PLUNKETT COONEY

The Life and Death of Saurman

January 16, 2012

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Oakland County Bar Association's Laches Magazine

In April 2011, the Michigan Court of Appeals issued the most influential and most controversial opinion on residential mortgage foreclosure law in recent years.

In its opinion in *Residential Funding Co, LLC v. Gerald Saurman*,[1] a consolidated case known as *Saurman*, the appellate court held that Mortgage Electronic Registration Systems (MERS) may not foreclose upon a real estate mortgage using Michigan's extra-judicial advertisement process, as MERS did not fall into one of the enumerated categories of entities authorized to use the foreclosure-by-advertisement process.

In finding that mortgage foreclosures conducted by MERS were *void ab initio*, (null from the beginning and having no effect), *Saurman* upended thousands of foreclosures, derailed post-foreclosure evictions, and called into question countless pending and completed bank-owned property sales (REOs). Given the wide-reaching uncertainty caused by the opinion, leave was sought with the Michigan Supreme Court.

Upon review, in November 2011, the Michigan Supreme Court reversed the judgment of the appellate court and held that MERS can foreclose in its own right under Michigan's foreclosure-by-advertisement laws. In the vernacular of Michigan real estate lawyers, the Supreme Court ruled that MERS is the owner of an interest in the indebtedness, i.e., the ownership of legal title to a security lien whose existence is wholly contingent on the satisfaction of the indebtedness, which means that MERS is authorized to foreclose by advertisement under M.C.L. 600.3204(1)(d).[2] Regardless of whether the end result of *Saurman* is viewed as a correct or incorrect outcome, the Michigan Supreme Court's ruling put an end to great uncertainty.

"In 1993, the MERS system was created by several large participants in the real estate mortgage industry to track ownership interests in residential mortgages. …The initial MERS mortgage is recorded in the County Clerk's office with 'Mortgage Electronic Registration Systems, Inc.' named as the lender's nominee or mortgagee of record on the instrument.

During the lifetime of the mortgage, the beneficial ownership interest or servicing rights may be transferred among MERS members (MERS assignments), but these assignments are not publicly recorded; instead they are tracked electronically in MERS's private system."[3]

The players in the mortgage market set up this system to, among other things, allow for the ease in transferring mortgages without the necessity, and related time and expense, of having to record an assignment of mortgage with the local register of deeds with each transfer. The MERS system improved the accuracy of real estate records, increased the accessibility of information related to real estate transactions, and simplified securitization.

A typical mortgage grants a security interest in real property, given from the property owner/borrower/mortgagor to the lender/mortgagee. However, in a MERS mortgage, the mortgagor grants this security to MERS as "nominee for the Lender." The traditional language in a MERS mortgage states that the borrower "understands and agrees that MERS holds only legal title to the interests granted by Borrower in this Security Instrument, but, if necessary to comply with law or custom, MERS (as nominee for Lender and Lender's successors and assigns) has the right to exercise any or all of those interests, including, but not limited to, the right to foreclose and sell the Property, and to take any action required of the lender, including, but not limited to, releasing or canceling this Security Instrument."

The originating lender's interest in a mortgage is often fleeting, and the lender's interest in the mortgage is often assigned. In many instances, MERS as "nominee for the lender" and not the lender itself, would execute the assignment of mortgage that would ultimately be recorded with the register of deeds.

After a borrower's default, sometimes the mortgage is foreclosed by the originating lender. In other instances, MERS foreclosed mortgages in its own name as nominee for the lender. Other times, a mortgage is assigned in a formal assignment of mortgage from MERS to a new entity that is the foreclosing party.

Sometimes, a mortgage is formally assigned multiple times and foreclosed by the last entity holding the mortgage. Given that it is estimated that between 50 to 60 percent of all of the mortgages nationally are MERS mortgages, it is easy to see how a successful challenge to the MERS system could have a massive impact upon the national real estate market.

As one might expect, given the state of the economy and turbulent real estate markets, mortgage foreclosure law has been hot for a number of years in Michigan and other states. One issue that has been a driving force behind much foreclosure litigation is MERS' ability to foreclose and even its ability to assign mortgages that are a part of the MERS' system.

This issue has been litigated in numerous states around the nation and reached state Supreme Courts in a handful of states. For example, while addressing whether MERS' interest in a property was sufficient to require notice and opportunity to be heard in a foreclosure action, the Supreme Court of Kansas found that MERS' interest was akin to that of a straw man, without ownership of the mortgage instrument or any enforceable right.[4]

The Supreme Court of Arkansas, addressing a similar question, found that "MERS holds no authority to act as an agent and holds no property interest in the mortgaged land" and was, therefore, not a necessary party to the action.[5]

The Minnesota Supreme Court upheld MERS' ability to foreclose based upon a state statute that permits foreclosure by advertisement if "a mortgage is granted to a mortgagee as nominee or agent for a third party identified in the mortgage, and the third party's successors and assigns."[6]

Numerous state appellate courts have also addressed this issue with varied results, some in favor and some against MERS' ability to foreclose by advertisement. However, there is no standard for state laws regarding foreclosure by advertisement – there is no UCC-like guidance or a restatement – so just as the actual laws vary state by state, the decisions of one state court do not necessarily bear on the decisions in other states. Indeed, not all states even permit extra-judicial foreclosures, requiring that all foreclosures proceed through the courts.

Michigan's foreclosure law empowers three categories of entities to foreclose a mortgage by advertisement: an entity with "an interest in the indebtedness," a mortgage servicer, and an owner of the indebtedness. M.C.L. 600.3204(1)(d).

The sole question addressed by the Michigan Court of Appeals in *Saurman* was whether MERS is an entity that qualifies under M.C.L. 600.3204(1)(d) to foreclose by advertisement. Specifically, the case addressed whether MERS held an "interest in the indebtedness," as it was undisputed that MERS was not a mortgage servicer or the owner of the indebtedness. The Court of Appeals found that while MERS held an interest in the underlying real property, "in order to own an interest in the indebtedness, it must have a legal share, title, or right in the [promissory] note."[7] The court held that MERS held no interest in the note itself and, therefore, no interest in the indebtedness and, accordingly, lacked the authority to foreclose.

In his dissent, Judge Wilder concluded that "MERS owned a contractual interest in the indebtedness," and that MERS had the right to take any action required of the lender, including, but not limited to, releasing and canceling the mortgage and, therefore, held an interest in the indebtedness sufficient to satisfy the requirements of M.C.L. 600.3204(1)(d).

When the Court of Appeals ruled in *Saurman*, it immediately derailed pending foreclosure sales and post-foreclosure eviction cases – numerous completed foreclosure sales were voluntarily set aside to allow for re-foreclosure. It also sparked numerous lawsuits that tested the limits of the *Saurman* decision, challenging foreclosures by entities that were assigned a mortgage by MERS, and foreclosures where MERS simply appeared somewhere in the chain of title or was named in the mortgage.

In a typical case, the borrowers/mortgagors argued that since MERS had no authority to foreclose because it was not the "owner of the indebtedness," MERS' assignee could not foreclose because MERS could not assign any rights it did not possess in the first place.

It also triggered other lawsuits that challenged the validity of foreclosures by MERS that had taken place years before. The ramifications of these challenges were staggering. If the foreclosure was void, what about subsequent sales of the property? If a home was foreclosed by MERS years ago and now owned and resided in by an unrelated party, what was the impact on that party's ownership interest and what did it mean for their living situation?

Was there any way to unwind these transactions? Could someone be evicted from a property after a MERS foreclosure, even if the default was undisputed? What about all of the transfer taxes that had been paid?

It also introduced great uncertainty to the REO market in Michigan, causing some title companies to refuse to insure properties that had been foreclosed by MERS or an assignee of MERS, killing prospective sales of unoccupied properties, thereby further depressing Michigan's real estate market. Notably, MERS actually revoked the authority of its members to initiate foreclosures in the name of MERS in all states in July 2011.

However, in November 2011, the Michigan Supreme Court definitively held that MERS was among the entities empowered to foreclose by advertisement under M.C.L. 600.3204(1)(d).

In reversing the Court of Appeals' *Saurman* decision, the Michigan Supreme Court held that MERS "***is the owner ... of an interest in the indebtedness*** secured by the mortgage' ... because [MERS'] contractual obligations as mortgagee were dependent upon whether the mortgagor met the obligation to pay the indebtedness which the mortgage secured." *Saurman* (emphasis added). The Supreme Court elaborated:

[A]s record holder of the mortgage, MERS owned a security lien on the properties, the continued existence of which was contingent on the satisfaction of the indebtedness. This interest in the indebtedness– i.e., the ownership of legal title to a security lien whose existence is wholly contingent on the satisfaction of the indebtedness – authorized MERS to foreclose by advertisement under MCL 600.3204(1)(d).

The Supreme Court's decision in *Saurman* gutted the basis for the lawsuits that challenged foreclosures on the basis of MERS' involvement. It restored confidence to the title insurers sufficient to reactivate the REO market.

With the *Saurman* decision, Michigan law is now clear that MERS can foreclose in its own right in Michigan and so too can its assignees. However, while there is clarity in the mitten state, the law is far from settled in other parts of the country.

Further, any legislative changes to Michigan's foreclosure by advertisement laws–which have already been revised multiple times in recent years to deal with current economic conditions–could also prospectively affect MERS mortgages. While the Michigan Supreme Court's opinion in *Saurman* calmed our local waters for the time being, it by no means settled the residential mortgage foreclosure seas for good.

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[1] *Residential Funding Co, LLC v. Gerald Saurman*, consolidated with *Bank of New York Trust Company v. Corey Messner*, ___ Mich. App. ___ (2011); Mich. Ct. App. Dockets 290248 and 291443 (April 21, 2011).

[2] *Residential Funding Co, LLC v. Gerald Saurman*, Mich. S. Ct. Dockets 143178 and 143179 (November 16, 2011).

[3] *MERSCORP, Inc. v Romaine*, 8 N.Y.3d 90, 96; 861 N.E.2d 81 (2006).

[4] *Landmark National Bank v Kesler*, 289 Kan. 528; 216 P.3d 158 (2009).

[5] *Mortgage Electronic Registration Systems, Inc. v. Southwest Homes of Arkansas, Inc.*, 2009 Ark. 152, at *5; 301 S.W.3d. 1 (2009).

[6] *Jackson v Mortgage Electronic Registration Systems, Inc.*, 770 N.W.2d 487, 491 (Minn. 2009).

[7] *Residential Funding Co, LLC v. Gerald Saurman*, consolidated with *Bank of New York Trust Company v. Corey Messner*, ___ Mich. App. ___, at 5 (2011); Mich. Ct. App. Dockets 290248 and 291443 (April 21, 2011).