. See *supra* note 120 with accompanying text.

246. Patrick Pulatie, LFI Analytics, A White Paper on the Recording Process, Securitization, MERS & Innovation 1 - 11 (2012), available at <http://lfi-analytics.com/home/a-working-paper-recording-issues-and-mers/> (discussing the defects and shortcomings prevalent in our current titling process).

247. See, *e.g.*, Christopher Peterson, *Predatory Structured Financing*, 28 Cardozo L. Rev. 2185, 2212 (2007) ("Most counties charge a fee to record the assignment, and use those fees to cover the cost of maintaining the real property records...In this respect, MERS' role in acting as a mortgagee of record in nominee capacity is simply a tax evasion tool."); Hudspeth, *supra* note 17, at 9 ("[MERS] detractors argue that [MERS] deprives county clerks at needed recording fees."); *contra* Arnold Statement, *supra* note 20, at 65:

Some have raise questions about the reduction of recording fees...and there have been suggestions that these fees are somehow owed or outstanding. Fees are paid for services performed, and if a document is eliminated because it is no longer necessary, no fee is due and owing because there is nothing to record...MERS greatly reduces the workload of county recorders.

248. See, *e.g.*, Weber, *supra* note 17, at 102 ("Among the many problems are the lack of transparency in a historically transparent legal regime, the inability of mortgagors or trustors to ascertain the identity of anyone other than a loan servicer in order to engage in settlement discussions or loan workouts.")

249. See KURTZ & KAMP, *supra* note 244, at 1174 - 76 (explaining the thoroughly-developed law surrounding the recording statutes).

250. Arnold Statement, *supra* note 20, at 65:

The concept of nominees appearing in land records has long been recognized. It has never been the case that the true owners of interests in real estate could be determined using land records...when MERS is the mortgagee, the mortgage is recorded in the county land records, thereby putting the public on notice that there is a lien on the property.

251. See *supra* note 137.

252. See *supra* this text Part VI.C.

253. See *id.*

254. See *id.*

255. See *id.*

Supreme Court in *Carpenter v. Longan*²⁵⁶ that the mortgage, as ancillary to the promissory note, will follow it; attempts to assign the mortgage without the note will be a “nullity.”²⁵⁷ As the promissory note is assigned from member to member, MERS Sub continues to maintain actual authority to act on behalf of each member by continuing to act as the mortgagee of record, thus preventing separation of the promissory note and mortgage.²⁵⁸

If a foreclosure proceeding is commenced, and the mortgage loan is transferred out of the MERS System, the MERS Parent By-Laws state that MERS Sub has actual authority to assign the mortgage on behalf of the current note holder.²⁵⁹ Through the Signing Officers, MERS Sub will assign the mortgage to whomever may be necessary to either foreclose upon the property or to protect the interest of the beneficial owner of the promissory note.²⁶⁰

It is also important to understand that action by the Signing Officers does not destroy the agency relationship. The members have granted MERS Sub the actual authority to allow the Signing Officers to act in MERS Sub’s stead.²⁶¹ Signing Officers, as agents of the agent MERS Sub, are also given certain authority to do particular acts on behalf of MERS Sub when MERS Sub is to act on behalf of the member.²⁶² Therefore, the members maintain control of who is acting to maintain their interests.

C. Transferring the Promissory Note

Whenever MERS Sub undertakes to transfer a promissory note on behalf of a member, it has actual authority to do so through the language of the MERS Parent

By-laws. All members have agreed that MERS Sub may “take such actions as may be necessary to fulfill such Member’s servicing obligations to the beneficial owner of such mortgage loans.”²⁶³ Therefore, any transfers by MERS Sub of the documentation necessary to effectuate the servicer’s obligation to the owner of the loan will be within MERS Sub’s actual authority, as long as the document executed is connected to a home loan registered in the MERS System.²⁶⁴

If a note is a negotiable instrument, a transfer of the note must meet the requirements of a negotiation under UCC section 3-201 if the transferee is to claim the status of holder.²⁶⁵ Accordingly, if a bank claims that MERS Sub negotiated the note to it, that same bank would need to be in possession of the note, and it would need to be indorsed to that bank, or to bearer.²⁶⁶ If the note is not indorsed to order or to bearer, and is not in the possession of the bank, then the bank is not a holder and UCC Article 3 would require proof of the transaction in which the prior holder intended to grant the bank the right of enforcement.²⁶⁷ So, for example, the bank would need to show that it obtained the instrument from MERS Sub for the purpose of granting the bank the right of enforcement. In the event MERS Sub was not the prior holder, but was acting on behalf of the holder, the bank also would need to prove that MERS Sub was authorized and intended to transfer the note for the purpose of granting the right of enforcement to the bank.

IX. Conclusion

MERS Sub’s authority should be clearly recognized, because it comports with the well-established rules of Article 3 and agency law. Failing to do so frustrates the intent and purposes of

important areas of law, with potentially broad, adverse repercussions. Holders of negotiable instruments would question their enforcement, thereby impairing their liquidity, limiting their use and marketability. Negotiable instruments have been a lynchpin of commerce and the common law for over two centuries. The characteristic of negotiable instruments that makes them akin to “private money”²⁶⁸ is the fact that one may take an instrument with an assurance that it will be easily enforceable or transferable without the hazards that can accompany other contracts. To cast doubt on these transactions is to strip modern society of an important means by which it funds important transactions,²⁶⁹ which will broadly affect the economy. Also, UCC Article 3 contemplates the use of agents – due in part to agency law’s contribution to the law of negotiable instrument’s history – and because of this, and because modern society simply cannot function without agents,²⁷⁰ it is imperative that the law that controls these issues be clearly understood and enforced.

The intended erosion of MERS Sub’s authority by some courts seems to be essentially an attempt to ensure the most equitable and fair decision possible. However, “[a] purpose of the UCC is to provide clear and consistent rules to displace interminable variations and litigation...as to these basic and common

256. *Carpenter v. Longan*, 83 U.S. 271 (1872).

257. *Id.* at 274.

258. *See supra* this text Part VI.C.

259. *See supra* this text Parts VI.C. & D., and Part VII.D.

260. *See supra* this text Part VI.D. & Part VII.D.

261. *See supra* this text Part VI.D.

262. *See id.*

263. *See supra* this text Part VI.C.

264. *See supra* this text Part VI.C.

265. *See supra* Part IV.A.

266. *See id.*

267. *See id.*

268. Harrell Commentary, *supra* note 14, at 221 & 253 n. 537.

269. Historically, negotiable instruments have been an important means for people without means to escape perpetual poverty. *See Harrell Commentary, supra* note 14, at 5 (“Under the English common law as developed by Lord Mansfield and his colleagues, private negotiable instruments were legally recognized and thus became more widely used by ordinary people; this was a significant factor in the decline of economic serfdom and emergence of the industrial revolution.”). Today, not only are negotiable instruments used as a means for the average American to purchase a home, but they are also used by businesses to obtain start-up and working capital. *See Christopher W. Frost, Asset Securitization and Corporate Risk Allocation*, 72 *Tulsa L. Rev.* 101, 104 (1998) (“[I]ndustrial companies have begun to use asset securitization as a replacement for traditional bank loans...noninvestment-grade companies can achieve direct access to financial markets, thereby reducing their cost of capital.”).

270. *See SEVEAY, supra* note 91, at 2:

The agency relation exists in order to enable a person to utilize the services of others and thereby to accomplish what he could to achieve alone. Business is today almost wholly conducted by agents, mostly individuals, but in many cases partnerships and corporations, acting on behalf of principals who are usually corporations and partnership’s.

commercial transaction issues...clarity is more important...than the details of the resolution."²⁷¹ Without the hard and fast rules on which parties may rely to give negotiable instruments their marketability, or decisions enforcing and encouraging the use of agents, the law will fail to achieve this fundamental purpose.

Sometimes courts that are seeking a particular result overlook the fact that the result would have been reached anyway had they properly applied the UCC.²⁷² Agency law's rules also are intended to achieve cost-effective and legally-appropriate outcomes;²⁷³ if agency law is properly applied, these outcomes will result without the need for conspicuous judicial advocacy or inconsistent case law. Moreover, judicial efforts to stall

foreclosure proceedings, on the basis of an erroneous application of the law – though often advocated as a borrower remedy by counsel for individual borrowers – wastes judicial resources and causes higher litigation costs and foreclosure losses, which inevitably trickle down to consumers through fees, reduced credit availability, or some other means of offsetting the necessary cost.

These intricate and interwoven UCC and agency relationships are not intended to “hide the ball” or conceal the owner of the promissory note from the homeowner.²⁷⁴ Instead, they are intended to allow the inherently complex process of securitization to run more smoothly and economically than if assignments of mortgage had to be recorded with every

transfer of either an ownership interest in a loan or a right to enforce a note.²⁷⁵ Such recordings are obviously not required under any conventional reading of the law, and MERS is a legally sound mechanism for tracking these transfers.

While the process is not perfect, and procedural mistakes are bound to occur either because of general error, the pressures of a volume-driven business, or sometimes just sloppiness, this can be appropriately addressed through the UCC and agency law.²⁷⁶ Further, a failure of the judicial process to recognize agency relationships in conjunction with UCC Article 3 merely creates anomalies and inconsistencies that adversely affect the enforceability of negotiable instruments within the broader financial markets.

271. Harrell Commentary, *supra* note 14, at 247.

272. *Id.* at 233 (“[Usually] it is not necessary for a court to refuse application of the law or embrace a blatantly result-oriented analysis in order to reach an appropriate result. Instead, the law of negotiable instruments contemplates most such scenarios and (when] applied correctly) nearly always provides the optimal outcome.”).

273. *See supra* this text at Part VIII.E.

274. Hudspeeth, *supra* note 17, at 9 (“[MERS] detractors argue that [MERS]...impedes borrower-mortgagors in knowing who owns their debt and/or services their mortgage.”); *see supra* note 123 with accompanying text.

275. *See supra* this text Parts VI.A. & B. and Part VIII.E.

276. *See SEVEAY, supra* note 91, at 16.

It is not unjust...that the principals should be liable for many of the frauds of those he employed to make profits for him. The extension of liability upon contracts to cases in which there is neither authority nor apparent authority reacts ultimately to the benefit of the business community in that it tends to facilitate business transactions, now almost entirely conducted by agents. The imposition of liability causes the employer to use care to select good representation and police their conduct.

See also Dalley, *supra* note 96, at 497.

[U]se of agents increases the risk that torts will occur both because it increases the scope of the enterprise and because agents are more likely to commit torts than owners....’The losses caused by the torts of employees ...are placed upon [the] enterprise itself, as required cost of doing business.’

Quoting *Hinman v. Westinghouse Elec. Co.*, 471 P.2d 988, 990 (Cal. 1970).