

Legal analysis to guide the mortgage industry and protect its interests.

October 2009 Issue

Alabama Rules That MERS Pre-Foreclosure Assignment is Valid, but Kansas Rules That MERS is not a Necessary Party to a Judicial Foreclosure Action

by Jeffrey G. Miller & R. Ryan Daugherty

The Alabama Court of Civil Appeals – which is Alabama’s mid-level appellate court – ruled last month that an assignment of a mortgage by MERS is valid. The holding in this case is extremely important with regard to the enforceability and assignability of mortgages which name a nominee for the lender. The validity of assignments of these mortgages by the nominee has been repeatedly challenged by borrowers in pre- and post-foreclosure actions.

Crum v. LaSalle Bank, N.A., which was successfully handled by Sirote’s Mortgage Litigation Group, was a post-foreclosure ejectment case. In 2006, Deidra Crum gave a mortgage on real property to Nationpoint, a division of National City Bank, N.A. The mortgage recognized Nationpoint as the Lender, but actually named Mortgage Electronic Registration Systems, Inc. (MERS) as the mortgagee. The mortgage, like most current mortgage instruments, stated that MERS is a separate corporation and is acting solely as a nominee for Lender and Lender’s successors and assigns. MERS was the mortgagee under this Security Instrument. The mortgage further stated that Crum irrevocably mortgages, grants and conveys to MERS (solely as nominee for Lender and Lender’s successors and assigns) and to the successors and assigns of MERS, with power of sale, . . . [of] the property . . . MERS was also authorized by the mortgage to take any action required of Lender.

The underlying facts were undisputed. MERS, as nominee for Nationpoint, assigned the mortgage to LaSalle Bank. Crum defaulted on the mortgage by failing to make payments, and LaSalle initiated foreclosure proceedings and conducted a non-judicial foreclosure. After the foreclosure, Crum failed and refused to vacate the property, and LaSalle filed an ejectment complaint in the trial court, seeking possession of the real property. Crum did not deny that the mortgage was in default, but instead sought to impugn the validity of LaSalle’s title by contending that MERS, as merely a nominee in the mortgage, was not entitled to the money thus secured by the mortgage. Stated otherwise, because MERS did not actually own the debt, it therefore could not assign anything to LaSalle. This argument was based on Crum’s interpretation of *Ala. Code* § 35-10-12, which states that the power to sell may be exercised only by a person who becomes entitled to the money secured by the mortgage.

The trial court disagreed with Crum and held that MERS did in fact have the ability to assign the mortgage, including the power of sale, to LaSalle on behalf of Nationpoint. The trial court entered a judgment of possession in favor of LaSalle, and Crum appealed. The Alabama Court of Civil Appeals affirmed the trial court’s judgment, holding that MERS was expressly acknowledged by the borrower in the mortgage instrument itself as not only having any or all of the Lender’s interests in the property, but also as having the power to take any action required of the Lender under the mortgage. These authorized actions included assigning the mortgage to a third party, such as LaSalle. Thus, the assignment to LaSalle was proper and effectual, vesting LaSalle with the power of sale.

The argument has also been advanced that naming MERS as nominee in the mortgage diverges legal and equitable ownership of the debt (which remains in the Lender) and the security for the repayment of the debt (which is given to MERS). The Alabama Court of Civil Appeals addressed this argument and noted the common law rule that a transfer of a mortgage also transfers the obligation the mortgage secures unless the parties to the transfer agree otherwise. Because MERS had the ability to assign the mortgage on behalf of the Lender, who owned the debt, there was no divergence of ownership. Crum did not properly preserve the issue for appeal as to whether the provisions of the Uniform Commercial Code required the note to be negotiated to LaSalle in addition to the assignment of the mortgage by MERS, because Crum failed to make this argument at the trial court level. Therefore, the Court of Civil Appeals refused to address this argument and affirmed the judgment in favor of LaSalle. Crum has asked the Court of Civil Appeals to reconsider its decision, but the Court has not ruled on this request as of this writing.

While this decision is extremely important, the ultimate issue of the enforceability of MERS mortgage assignments and of MERS’s right to foreclose across the nation is far from settled. Case in point is the recent case of *Landmark National Bank v. Kesler* out of Kansas, which is a judicial foreclosure state, in which the Kansas Supreme Court reached the opposite conclusion, essentially, as the decision reached by the Alabama Court of Civil Appeals in *Crum*.

In *Kesler*, Boyd Kesler gave a mortgage to Landmark National Bank in 2004. A year later, he gave a second mortgage on the same piece of property to Millennia Mortgage Corp. The Millennia mortgage listed Millennia as the Lender but identified MERS as the mortgagee; it recited that MERS was acting solely as nominee for the Lender and its successors and assigns. The Millennia note was later sold to Sovereign Bank, but no assignment of the Millennia mortgage to Sovereign was recorded.

In 2006, Landmark filed a petition to foreclose on its mortgage, naming Kesler and Millennia as defendants; it did not name MERS or Sovereign as defendants. Neither Kesler nor Millennia answered the petition, so the trial court entered default judgment against them and ordered the sale of the property at public auction.

Subsequently, Sovereign and MERS filed motions to set aside the default judgment, arguing that MERS was a necessary party to the foreclosure suit. The trial court ruled that MERS was not a necessary party and Landmark was not required to name it as a party to the foreclosure action. Instead, the trial court found that MERS served only as an agent or representative for Millennia. MERS and Sovereign appealed.

The critical issue on appeal was whether the trial court erred by refusing to join MERS as a necessary party to the foreclosure suit. The answer to this question is crucial because Landmark, in seeking to foreclose on its first mortgage, had to give notice to the proper parties in connection with the second mortgage on the property as the foreclosure would wipe out that second mortgage. The Kansas Supreme Court agreed with the trial court that MERS was not a necessary party.

In language evidencing a bit of disdain toward MERS and its role in the mortgage industry, the Court determined that as a nominee, MERS’s relationship to Sovereign, which had purchased the second mortgage from Millennia, was “more akin to a straw man than to a party possessing all the rights given a buyer.” The Court stated that the law generally understands that a mortgagee is not distinct from a lender. It further reasoned that since MERS did not make the loan to Kesler and it was not entitled to receive payments from Kesler, MERS did not really have a stake in the outcome of the foreclosure suit. For good measure, the Court belittled MERS’s role in the process as being merely a digital mortgage tracking service that masks the identity of the current note holder and sidesteps the recording requirements for assignments. Specifically, the Court said that “[i]n attempting to circumvent the statutory registration requirement for notice, MERS creates a system in which the public has no notice of who holds the obligation on a mortgage.” Thus, the Court affirmed the decision of the trial court.

This decision has far-reaching consequences in Kansas and in other judicial foreclosure states whose courts are inclined to agree with and follow this reasoning. If MERS is not a necessary party to a judicial foreclosure action, then there is no assurance that the current note holder will ever get notice of the foreclosure action in time to assert its interest in the subject property. That reality did not seem to be lost on the Kansas Supreme Court, but it appeared as if the Court gave short-shrift to the consequences in light of the role that MERS plays in the mortgage industry.

In any event, as we reported last month, lawsuits challenging MERS’s involvement in the foreclosure process and in the mortgage industry in general are steadily rising, and the results are a mixed bag thus far. We will continue monitoring these suits and will report on significant developments that will undoubtedly affect the mortgage industry as we continue to move through this recession.