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Please Don't Let Me Be MERS-Understood

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Just as in the lyrics for the Animals hit "Please Don't Let Me Be Misunderstood" "MERS" [1] has good intentions, but when "things go wrong I seem to be bad."

In two recent bankruptcy cases, which involved different understandings of MERS role in the bankruptcy and foreclosure process, things did indeed go wrong, but not because MERS was "bad."

In the case of *In re Allman 2010 WL 3366405 (Bkrtcy D. Or.),* the bankruptcy court misconstrued the definition of the word "beneficiary" (as applied to a holder of a note) to disenfranchise MERS as the nominee for the Lender (current beneficiary) in regards to the notice required to MERS under the Deed of Trust. Oregon law requires service of actions on lienholders of record, of which MERS was the nominee. The beneficiary under the Note received actual notice of the action, and the issue was whether MERS should also have been served. The Court is considering amending or withdrawing the opinion that no service was required as to MERS because the service issue was not germane to the substantive issue of priority and subrogation. However, the Court's opinion was emblematic of the confusion over MERS role and consistent and based upon other cases in Kansas, Nebraska and Arkansas that have found MERS to be a "mere bystander" and not deserving of notice.

In a recent contrasting case in California, *In re Walker,* Case No. 10-21656-E-11 (Bankr. E.D. CA), an issue was raised in the context of an Objection to Claim, regarding MERS role. Here the presiding Judge Sargis initially found that "Since no evidence of MERS ownership of the underlying note has been offered, and other courts have concluded that MERS does not own the underlying note, this court is convinced that MERS had no interest it could transfer to Citibank. Since MERS did not own the underlying note, it could not transfer the beneficial interest of the Deed of Trust to another. Any attempt to transfer the beneficial interest of a trust deed without ownership of the underlying note is void under California law."[2]

> ***"In both cases, the Courts, many debtor and creditor attorneys and the public at large do not understand the concept of MERS, leading to overly broad (and narrow) and incorrect statements of MERS' role in the lending, bankruptcy and foreclosure processes."***

In both these cases, the Courts, many debtor and creditor attorneys and the public at large do not understand the concept of MERS, leading to overly

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broad (or narrow) and incorrect statements of MERS' role in the lending, bankruptcy and foreclosure processes. In part this is due to the paucity of the English language, in which the MERS Deeds of Trust have attempted to delineate its hybrid status by referring to itself as a "Nominee" for the Lender (or beneficiary, or current holder) of the Note.

While Courts are familiar with the roles of a foreclosure "trustee" (not to be confused with a *bankruptcy trustee)*, most Courts and attorneys do not know what the role of a "nominee" is or its role as reflected in the sale of Promissory Notes and their successors or assignees.

The *Walker* case is illustrative of this confusion, in that the Debtor attorney filed an Objection to the Claim of Citibank, N.A. for failing to establish that it had "standing" to enforce the Note and Deed of Trust.

When a loan is made to a buyer of real property, the transaction is memorialized in a "Promissory Note" which guarantees a right to payment and states that the property being purchased is security for the right to payment. The "Deed of Trust" or "Mortgage" is recorded in the public records to give everyone notice the property is acting as security for the Note.

Courts have confused the right to receive payments under the note (beneficiary) with the ancillary right held by MERS, which is the beneficial right to receive notice.[3]

In *Walker*, the Court took the Debtor's objection to claim at face value, and because of improper service, the Court was not apprised of the actual facts as to standing.

In bankruptcy proceedings, state substantive law controls the rights of note and lienholders, and under the California Commercial Code, "the person entitled to enforce an instrument means (a) **the holder of the instrument,** (b) a nonholder in possession of the instrument who has the rights of a holder, or (c) a person not in possession of the instrument who is entitled to enforce the instrument pursuant to Section 3309 or subdivision (d) of Section 3418. (emphasis added).

In addition, Cal. Com. C Section 3201 provides in pertinent part:

a. "Negotiation" means a transfer of possession, whether voluntary or involuntary, of an instrument by a person other than the issuer to a person who thereby becomes its holder.

b. Except for negotiation by a remitter, **if an instrument is payable to an identified person, negotiation requires transfer of possession of the instrument and its indorsement by the holder.** If an instrument is payable to bearer, it may be negotiated by transfer of possession alone. (emphasis added).

In other words, for a new beneficiary to become entitled to the right to receive payments, the holder of the Note must (1) transfer possession of the Note; (2) **indorse the Note to the transferee (the new beneficiary) or in blank**.

The new beneficiary (or holder) may also convert a blank indorsement that consists only of a signature from the original lender or prior beneficiary into a special indorsement by writing, above the signature of the indorser, words identifying the person to whom the instrument is made payable. Cal. Com. Code Section 3205(c).

It is this trail of the Note that is most misunderstood when Courts or Debtor attorneys review the public records for evidence as to the current holder of the Mortgage or Deed of Trust.

For instance, in *Walker,* Bayrock Mortgage was the original lender that indorsed the Note in blank to EMC. This made the Note "bearer" paper but tangled the ownership of the Note into a Master Servicer Agreement, and convoluted the assignment of the bearer paper, so that ultimately EMC as the Trustee of a Trust, caused Citibank's name to be inserted in the "blank" indorsement, turning bearer paper into one that was "specially indorsed" so that the whole chain could again start.

As to the Deed of Trust, California Civ. Code Section 2936 provides that "assignment of a debt secured by a mortgage carries with the security."

Thus, under California law, any transfer of the Note necessar-

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ily transfers the Deed of Trust *without the need for any formal assignment.*[4]

The recent meltdown in property values and on Wall Street have caused greater scrutiny of the actual parties entitled to payments in the bankruptcy and in the foreclosure context, the entity who is entitled to foreclose for delinquent payments.

Prior to the meltdown, many courts found that MERS may act as a "beneficiary" of the Deed of Trust on behalf of the lender. Tellingly, under MERS, the lender still retains its legal and equitable rights in both the Note and Deed of Trust, but MERS acts on behalf of the current Lender in both the bankruptcy and foreclosure arenas as long as its role is described and understood.

MERS acts as a "nominee" for the beneficiary and as an agent. As a nominee, there is no split or transfer between the current holder/beneficiary's rights as a holder of the Note and the Deed of Trust that has followed the Note in its assignment.[5]

The issue of whether a Note and Deed of Trust can "part ways" and destroy the right to collect on the Note for the Lender is the Holy Grail for debtor bankruptcy attorneys but occurs much less often than is commonly understood. Specifically, under California law there is no split as long as the paper (the Note) is either bearer paper (indorsed in blank) or "specially indorsed" (a holder names the assignee who becomes the new holder) because under California law (and many states) the "mortgage/deed of trust" follows the Note without the need of an assignment.

It is only at the time of foreclosure, that MERS as the entity/nominee acting on behalf of the Lender may either foreclose in the name of MERS or assign the right to foreclose to the current "beneficiary."

As this review of the current understanding of the MERS process reflects in several bankruptcy courts, MERS is "just a soul whose intentions are good," [6] and the creditor attorneys in those cases would certainly request that the Courts not misunderstand the role of MERS as a beneficiary, and nominee of the Lender in the bankruptcy and foreclosure process.

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1 Mortgage Electronic Registration Systems, Inc.," will be referred throughout as "MERS", its colloquial name.

2 Judge Sargis has since amended his minute order to clarify that the beneficiary of the Note can transfer such an interest under California law which is what actually occurred.

3 In bankruptcy court, the right to receive payments as a "beneficiary or holder of a note" is a key issue for standing in Motions for Relief from the Automatic Stay. In the Allman case cited above, the issue was not the right to receive payments as a beneficiary as that was not in dispute, but rather the right to receive notice as a beneficiary under the Deed of Trust. Most fascinating in the Allman case was that MERS was the nominee for two different lenders in what ultimately is a factual dispute revolving around subordination and race-notice under Oregon law.

4 See also Restatement (Third) of Property (Mortgages) Section 5.4 (citing *Carpenter v. Longan*, 83 U.S. 271, 275 (1873).

5 See, *In re Tucker*, 10-61004 (Western District of Missouri) for a thorough discussion of the process and relationship of MERS to the Note and Deed of Trust under Missouri law which is too lengthy to include here.

6 Per Wikipedia, "Don't Let Me Be Misunderstood" is a song written by Bennie Benjamin, Gloria Caldwell and Sol Marcus for the singer/pianist Nina Simone, who first recorded it in 1964. Probably the most well known version is the one quoted here, from the "Animals" single released January 1965(U.K) and February 1965 (U.S.)

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