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All in One Basket: The Bankruptcy Risk of a National Agent-Based Mortgage Recording System

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Mortgage Electronic Registration Systems, Inc. (“MERS, Inc.”) owns legal title to some thirty million mortgages in the United States via its role in the Mortgage Electronic Registration System (“MERS”). The company,

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which was a key part of the mortgage securitization apparatus in the late 1990s and 2000s, is now under intense pressure from public and private lawsuits and investigations and faces a very real threat of insolvency. Policymakers are looking ahead to potential replacements for MERS, as a recent Fed staff proposal for a substitute system indicates. This Article examines what might happen to the mortgages that MERS, Inc. at least nominally owns in the event that the company enters bankruptcy, a question that apparently has never been explored in a publicly available analysis.

Although the legal analysis underlying the design of MERS does not appear to be publicly available, a key assumption seems to have been that if the company ever entered bankruptcy, the mortgages in its hands would not enter the company's bankruptcy estate and would not be available to creditors. This Article challenges that assumption, pointing to the broad authority the Bankruptcy Code confers on the bankruptcy trustee with respect to interests in real property, such as mortgages. Most courts that have considered the issue have found that the bankruptcy trustee can bring into the estate any real property interest that the debtor could have conveyed to a good-faith purchaser. There is a risk that MERS, Inc. can convey MERS mortgages to a purchaser acting in good faith.

The risk arises in large part from the company's conduct in making and acquiescing in claims in court that the company can sell the mortgages, has constitutionally protected property interests in the mortgages, is a creditor of mortgage borrowers, and owns a beneficial interest in the mortgages. But under current law, part of the risk is inherent in any mortgage recording system that operates nationally, is subject to the Bankruptcy Code, and holds mortgages as an agent. Policymakers should give serious consideration to creating a transparent, authoritative national mortgage registry with a solid legal foundation, and should consider the bankruptcy risk we identify as they do so.

TABLE OF CONTENTS

INTRODUCTION	3
I. MERS, MORTGAGE SECURITIZATION, AND BANKRUPTCY	8
A. MERS and Mortgage Securitization	8
B. Securitization and Bankruptcy	15
C. The Threat of MERS, Inc. Bankruptcy	18
II. TREATMENT OF MERS MORTGAGES IN BANKRUPTCY.....	22
A. The MERS, Inc. Bankruptcy Trustee Probably Could Bring into the Bankruptcy Estate Any Mortgages That MERS, Inc. Could Convey to a Good-Faith Purchaser.....	22
B. There Is a Risk That MERS, Inc. Can Convey the	

	<i>Mortgages Recorded in its Name to a Bona Fide Purchaser, Either as Owner or as Agent</i>	34
	1. MERS, Inc. as Mortgage Owner	34
	2. MERS, Inc. as Agent: The Power to Exercise “Any or All” Rights of the Lender	37
C.	<i>MERS, Inc. as Hybrid Owner-Agent Under Section 544(a)(3)</i>	43
	1. Policies Underlying Section 544(a)(3): Avoiding “Ostensible Ownership” Problems and Encouraging Use of the Recording System	44
	2. Creditors’ Ability to Reach Property Held for Principal	45
	3. Estoppel to Deny MERS, Inc.’s Authority to Convey Mortgages	47
	4. Countervailing Policy Arguments: MERS Is Efficient, and in Any Event “Too Big to Fail”	48
D.	<i>The Proposition that “the Mortgage Follows the Note” Does Not Remove the Risks Posed by MERS, Inc. Bankruptcy</i>	49
III.	BANKRUPTCY OF MERS VERSUS BANKRUPTCY OF THE TRUSTEE OF AN EXPRESS TRUST	54
IV.	POTENTIAL SOLUTIONS	58
	CONCLUSION.....	63

INTRODUCTION

Some thirty million mortgages in the United States¹ are owned, nominally at least, by a company known as “MERS, Inc.”² that has no employees and no purpose other than owning legal title to mortgages as an agent for others.³ Since the beginning of the foreclosure crisis, this

¹ TESTIMONY OF R.K. ARNOLD, PRESIDENT AND CEO OF MERSCORP, INC. BEFORE THE SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY, HOUSE FINANCIAL SERVICES COMM., at 11 (Nov. 18, 2010) [hereinafter Arnold Testimony] (“Since [MERS’s] establishment in 1997, about 66 million loans have been registered and tracked on the MERS® System. About half of those loans (about 31 million) are active mortgage loans.”).

² The legal name of the entity we call “MERS, Inc.” is “Mortgage Electronic Registration Systems, Inc.” MERS, Inc. is a subsidiary of MERSCORP, Inc., a privately held corporation. MERSCORP, Inc.’s owners are major participants in the mortgage industry.

³ See Deposition of William Hultman, Secretary & Treasurer of MERS, Inc., April 7, 2010, at 31 [hereinafter Hultman Depo.] (stating that MERS, Inc. is a “single purpose corporation that was incorporated for the sole purpose of holding title to the mortgage”); *id.* at 69-72 (noting that MERS, Inc. has no employees, and operates

entity has come under increasing pressure from public and private lawsuits and investigations, and many informed observers have begun to wonder whether it will find itself compelled to file for bankruptcy. Nobody doubts that bankruptcy could be a calamity, although exactly what sort of calamity is a question that has not been fully explored. In particular, there is the matter of whether the mortgages to which MERS, Inc. has at least nominal title would pass into the company's bankruptcy estate and become available to satisfy creditors' claims. There is a presupposition that these mortgages cannot become part of the bankruptcy estate.⁴ This Article examines this presupposition, concluding that it is at least too hasty and may very well be wrong. In fact, there are straightforward arguments that the mortgages would pass to the bankruptcy trustee and become property of the estate. Even if these arguments do not in the end prevail, they are plausible enough to raise grave concerns among policymakers and investors. Any replacement for MERS should be designed with these concerns in mind.

The Mortgage Electronic Registration System, known as "MERS," is a nationwide electronic mortgage registry that is supposed to track mortgage ownership and obviate recording of mortgage assignments with local authorities. MERS is operated by a company called MERSCORP Holdings, Inc.⁵ ("MERSCORP") that is owned by the mortgage industry,⁶ and MERS, Inc. is a single-purpose subsidiary of MERSCORP that holds legal title to the thirty million mortgages registered on MERS.⁷ The system has drawn intense attention during the foreclosure crisis because mortgage borrowers frequently contest the issue of mortgage ownership. Some of the most widely read law review articles of the past few years criticize MERS.⁸ Most of this

through thousands of officers employed by other parties).

⁴ See discussion *infra* Part I. B.

⁵ The mortgage registry, MERS, apparently is operated by MERSCORP, the parent company of MERS, Inc. See Hultman Depo., *supra* note 3, at 29-31 (stating that MERS, Inc. is a "single purpose corporation that was incorporated for the sole purpose of holding title to the mortgage"). "MERSCORP Holdings, Inc." is the current name of the company formerly called "MERSCORP, Inc." See e-mail from Karmela Lejarde to John Patrick Hunt (May 24, 2012, 3:54 p.m.) (on file with author).

⁶ Arnold Testimony, *supra* note 1, at 1 n.1 (identifying principal owners of MERSCORP, Inc. as the Mortgage Bankers Association, Fannie Mae, Freddie Mac, Bank of America, Chase, HSBC, Citimortgage, GMAC, American Land Title Association, and Wells Fargo). MERSCORP, Inc. is the corporate parent of Mortgage Electronic Registration Systems, Inc. ("MERS, Inc."). MERSCORP, Inc. operates the MERS system. *Id.* at 8 n.8.

⁷ See Hultman Depo., *supra* note 3, at 31.

⁸ See, e.g., Tanya Marsh, *Foreclosures and the Failure of the American Land Title System*, 111 COLUM. L. REV. SIDEBAR 19, 24 (2011) ("The residential foreclosure crisis

criticism comes from the standpoint of mortgage debtors and examines how MERS's deficiencies may create defenses for homeowners facing foreclosure.⁹ Critics writing in this vein also often take the part of local land recording authorities, pointing to fees lost due to the use of MERS.¹⁰ MERS also has its defenders, who emphasize

has brought MERS's flaws into clearer view. The inherent opaqueness of MERS has apparently hidden from public view some rather shoddy recordkeeping practices on the part of the lenders.”); Christopher L. Peterson, *Foreclosure, Subprime Mortgage Lending, and the Mortgage Electronic Registration System*, 78 U. CIN. L. REV. 1359, 1407 (2010) [hereinafter *Foreclosure and MERS*] (“the judiciary has an obligation to aggressively reexamine our financiers’ cut corners, false assumptions, and jaundiced legal theory”) (downloaded 4,790 times on SSRN as of Nov. 5, 2012); Christopher L. Peterson, *Two Faces: Demystifying the Mortgage Electronic Registration System’s Land Title Theory*, 53 WM. & MARY L. REV. 111, 120, 160 (2011) [hereinafter *Two Faces*] (arguing that MERS maintains an “incoheren[t]” legal position that is “exacerbated by a corporate structure that is so unorthodox as to be considered arguably fraudulent” and comparing MERS, Inc. and the members of MERS to mythological figures such as Icarus who committed the “vital sin” of “hubris”) (downloaded 7,022 times on SSRN as of Nov. 5, 2012); Nolan Robinson, *The Case Against Allowing Mortgage Electronic Registration Systems, Inc. (MERS) to Initiate Foreclosure Proceedings*, 32 CARDOZO L. REV. 1621, 1653-54 (2011) (“While the MERS system may be a ‘commercially effective means of business,’ it runs afoul of established foreclosure law, and courts should rule accordingly.”); David P. Weber, *The Magic of the Mortgage Electronic Registration System: It Is and It Isn’t*, 85 AM. BANKR. L.J. 239, 240 (2011) (arguing that use of MERS results in lack of transparency, insulation from damages of mortgage originators who may have engaged in fraud, and propagation of “a false dichotomy where MERS . . . can claim to be the mortgagee when that status is to its benefit, while simultaneously disclaiming that role when it sees fit”); Dustin A. Zacks, *Standing in Our Own Sunshine: Reconsidering Standing, Transparency, and Accuracy in Foreclosures*, 29 QUINNIPIAC L. REV. 551, 552 (2011) (“MERS’s arguments to courts are so numerous and contradictory as to make pinning down one core theory of standing impossible.”).

⁹ See Peterson, *Foreclosure and MERS*, *supra* note 8, at 1407 (“[T]here is a compelling argument that loans where MERS is recorded as the original mortgagee should be avoidable by bankruptcy trustees in many states.”); Peterson, *Two Faces*, *supra* note 8, at 141-43 (arguing that mortgages that name MERS as the original mortgagee are invalid because they do not name the true mortgagee, and that courts should respond by converting mortgages recorded on MERS into “equitable mortgages,” which would give borrowers “significant leverage”); Alan M. White, *Losing the Paper – Mortgage Assignments, Note Transfers and Consumer Protection*, 24 LOY. CONSUMER L. REV. 468, 488 (2012) (“[T]he ability of any MERS member to alter the mortgage ownership information more or less at will may lead courts to become increasingly reluctant to recognize MERS assignments as a valid basis for a foreclosure sale.”); Elizabeth Renuart, *Property Title in Trouble in Non-Judicial Foreclosure Sales: The Ibanez Time Bomb?* 29 (Feb. 21, 2012) (unpublished manuscript) available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1968504 (“The mere presence of MERS in a mortgage loan transaction increases the likelihood of legal challenges to the authority to foreclose.”).

¹⁰ See Peterson, *Foreclosure and MERS*, *supra* note 8, at 1403 (“MERS is usurping the recording fees that once funded maintenance, innovation, and vigilance in public

the cost and time savings the system offers its users.¹¹ This Article does not take the perspective of mortgage debtors, foreclosing lenders or mortgage services, or title recording authorities. Instead, it addresses MERS from the standpoint of economic policymakers and mortgage investors.

MERS may or may not prevail in its nationwide battle with mortgage borrowers. Even if it does, investors and policymakers should be concerned by the fact that nominal ownership of thirty million mortgages is centralized in a shell entity. In fact, as this Article demonstrates, the efforts of MERS and its members to win the foreclosure wars have increased the risk that a MERS, Inc. bankruptcy poses to investors, financial markets, and the economy.

The reason that MERS mortgages are so vulnerable to bankruptcy is that the Bankruptcy Code, as interpreted by most courts, confers broad power on the bankruptcy trustee to bring real property interests such as mortgages into the bankruptcy estate, subjecting them to bankruptcy court jurisdiction and potentially making them available to satisfy creditors' claims. Specifically, the bankruptcy trustee probably can bring into the estate under Section 544(a)(3) of the Code any real property interests the debtor could convey to a good-faith purchaser.¹² Two factors combine to create a risk that a court would find that MERS, Inc. could convey MERS mortgages to a good-faith purchaser: the company's status as a hybrid owner/agent and the claims of extensive power over mortgages made on the company's behalf over the past few years in litigation.

recordkeeping systems."); Peterson, *Two Faces*, *supra* note 8, at 115-17; Robinson, *supra* note 8, at 1625 ("foreclosure actions brought in MERS's name, without joining the real party in interest, are unlawful"); Weber, *supra* note 8, at 240 (noting "loss of millions of dollars to the counties from recording"). See also *MERSCORP, Inc. v. Romaine*, 861 N.E.2d 81, 88-89 (N.Y. 2006) (Kaye, J., dissenting in part) (noting New York county clerks' concern about revenue loss).

¹¹ See Gerald Korngold, *Legal and Policy Choices in the Aftermath of the Subprime and Mortgage Financing Crisis*, 60 S.C. L. REV. 727, 742-43 (2009) (arguing that MERS "facilitates an efficient secondary market in mortgages" by permitting transactions to be accomplished "quickly at a low cost" and that courts and legislatures should address concerns about "residential owners losing their homes" and "hard-pressed borrowers in general" directly, rather than through rulings on MERS). Although Zacks criticizes MERS's self-contradictory theories of standing, he concludes that the system should be improved rather than terminated. Zacks, *supra* note 8, at 554 (asserting that "the best solution to the problems raised by widespread use of MERS is . . . to bolster its information-storing capability by forcing it to store actual electronic documents that were previously recorded at the local recording level, such as mortgages and assignments," so that MERS can become "a modern alternative to outdated and inefficient recording practices").

¹² See discussion *infra* Part II. A.

If MERS, Inc. were to enter bankruptcy and MERS mortgages were to enter the bankruptcy estate, some reasonable people might applaud the result. After all, the claimants by hypothesis would be public and private entities who have won judgments and levied fines against MERS, Inc. because they have prevailed on claims that the company engaged in wrongdoing.¹³ The losers would be investors who chose to invest in MERS mortgages and who by and large have a more voluntary relationship with the company.¹⁴ Although many investors in mortgage-backed securities are pension funds set up for rank-and-file employees, the claimants might as a group be more appealing than the investors. Indeed, that probably increases the likelihood that the claimants would prevail.

Although reasonable people could differ on whether MERS mortgages ought to enter the bankruptcy estate, there can be little doubt either that this result would represent a failure in MERS's design or that it would be a most significant development. It would be important because investors in MERS mortgages include the nation's largest banks, those highly leveraged institutions treated as indispensable to financial stability.¹⁵ Placing MERS mortgages under the administration of the bankruptcy court would create market uncertainty, and forcing investors to share the value of MERS mortgages has implications for financial stability. The fact is that sums probably running into the trillions of dollars¹⁶ have been invested on the implicit assumption that MERS mortgages would not enter MERS,

¹³ See discussion *infra* Part I. C.

¹⁴ Some mortgage-backed security investors are protected from certain types of loss because they have entered into credit default swaps. See, e.g., Christine Hurt, *Regulating Compensation*, 6 OHIO ST. ENTREPRENEURIAL BUS. L.J. 21, 27 (2010) ("The purchasers of [mortgage-backed] securities also entered into credit default swaps."). It is conceivable that these arrangements could protect investors in the event of MERS bankruptcy. Terms of individual credit default swaps typically are not public, and we express no further opinion on the subject.

¹⁵ See, e.g., FINANCIAL STABILITY BOARD, *Policy Measures to Address Systemically Important Financial Institutions*, Nov. 4, 2011, at 4 (listing "financial institutions whose distress or disorderly failure . . . would cause significant disruption to the wider financial system and economic activity").

¹⁶ This figure is an estimate. The Federal Reserve reports \$10.18 trillion in outstanding mortgage debt as of the first quarter of 2012. BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *FLOW OF FUNDS ACCOUNTS OF THE UNITED STATES L.218* (June 7, 2012) [hereinafter *FLOW OF FUNDS*]. If MERS has even 20% of the total, that would be \$2 trillion. Similarly, if the thirty million mortgages recorded on MERS have an average balance of \$66,666, then MERS mortgages have an aggregate balance of \$2 trillion.

Inc.'s bankruptcy estate.¹⁷ It is worth understanding the merits of this assumption, whether we like the results or not.

MERS as it currently exists is uniquely vulnerable to the problems identified here due to its history, but the issues raised in this Article attend any entity that conveys title to mortgages as an agent and can enter bankruptcy. Policymakers should take them into account in the ongoing discussion of the land title recording system in the United States. For example, the Federal Reserve's staff has suggested creating a national lien recording system,¹⁸ and scholars have expressed support for the idea.¹⁹ The proposal as it stands does not prescribe any specific legal form for the registry, but if the proposal moves forward it should take into account the risks of holding mortgages in an agent that can enter bankruptcy.

Part I of this Article explains MERS's pivotal role in the mortgage securitization markets, explores the effects of a finding that MERS owns the mortgages registered in its name, and demonstrates the risk that MERS, Inc. could become insolvent and seek bankruptcy protection. Part II explains the legal arguments that MERS mortgages could enter the MERS, Inc. bankruptcy estate. Part III contrasts the case of a MERS, Inc. bankruptcy with the bankruptcy of the trustee of an express trust, and Part IV explores alternatives to MERS.

I. MERS, MORTGAGE SECURITIZATION, AND BANKRUPTCY

A. MERS and Mortgage Securitization

As of November 2010, over thirty million mortgages,²⁰ around half of the mortgage loans then active in the United States,²¹ reportedly were recorded in MERS, Inc.'s name. The system has in its fifteen years of existence²² become a central part of the nation's housing finance infrastructure.

MERS owes its ascent to mortgage securitization, a practice that places a premium on streamlining mortgage transfers.²³ The typical

¹⁷ See discussion *infra* Part I. B.

¹⁸ See BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, THE U.S. HOUSING MARKET: CURRENT CONDITIONS AND POLICY CONSIDERATIONS 24-25 (2012) [hereinafter U.S. HOUSING MARKET].

¹⁹ See White, *supra* note 9, at 498; Marsh, *supra* note 8, at 24-26.

²⁰ Arnold Testimony, *supra* note 1, at 1.

²¹ *Id.* at 10.

²² *Id.* at 11 (MERS established in 1997).

²³ See INTERAGENCY TECHNOLOGY TASK FORCE, WHOLE LOAN BOOK ENTRY CONCEPT FOR THE MORTGAGE FINANCE INDUSTRY II-1 (1993) ("Today, the process for transferring

“private label”²⁴ mortgage securitization involves the transfer of several thousand mortgages, usually from different parts of the country,²⁵ to a “special purpose vehicle” or “SPV,” usually a trust, that issues certificates to investors. In the typical transaction from the 2000s, each mortgage was transferred several times in the course of the deal: from the originator to an entity called a “sponsor,” thence to another entity called a “depositor,” and finally to the trust.²⁶ A single mortgage securitization transaction thus would require that tens of thousands of individual mortgage transfers be completed in a short time.²⁷ The arrows in Figure 1 starting with “Borrower” and passing

and tracking mortgage rights is paper-intensive, time-consuming, and costly. A major portion of these costs stem from the need to prepare, record, and manage physical assignment documents that are required to evidence interests in mortgages.”); Phyllis K. Slessinger & Daniel McLaughlin, *Mortgage Electronic Registration System*, 31 IDAHO L. REV. 805, 808 (1995) (“The establishment of MERS will greatly simplify a terribly cumbersome, paper-intensive, error-prone, and therefore costly process for transferring and tracking mortgage rights.”). This law review article is important for understanding MERS’s genesis because the authors were the Senior Director, Secondary Market & Investor Relations, and the Director of Technology Initiatives at the Mortgage Bankers Association while MERS was planned and they appear to have been involved in its creation. *Id.* at 805.

²⁴ Many mortgage securitizations are carried out by the government-sponsored housing enterprises (GSEs), Fannie Mae and Freddie Mac. The term “private label” refers to securitizations that are not carried out through this channel. Private-label mortgage securitization was quite common in the 2000s, but has nearly ground to a halt since the 2008 financial crisis. GSE securitizations have a somewhat different structure from private-label securitizations, but the multiple-transfer problem exists there as well. See John Patrick Hunt et al., *U.S. Residential-Mortgage Transfer Systems: A Data-Management Crisis*, in HANDBOOK OF FINANCIAL DATA AND RISK INFORMATION, prepublication draft at 16-25 (Margarita Brose et al. eds., 2012).

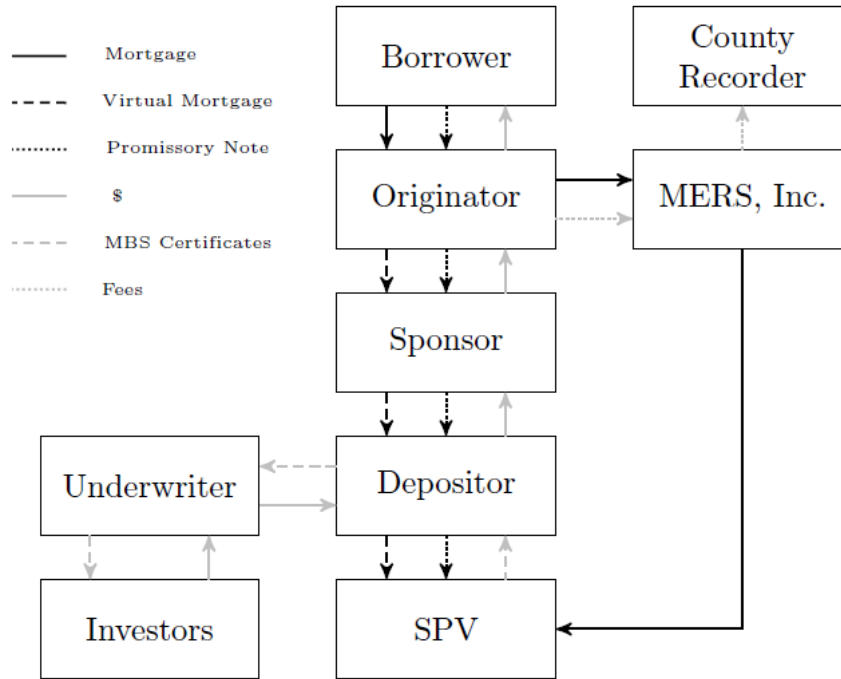
²⁵ See GSAMP Trust 2006-HE3, Prospectus Supplement for Mortgage Pass-Through Certificates (Sept. 7, 2006), at S-40 (describing mortgage pool for one transaction as containing 10,736 mortgage loans with aggregate principal balance of \$1.6 billion, with no more than 0.23% of the loans secured by properties in any one area).

²⁶ The apparently superfluous sponsor-depositor step appears to have its origins in accounting rules adopted in the early 2000s. See FINANCIAL ACCOUNTING STANDARDS BOARD [hereinafter FASB], STATEMENT OF FINANCIAL ACCOUNTING STANDARDS NO. 140 [hereinafter FAS 140] § 9 (2000); FASB TECHNICAL BULLETIN NO. 01-1 (2008); Deloitte & Touche, *Learning the Norwalk Two Step*, HEADS UP, Apr. 25, 2001, at 4; Marty Rosenblatt, Jim Johnson, & Jim Mountain, *Securitization Accounting: The Ins and Outs (And Some Do’s and Don’ts) of FASB 140, FIN 46R, IAS 39 and More* (2005).

²⁷ Tax rules governing the typical mortgage securitization vehicle, the Real Estate Mortgage Investment Conduit (“REMIC”) impose a 100% tax on contributions to the vehicle more than three months after the vehicle’s startup date. See 26 U.S.C. § 860G(d) (2012).

through the intermediate entities to “SPV” indicate the path the mortgage would have to travel in a typical securitization.

Figure 1: Mortgage and Promissory Note Transfer with Traditional Recording



State recording statutes often can be interpreted to provide that if a mortgage transfer is not recorded, the transferee is vulnerable to competing claims.²⁸ States generally maintain land records at the county level, so recording a mortgage assignment historically entailed dealing with an official in the county where the property was located (and paying a fee). County recorders and clerks reportedly are often short on resources and have backlogs of work, so that recording, say,

²⁸ For example, if A were to assign the mortgage to B, who did not record its interest, and then transfer the same mortgage to C, who did record its interest, C could prevail over A. See 14 RICHARD R. POWELL ET AL., POWELL ON REAL PROPERTY § 82.02[1][b] (2011); GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW 456 (5th ed. 2007) (recording acts apply to mortgage assignments in “all but a very few jurisdictions”); Renuart, *supra* note 9, at 20 (“[T]he transfer of the mortgage generally is covered by the state law of conveyance and real property.”).

30,000 mortgage assignments in 1,000 different counties in 60 days would have been a daunting task.²⁹ MERS was intended to ease the burden on securitization arrangers by tracking mortgage assignments in an electronic database. As the system evolved over time, MERS came to play the role of the mortgagee as well as that of a mere tracking system.³⁰ The original lender would record the original mortgage in county records in MERS's name, and subsequent assignments would be tracked on the electronic system rather than recorded in states' official records.³¹ Figure 2 illustrates this process. The arrow from "Borrower" to "MERS, Inc." represents the fact that MERS, Inc. is recorded as the legal owner of the mortgage, as nominee on behalf of the originator. Subsequent transfers are not recorded, other than in MERS, Inc.'s database. The broken arrows in Figure 2 represent this. In the event of foreclosure, under current practice MERS, Inc. records an assignment of the mortgage to the servicer or other agent of the SPV, although in the past MERS, Inc. has foreclosed in its own name.³²

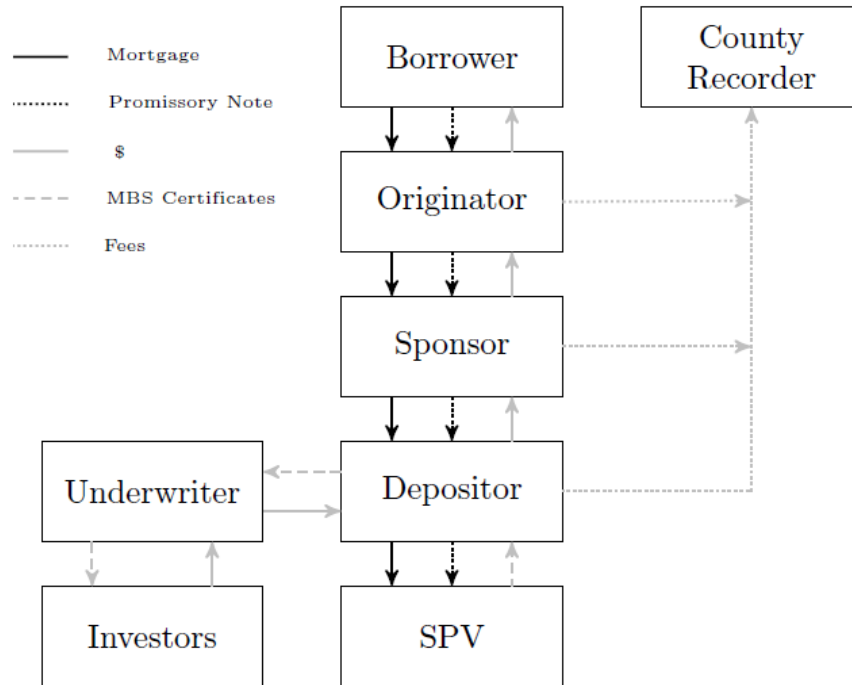
²⁹ See Arnold Testimony, *supra* note 1, at 18 ("[A]t certain time periods, the flow of assignments [was] overwhelming the county recorder system, resulting in long backlogs, and in some cases, taking the county recorded over a year to record an assignment.").

³⁰ See *id.* at 16-20 (describing use of MERS to track mortgage assignments).

³¹ In this situation, where MERS, Inc. is the original mortgagee, the mortgage is known as a "MOM" mortgage. In other situations, the original lender may assign the loan to MERS, Inc. Figure 2 and the text describe a situation where MERS, Inc. is the original mortgagee.

³² See *In re Tucker*, 441 B.R. 638, 644 (Bankr. W.D. Mo. 2010) (summarizing testimony of MERS, Inc. officer: "MERS members often wait until a default or bankruptcy case is filed to have a mortgage or deed of trust assigned to them so that they can take steps necessary to seek stay relief and/or to foreclose."). Historically, MERS, Inc. frequently foreclosed in its own name. See *infra* Parts II. B, II.C. After a rule change last summer, MERS, Inc. no longer forecloses in its own name. MERS rules now provide that the mortgage must be assigned from MERS to a servicer in a recorded assignment before foreclosure can proceed. See MERS SYSTEM RULES OF MEMBERSHIP, Rule 8.

Figure 2: Mortgage and Promissory Note Transfer with MERS Recording



Although MERS undoubtedly seemed like a simple and attractive solution for the industry — hence its widespread adoption — there is little publicly available evidence that it was carefully designed to take account of widely varying state laws relating to mortgage recording, foreclosure procedure, and the legal form of mortgages.³³ The

³³ For example, the 1993 white paper that presented the MERS concept devoted two of its thirty-six pages to discussing the legal and regulatory framework for the system. The paper states that MERS “is essentially designed to be capable for implementation within the current legal framework” but does not treat differences among the states’ laws or address potential insolvency of the legal entity operating the system. See INTERAGENCY TECHNOLOGY TASK FORCE, *supra* note 23, at III-11 to III-13 (asserting that the MERS concept “is essentially designed to be capable for implementation within the current legal framework”). R.K. Arnold testified to Congress that “[a] review of the use of MERS in all fifty states was done by Covington and Burling in 1996 and 1997 as part of the due diligence associated with the creation of MERS. It is available upon request.” Arnold Testimony, *supra* note 1, at 20 n.16. One of the authors requested this document using the automated “Contact Us” feature of the mersinc.org website on January 3, 2012, and via phone and e-mail on several

mortgage crisis has brought MERS's potential deficiencies to the fore, as the foreclosure defense and consumer bankruptcy bars have raised myriad questions about MERS's legal and technical sufficiency under the laws of states across the country.³⁴

It is difficult to generalize about the overall trend in the hundreds, if not thousands, of reported foreclosure defense cases involving MERS,³⁵ and MERS certainly has suffered some important defeats.³⁶

subsequent occasions. A MERS representative responded on May 18, 2012 by telephone, telling the author that the study would be sent on May 21. On May 22, MERS's representative informed the author that the study would not be provided after all because it is "out of date" and because Arnold's representation that it would be provided on request "was for the legislators' use if they wished to see a copy of it." E-mail from MERSCORP employee to John Patrick Hunt (May 22, 2012, 9:41 a.m.) (on file with author).

³⁴ For an overview of legal challenges to MERS, see Shelby D. Green, *MERS: Its Standing and Future: Old and New Challenges*, Oct. 24, 2012 (CLE presentation on file with authors). Although the most salient accusations against MERS are that it degrades land records and promotes fraud because it apparently has been quite easy to become an officer of MERS, Inc. and make entries on the registration system, homeowner challenges to MERS have focused on technical issues such as whether MERS splits mortgage and note or whether its status as "nominee" confers sufficient authority on the company to assign or foreclose on mortgages. See discussion *infra* Part II. B.

³⁵ A search on the terms "MERS and foreclosure" in the ALLCASES database on Westlaw on Dec. 11, 2012 returned 3,590 documents.

³⁶ The Supreme Court of Washington has concluded that MERS, Inc. is not a lawful beneficiary of a deed of trust under Washington law unless it holds the note, seemingly holding that MERS cannot perform its core function. See *Bain v. Metropolitan Mortg. Grp., Inc.*, 285 P.3d 34, 36-37 (Wash. 2012) ("CERTIFIED QUESTIONS: 1. Is Mortgage Electronic Registration Systems, Inc., a lawful 'beneficiary' within the terms of Washington's Deed of Trust Act . . . if it never held the promissory note secured by the deed of trust? [Short answer: No]" (brackets in original)). Other courts have questioned whether MERS can be simultaneously both deed of trust beneficiary (or mortgagee) and agent. See *Joseph v. Bank of Am., No. CV-11-129-RLG-RFC-CSO*, 2012 WL 2804859, at *8-*12 (D. Mont. Apr. 23, 2012) (MERS not beneficiary under applicable Montana nonjudicial foreclosure statute); *Citimortgage, Inc. v. Barabas*, 975 N.E.2d 805, 817-18 (Ind. 2012) ("[W]e do not believe that the authors of this statute, writing in 1877, would have understood the term 'mortgagee' to refer to an entity like MERS that neither holds title to the note nor enjoys a right of repayment."). *Niday v. GMAC Mortg., LLC*, 284 P.3d 1157, 1167 (Or. Ct. App. 2012), *pet'n for review granted*, No. S060655 (Or. Sept. 27, 2012) ("[D]efendant's suggestion that a nominee or agent might hold 'legal title' as a 'beneficiary' of a trust deed finds no support in the [Oregon Trust Deed Act] or Oregon case law . . . Despite referring to MERS as the beneficiary, the trust deed designates GreenPoint as the party to whom plaintiff, the borrower, owes the obligation secured by the trust deed . . . GreenPoint, the lender, is therefore the 'beneficiary' of the trust deed."). The Supreme Judicial Court of Maine has made rulings adverse to MERS's basic foreclosure-related legal theories. See *HSBC Bank USA v. Gabay*, 28 A.3d 1158, 1165 (Me. 2011) (rejecting MERS's claim to be able to assign

But if anything the trend in foreclosure litigation appears to be in MERS's favor, both in state supreme courts³⁷ and in federal cases accusing MERS, Inc. of wrongful foreclosure,³⁸ even as law

note along with mortgage); *MERS, Inc. v. Saunders*, 2 A.3d 289, 300-01 (Me. 2010) (holding that MERS lacks standing to foreclose because it lacks an interest in the promissory note). Apparently in response to rulings like this, MERS, Inc. no longer forecloses in its own name. Other state supreme courts have held that when a mortgage is recorded on MERS, a foreclosure based on *another* mortgage on the same property can go forward without MERS, Inc.'s participation. See *MERS, Inc. v. Southwest Homes of Arkansas*, 301 S.W.3d 1, 1 (Ark. 2009) (stating that because MERS is "at most at the mere agent" of the lender, it is not a necessary party to a foreclosure action on property subject to a mortgage entered on MERS); *Landmark Nat'l Bank v. Kesler*, 216 P.3d 158, 166 (Kan. 2009) (asserting that MERS is "more akin to . . . a straw man than to a party possessing all the rights given a buyer," so it was not error to permit foreclosure on a property subject to a mortgage entered on MERS). These holdings, however, do not directly bear on disputes between borrowers and lenders over MERS mortgages.

³⁷ For example, considering only the highest decisions of state courts rendered in 2011, MERS won in *RMS Res. Props., LLC v. Miller*, 32 A.3d 307, 317 (Conn. 2011) (rejecting borrowers' contention that MERS could not validly be named mortgagee because it was not the lender); *Savage v. U.S. Bank, N.A.*, 19 A.3d 302 (Tbl.), 2011 WL 1878008, at *1-2 (Del. May 12, 2011) (rejecting borrowers' contention that they were entitled to notice of mortgage assignment from MERS to foreclosing bank); *Residential Funding Co., L.L.C. v. Saurman*, 805 N.W.2d 183, 183-84 (Mich. 2011) (holding that MERS's interest in security lien authorized MERS to foreclose by advertisement); *Thomas v. BAC Home Loans Servicing, LLP*, No. 56587, 2011 WL 6743044, at *3 (Nev. Dec. 20, 2011) ("MERS as the nominee beneficiary holds the deed of trust for BAC's benefit."). Cases in which MERS's positions were rejected tended to focus on case-specific evidentiary matters. See *Bevilacqua v. Rodriguez*, 955 N.E.2d 762, 771-72 (Mass. 2011) (holding that purchaser at foreclosure sale lacked standing to try title where purchaser conceded that MERS did not assign deed to foreclosing bank before foreclosure); *Bank of New York v. Bailey*, 951 N.E.2d 331, 334 (Mass. 2011) (stating that summary judgment for bank in process for possession after foreclosure by sale vacated because bank did not submit proper affidavit; MERS's role not addressed although MERS purported to assign mortgage and note to foreclosing bank); *HSBC Mortg. Servs., Inc. v. Murphy*, 19 A.3d 815, 820 (Me. 2011) (denying judgment of foreclosure because of "serious irregularities" in lender's inconsistent affidavits); *Heredia-Bonnet v. First American Loanstar Trustee Servs., LLC*, No. 56571, 2011 WL 5006303, at *1 (Nev. Oct. 18, 2011) (denying foreclosure because MERS failed to produce deed of trust at mediation); *U.S. Bank, N.A. v. Kimball*, 27 A.3d 1087, 1092 (Vt. 2011) (holding that bank abandoned claim that MERS mortgage assignment sufficed to establish interest in promissory note). MERS has continued to win in state high courts in 2012. See, e.g., *Edelstein v. Bank of New York Mellon*, 286 P.3d 249, 260 (Nev. 2012) (holding MERS can assign mortgage and note under Nevada law); *Trotter v. Bank of New York Mellon*, 275 P.3d 857, 862-63 (Idaho 2012) (refusing to consider borrower's argument that MERS could not assign interests in deeds of trust).

³⁸ See *In re Mortg. Elec. Reg. Sys. (MERS) Litig.*, No. 09-2119-JAT, 2011 WL 4550189, at *3 (D. Ariz. Oct. 3, 2011) (dismissing 72 cases against MERS based on theories that MERS is not a beneficiary of deeds of trust, that MERS Deeds of Trust are

enforcement and government officials demonstrate increasing skepticism toward the system, skepticism that often has manifested itself in lawsuits.³⁹ Although this trend could well change, as the law-enforcement actions against MERS, Inc. do attack the company's basic business practices,⁴⁰ for the moment it seems that judicial wariness about letting borrowers get away with default more often than not overcomes qualms about MERS's strict compliance with state laws.⁴¹

But MERS's very success in litigation should make investors nervous, because the desire to win foreclosure cases against borrowers has led MERS and its members to cast MERS as much more than a mere registration system. Instead, foreclosures proceed because courts accept descriptions of MERS as an agent of the lender possessing the right as agent to do anything with respect to the mortgage that the lender itself could do, particularly the right to assign the mortgage. MERS has even successfully claimed to own mortgages and to possess a constitutionally protected property interest in them. As explained below,⁴² these claims increase the risk that if MERS enters bankruptcy, the mortgages to which it holds legal title will enter the MERS bankruptcy estate.

B. Securitization and Bankruptcy

Mortgage securitization is based on the premise that buyers of mortgage-backed securities are entitled to the flow of funds from the underlying secured notes and will not have to share those funds with anyone else.⁴³ As a corollary, investors are assumed to be entitled to

not valid and enforceable because they never named a valid beneficiary and were split from the note at creation, and that MERS cannot assign deeds of trust).

³⁹ See discussion *infra* Part I. C.

⁴⁰ See, e.g., Complaint at Relief, ¶ B, People of the State of New York v. JPMorgan Chase Bank, N.A. et al. (Kings Cty. Sup. Ct. Feb. 3, 2012) [hereinafter New York Complaint] (seeking to enjoin MERS, Inc. from operating through non-employee certifying officers).

⁴¹ *But see* White, *supra* note 9, at 499 ("Courts have been shocked at bank practices, but are probably unwilling to issue decisions that will void titles on a vast scale. On the other hand, they are perfectly willing to delay foreclosures when homeowners point out the gaps.").

⁴² See discussion *infra* Part II. B.

⁴³ Kenneth C. Kettering, *Securitization and Its Discontents: The Dynamics of Financial Product Development*, 29 CARDOZO L. REV. 1553, 1561 (2008) ("The prototypical securitization structure has no purpose, and no significant effect, other than to circumvent the . . . 'Bankruptcy Tax' that the Bankruptcy Code can be thought of as imposing on secured lenders"); Thomas E. Plank, *Sense & Sensibility in Securitization*, 30 CARDOZO L. REV. 617, 619 (2008) ([M]ortgage securitization lowers financing costs because it avoids the costs that the Bankruptcy Code imposes —

the value of the security interests securing the notes. In particular, investors are not supposed to have to share the value of the mortgages with creditors of the original lender or anyone else in the securitization chain. If bankruptcy of an entity in the chain is a realistic possibility and would cause the securitized assets to enter the debtor's bankruptcy estate, that would defeat the purpose of the transaction.

Securitization transactions thus are designed to minimize the possibility that the securitized assets will be subject to this process. That is, they are designed so that the assets have only a remote chance of entering any party's bankruptcy estate. The originator-sponsor-depositor-SPV transfer sequence described above was adopted to achieve bankruptcy remoteness, and securitization transactions are accompanied by lawyers' letters opining that the structures are effective in doing so.⁴⁴

Bankruptcy is so important to securitization that much academic commentary attempting to explain why securitization happens focuses on the importance of transacting around bankruptcy.⁴⁵ Likewise, the

unwisely, in my view — on secured creditors”); Steven L. Schwarcz, *Securitization Post-Enron*, 25 *CARDOZO L. REV.* 1539, 1573-74 (2004) (“Securitization . . . typically transfers ownership of financial assets from the originator to the SPV, thereby obviating the originator's ability, in bankruptcy, to use their cash collections or to raise cash by granting to new lenders a lien on such collections.”).

⁴⁴ The bankruptcy opinion letters given in connection with mortgage securitization transactions apparently are not public. These letters may be limited to concluding that the transferred assets would not become part of the *transferor's* bankruptcy estate and may not address the possibility of a MERS bankruptcy. *See, e.g.*, James R. Mountain et al., *New Developments in Securitization 2010*, in *COMMERCIAL LAW 2010*, at 1088-89 (Practising Law Inst. ed., 2010) (giving examples of legal opinions found persuasive by accountants; examples assert only bankruptcy remoteness from “Seller”). Even if the legal opinions are so limited, the basic assumption of bankruptcy remoteness would be thwarted as much by the mortgages' entry into the MERS, Inc. bankruptcy estate as by their entry into the transferor's bankruptcy estate.

⁴⁵ *See* sources cited *supra* note 43. The argument that securitization is in large part a device for circumventing bankruptcy has also been advanced in the economic literature. *See* Kenneth Ayotte & Stav Gaon, *Asset-Backed Securities: Cost and Benefits of “Bankruptcy Remoteness,”* 24 *REV. FIN. STUDS.* 1299, 1300-01 (2011); Gary B. Gorton & Andrew Metrick, *Securitization*, in *HANDBOOK OF THE ECONOMICS OF FINANCE*, (G. Constantinides, M. Harris, & R. Stulz eds., forthcoming 2013) (manuscript at 3) (presenting “a simple model of the private decision to securitize, driven by such factors as bankruptcy costs, taxes, and the convenience yield (if any) for bank deposits and securitized bonds”); Gary B. Gorton & Nicholas Souleles, *Special Purpose Vehicles and Securitization*, in *THE RISKS OF FINANCIAL INSTITUTIONS* 549 (Mark Carey & René M. Stulz eds., 2006). A popular alternative explanation is that pooling financial assets increases the cost of becoming informed about the pool's aggregate payoffs and

debate over whether securitization is good or bad is to a very large extent a debate over whether contracting around bankruptcy is good or bad.⁴⁶

Whether contracting around bankruptcy is desirable or not, the fact is that vast sums have been invested on the assumption that mortgage securitization does in fact insulate investors from the bankruptcy of entities in the securitization chain, despite the misgivings expressed by some scholars about the likely effectiveness of securitization structures in accomplishing this goal.⁴⁷ The nation's banking system is heavily

therefore induces intermediaries to remain uninformed, so that end purchasers are not deterred from buying because of the intermediary's superior information. See Edward L. Glaeser & Hedi H. Kallal, *Thin Markets, Asymmetric Information, and Mortgage-Backed Securities*, 6 J. FIN. INTERMEDIATION 64, 64-68 (1997); Edward Iacobucci & Ralph Winter, *Asset Securitization and Asymmetric Information*, 34 J. LEGAL STUDS. 161, 161-64 (2005). Other explanations for securitization include: signaling benefits, see Stuart Greenbaum & Anjan Thakor, *Bank Funding Modes: Securitization versus Deposits*, 11 J. BANKING & FIN. 379, 395-97 (1987); regulatory capital arbitrage, see George Pennacchi, *Loan Sales and the Cost of Bank Capital*, 43 J. FIN. 375, 375-76 (1988); tax savings, see Hayne Leland, *Financial Synergies and the Optimal Scope of the Firm: Implications for Mergers, Spinoffs, and Structured Finance*, 62 J. FIN. 765, 765-67 (2007); and a combination of information cost savings, specialization benefits, and reduction of transaction costs, see Claire Hill, *Securitization: A Low Cost Sweetener for Lemons*, 74 WASH. U. L.Q. 1061, 1085-1104 (1996).

⁴⁶ So understood, the question of securitization's desirability is a "transposition into a minor key of the larger question" of the desirability of secured credit. See Kettering, *supra* note 43, at 1717. As Kettering points out, "[b]y relieving financiers of the burden of the Bankruptcy Tax, securitization does no more than enhance the rights of secured creditors." *Id.*; see also Dov Solomon, *The Rise of a Giant: Securitization and the Global Financial Crisis*, 49 AM. BUS. L.J. 859, 884-90 (2012) (arguing that originators may pursue inefficient securitization transactions to transfer wealth from unsecured creditors (including involuntary creditors) to secured creditors and equity owners). The debate over secured credit, in turn, has spawned a large literature. Kettering, *supra* note 43, at nn.541-42 (collecting articles addressing the issue); see also Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 YALE L.J. 857, 859 (1996) (arguing that "the efficiency case for full priority [for secured claims in bankruptcy] is at best problematic" because preferential treatment of secured creditors induces inefficient behavior by debtors and lenders and suggesting possible ways to reduce the preference afforded secured debt).

⁴⁷ See David Gray Carlson, *The Rotten Foundations of Securitization*, 39 WM. & MARY L. REV. 1055, 1059-61 (1998); Kettering, *supra* note 43, at 1585 ("Fraudulent transfer law can be applied, consistent with established usages, to avoid the asset transfer from Originator to SPE that is the core of the prototypical securitization transaction, in order to vindicate the bankruptcy policy that the securitization structure is designed to circumvent."); Kenneth N. Klee & Brendt C. Butler, *Asset-Backed Securitization, Special Purpose Vehicles and Other Securitization Issues*, 35 UCC L.J. 23, 66 (2002) ("[F]raudulent transfer law can be a useful tool in avoiding an asset securitization transaction as either an actual or a constructive fraudulent transfer."); Lois R. Lupica,

invested in mortgage-backed securities,⁴⁸ so the concentration of thirty million mortgages in MERS, Inc. poses a systemic risk.

C. *The Threat of MERS, Inc. Bankruptcy*

MERS, Inc. apparently is a shell company without substantial assets other than the mortgages it holds.⁴⁹ The assumption behind structuring MERS, Inc. in this way presumably was that the company would not face substantial litigation risk. This assumption was always questionable in light of the scope, novelty, and nature of the plan for MERS, Inc.'s intended operation — owning legal title to, assigning, and foreclosing on millions of mortgages.⁵⁰

This is contentious business, as the many lawsuits now pending against MERS, Inc. and its parent MERSCORP demonstrate. Moreover, the MERS entities apparently have not handled their business impeccably in the past. After a federal interagency review found in 2011 that MERS's members did not adequately assess MERS's internal controls,⁵¹ MERSCORP and MERS, Inc. entered into a consent decree with federal banking regulators under which the companies did not contest the regulators' finding that they employed “unsafe and unsound” practices,⁵² and under which they agreed to make

Asset Securitization: The Unsecured Creditor's Perspective, 76 TEX. L. REV. 595, 636-50 (1998). Kettering also argues that “a bankruptcy court so inclined could readily defeat the prototypical securitization structure by ordering the substantive consolidation of the Originator and the SPE.” Kettering, *supra* note 43, at 1562.

⁴⁸ See, e.g., FLOW OF FUNDS, *supra* note 16, at L.110 (Dec. 8, 2011) (reporting that U.S.-chartered commercial banks hold over \$1.1 trillion in residential mortgage-backed securities, over 10% of total assets).

⁴⁹ See Hultman Depo., *supra* note 3, at 31, 69. MERS, Inc.'s financial statements apparently are not publicly available.

⁵⁰ MERS's architects drew an analogy between MERS and the book-entry system used for stocks. See INTERAGENCY TECHNOLOGY TASK FORCE, *supra* note 23, at I-4 (“Existing business entities such as the Depository Trust Corporation (DTC) and the Participants Trust Corporation (PTC) provide successful models for establishing a structure for the WLBE Clearinghouse [MERS].”). One weakness of this analogy is mortgages often have to be enforced through foreclosure, which very frequently entails litigation. This large source of litigation risk does not exist for stocks.

⁵¹ FEDERAL RESERVE SYSTEM, OFFICE OF THE COMPTROLLER OF THE CURRENCY, OFFICE OF THRIFT SUPERVISION, INTERAGENCY REVIEW OF FORECLOSURE POLICIES AND PRACTICES 11 (Apr. 2011) [hereinafter INTERAGENCY REVIEW].

⁵² See Consent Order at 2, *In re* MERSCORP, Inc., O.C.C. No. AA-EC-11-20 (Apr. 13, 2011).

operational improvements.⁵³ The decree may also require that MERS' members contribute additional capital to the MERS entities.⁵⁴

Even if MERS prevails in all pending litigation, the very existence of the lawsuits should give investors and policymakers pause. The current litigation does not exhaust all possible claims by all possible plaintiffs against MERS, Inc. under current law, and in any event laws can change. The sheer magnitude of MERS's operations and their controversial nature create an appreciable risk that MERS, Inc. will incur large litigation-related liabilities.

The Attorney General of New York has sued MERS, Inc.⁵⁵ The suit seeks damages for fraud and deceptive business practices,⁵⁶ as well as disgorgement of profits⁵⁷ and civil penalties of \$5,000 per violation for deceptive practices.⁵⁸ Although New York has settled some MERS-related claims against banks, its claims against MERSCORP and MERS, Inc. were still live as of December 2012.⁵⁹

MERS, Inc. has been sued by private plaintiffs in putative class actions around the nation. Although many of these cases were consolidated in a multidistrict proceeding in the District of Arizona and dismissed,⁶⁰ appeals are pending before the Ninth Circuit,⁶¹ and the scope of the actions illustrates the extent of MERS, Inc.'s potential exposure. Recent state court decisions disfavoring MERS open up further potential liability.⁶²

MERS, Inc. also faces claims from county recorders.⁶³ A putative class action brought by three Texas counties, including Dallas County

⁵³ *Id.* at 7-9.

⁵⁴ *Id.* at 8.

⁵⁵ New York Complaint, *supra* note 40, ¶ 13.

⁵⁶ New York Complaint, Relief, *supra* note 40, ¶ F.

⁵⁷ *Id.* ¶ E.

⁵⁸ *Id.* ¶ G.

⁵⁹ See David McLaughlin, *B of A Among Banks in \$25 Million Deal Over N.Y. Mortgage Case*, BLOOMBERG BUSINESSWEEK, Mar. 14, 2012, available at <http://www.bloomberg.com/news/2012-03-13/jpmorgan-among-banks-agreeing-to-25-million-mers-deal-with-n-y-.html>.

⁶⁰ See, e.g., *In re Mortg. Elec. Reg. Sys. Litig.*, MDL Dkt. No. 09-2119-JAT, 2011 WL 4550189 (D. Ariz. Oct. 3, 2011).

⁶¹ See, e.g., *In re Mortg. Elec. Reg. Sys. Litig.*, Dkt. No. 11-17615 (9th Cir.).

⁶² See *Bain v. Metropolitan Mortg. Gp., Inc.*, 285 P.3d 34, 49-51 (Wash. Aug. 16, 2012) (designating MERS, Inc. as a beneficiary on a deed of trust in Washington is "presumptively" deceptive, giving injured homeowner a private right of action if other elements, including injury, are present).

⁶³ See Press Release, Guilford County, North Carolina Register of Deeds (Mar. 2, 2011) ("Guilford County Register of Deeds Jeff Thigpen announced today that he will be conferring with [law enforcement officials] as to whether the Mortgage Electronic

and Harris County (Houston),⁶⁴ on behalf of all counties in Texas⁶⁵ where MERS operates has survived a motion to dismiss.⁶⁶ Other recorder cases have been dismissed at the trial level⁶⁷ and in some cases are on appeal.⁶⁸ Motions to dismiss are pending in other cases.⁶⁹

The MERS companies also face policy challenges, although these may not threaten solvency as directly as the lawsuits do. Senator Maria Cantwell recently advised the Attorney General bluntly, “The Mortgage Electronic Registration System should be shut down and

Registration Service [sic] (MERS) owes Guilford County fees estimated at \$1.3 million in lost revenue from mortgage assignments.”); *see also* Press Release, Commonwealth of Massachusetts Southern Essex District Registry of Deeds (Feb. 22, 2011) (“Essex South Register of Deeds John O’Brien announced today that he will be seeking over 22 million dollars from the Mortgage Electronic Registration System.”). *See generally* Karen Weise, *County Recorders vs. the MERS Machine*, BLOOMBERG BUSINESSWEEK, (Nov. 3, 2011), available at <http://www.businessweek.com/magazine/county-recorders-vs-the-mers-machine-11032011.html> (describing recorder suits).

⁶⁴ *See* Plaintiffs’ Third Amended Class Action Complaint ¶ 4, Dallas County v. MERSCORP, Inc., No. 3:11-CV-2733-O (N.D. Tex. July 13, 2012) [hereinafter Dallas Complaint] (stating plaintiffs include Dallas and Harris Counties). Projected populations of the counties are: Dallas County 2.48 million, Harris County 4.26 million. *See Population Data (Projections) for Texas Counties, 2012*, TEXAS DEP’T OF STATE HEALTH SERVS., <http://www.dshs.state.tx.us/chs/popdat/ST2012.shtm> (last visited Oct. 15, 2012).

⁶⁵ Dallas Complaint, *supra* note 64, ¶ 12.

⁶⁶ Motions Hearing Transcript at 81:10-20, Dallas County v. MERSCORP, Inc., No. 3:11-CV-3722-O (N.D. Tex. May 23, 2012) (denying motion to dismiss in part).

⁶⁷ Christian County Clerk *ex rel.* Kem v. Mortg. Elec. Reg. Sys., Inc., No. 5:11CV-00072-M, 2012 WL 566807, at *5 (W.D. Ky. Feb. 21, 2012); Memorandum Opinion & Order Regarding Defendants’ Motion to Dismiss, Plymouth County, Iowa v. MERSCORP, Inc., No. C 12-4022-MWB, 2012 WL 3597430 (N.D. Iowa Aug. 21, 2012), *leave to file amended complaint denied*, 2012 WL 4903099 (Oct. 16, 2012); Order at 31-32, Fuller v. Mortg. Elec. Reg. Sys., Inc., No. 3:11-CV-1153-J-20MCR, 2012 WL 3733869, (M.D. Fla. July 20, 2012). Courts also have dismissed a number of *qui tam* lawsuits based on claimed evasion of recording fees brought by an individual named Barrett Bates who is not a county recorder. *See, e.g.,* California *ex rel.* Bates v. MERS, Inc., No. 2:10-CV-01429-GEB-CMK, 2011 WL 892646, at *5 (E.D. Cal. Mar. 11, 2011) (granting each defendant’s motion to dismiss); Anderson County *ex rel.* Bates v. MERS, Inc., No. MCCHCVRE10-10 (Tenn. Ch. Montgomery Cty., Jan. 2, 2012) (same).

⁶⁸ *See, e.g.,* Christian Cnty. Clerk v. MERS, Inc., No. 12-5237 (6th Cir. 2012) (notice of appeal filed Mar. 5, 2012).

⁶⁹ Motion to Dismiss, Welborn v. Bank of New York Mellon, No. 3:12-CV-220 (M.D. La. July 20, 2012). The Louisiana complaint, brought by a large number of clerks of court of Louisiana parishes, asserts that MERS’s members violated RICO by misrepresenting the need to record mortgage assignments. Second Amended Complaint ¶1, Welborn v. Bank of New York Mellon, No. 3:12-CV-220 (M.D. La. Aug. 24, 2012).

dissolved,”⁷⁰ and Senator Bob Corker introduced legislation to replace MERS with “MERS2,” a system under the control of the Federal Housing Finance Agency governed by rules that “ensure that property title is transferred in accordance with all applicable provisions of law.”⁷¹

Certainly, MERS, Inc. may escape unscathed from the lawsuits and investigations in which it is currently entangled.⁷² But the scenario in which MERS, Inc.’s adversaries prevail and become large creditors so that MERS, Inc. enters into bankruptcy (unless backstopped by its owners) can hardly be described as a “remote” possibility. This is true even though MERS, Inc. is supposed to be structured as a “bankruptcy remote” entity, apparently at the insistence of credit rating agencies.⁷³ Even if MERS, Inc. cannot enter bankruptcy voluntarily,⁷⁴ the entity could be forced into involuntary bankruptcy by creditors.⁷⁵ Indeed, the possibility that a bankruptcy trustee could reach the mortgages nominally owned by MERS, Inc. could increase the likelihood that creditors would pursue this course.

Litigation against MERS, Inc. implicates a tangle of interests: private plaintiffs and state officials are proceeding against an entity that is owned indirectly by the government-sponsored housing enterprises (GSEs), which now are explicitly backed by the federal government, and by the largest banks, which may enjoy an implicit federal guarantee.⁷⁶ MERS, Inc. and MERSCORP claim to be indemnified by

⁷⁰ Letter from Senator Maria Cantwell to Attorney General Eric Holder (Dec. 15, 2011), available at <http://www.cantwell.senate.gov/news/record.cfm?id=335169>.

⁷¹ Residential Mortgage Market Standardization and Privatization Act of 2011, S. 1834, 112th Cong. § 8(b) (2011).

⁷² As of December 2012, MERSCORP and MERS, Inc. have moved to dismiss the New York Attorney General’s complaint and the motion to dismiss was pending. See MERSCORP, Inc. and MERS, Inc. Memorandum in Support of Motion to Dismiss at 1, *New York v. JPMorgan Chase Bank, N.A. et al.*, Index No. 2768/2012 (N.Y. Sup. Ct. Apr. 20, 2012).

⁷³ See Hultman Depo., *supra* note 3, at 32.

⁷⁴ See Hultman Depo., *supra* note 3, at 33 (MERS, Inc. has an independent director who must vote in favor of bankruptcy before the company can seek bankruptcy protection).

⁷⁵ See 11 U.S.C. § 303 (2012) (authorizing commencement of involuntary bankruptcy case).

⁷⁶ One of the principal goals of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 was to eliminate implicit government guarantees and “to end ‘too big to fail.’” See Dodd-Frank Wall Street Reform and Consumer Act of 2010, Pub. L. 111-203, Preamble (2010). Some are skeptical that the Act solves the problem, see, e.g., David Skeel, *Making Sense of the New Financial Deal*, 5 LIBERTY U. L. REV. 181, 192 (2011) (“What emerged [in Dodd-Frank] was a regulatory framework that relies on a partnership between the government and the largest banks, and is likely to require bailouts if any of

MERS's members, including banks and the GSEs.⁷⁷ At the same time, MERS, Inc. and MERSCORP continue to carry on a well-funded fight in the foreclosure wars while laboring under a federal consent decree that may require the companies to raise additional capital — capital that the owners may not be willing to contribute. We claim no special insight into the likely results of the multidimensional game of chess playing out among the various stakeholders; we simply note that at this writing, MERS faces more litigation and bankruptcy risk than it apparently was designed to face.

II. TREATMENT OF MERS MORTGAGES IN BANKRUPTCY

As this Part explains, if MERS, Inc. enters bankruptcy, its bankruptcy trustee probably can bring into the bankruptcy estate any real property interests that MERS, Inc. could convey to a bona fide purchaser. The mortgages registered in MERS, Inc.'s name are real property interests, and a court could properly find that MERS, Inc. could convey them to a bona fide purchaser. Thus, the MERS, Inc. bankruptcy trustee could properly bring the mortgages into MERS, Inc.'s bankruptcy estate. It is certainly possible that a court might find that the mortgages would not enter the estate. But the risk of such a ruling, combined with the very serious consequences if a court should make such a finding, suggests the existence of a design flaw in MERS.

A. *The MERS, Inc. Bankruptcy Trustee Probably Could Bring into the Bankruptcy Estate Any Mortgages That MERS, Inc. Could Convey to a Good-Faith Purchaser*

When an entity enters into bankruptcy, its property becomes part of the “bankruptcy estate.”⁷⁸ In the words of the Bankruptcy Code, the estate includes “all legal and equitable interests of the debtor as of the commencement of the case.”⁷⁹

the banks runs into trouble.”), while others doubt the problem can be solved at all. See, e.g., William Alden, *Warren Buffett: “Too Big to Fail” Will Never be Resolved*, HUFFINGTON POST (Feb. 11, 2011 9:42 a.m. ET), http://www.huffingtonpost.com/2011/02/11/warren-buffett-too-big-to-fail_n_821814.html (“You will always have institutions that are too big to fail, and sometimes they will fail.”).

⁷⁷ Alison Frankel, *After Mortgage Settlement, MERS Left Out in the Cold*, THOMSON REUTERS (Feb. 9, 2012), available at <http://newsandinsight.thomsonreuters.com/Legal/News/ViewNews.aspx?id=39047&terms=%40ReutersTopicCodes+CONTAINS+%27ANV%27> (stating that according to MERS Vice President Janis Smith, “MERS is indemnified by its members”).

⁷⁸ 3 ALAN N. RESNICK ET AL., *COLLIER BANKRUPTCY MANUAL* § 541.01 (4th ed. 2012).

⁷⁹ 11 U.S.C. § 541(a)(1) (2012).

The Bankruptcy Code also provides that the bankruptcy trustee⁸⁰ has several special powers to expand the bankruptcy estate beyond the legal and equitable interests of the debtor at the commencement of the case — in other words, to add certain types of property to the bankruptcy estate and bring them within the reach of creditors.⁸¹ These powers are set forth in § 544 of the Bankruptcy Code and are called the trustee’s “strong-arm powers.”⁸²

The trustee’s strong-arm powers generally derive from bankruptcy’s origin as a class action for *creditors*.⁸³ Although the strong-arm powers exceed the rights of creditors in some respects, they are founded on the rights of creditors to reach property, not on the debtor’s ownership of property.⁸⁴ Even if a debtor does not “own” certain property, the trustee may still be able to reach the property under the strong-arm powers, which have a different basis. This point is important because parties resisting the trustee would argue that MERS, Inc. is not the “true,” or “beneficial” owner of the mortgages recorded in its name, but only the owner of “legal title” as a “nominee.” But MERS’s lack of beneficial ownership simply does not dispose of the question whether the mortgages could enter the bankruptcy estate under the strong-arm powers.

Although some of the trustee’s strong-arm powers track creditors’ rights directly,⁸⁵ § 544(a)(3) of the Code provides that the trustee’s rights respecting real property interests are those of a bona fide purchaser of real property rather than a creditor, whether or not such

⁸⁰ The bankruptcy trustee represents the bankrupt debtor’s creditors as a group. JOHN D. AYER & MICHAEL L. BERNSTEIN, *BANKRUPTCY IN PRACTICE* 324 (4th ed. 2007).

⁸¹ *Belisle v. Plunkett*, 877 F.2d 512, 516 (7th Cir. 1989) (Easterbrook, J.) (“[W]e believe that allowing the estate to benefit from property the debtor did not own is exactly what the strong-arm powers are about . . . The estate gets what the debtor could convey under local law rather than only what the debtor owned under local law — a critical distinction . . .”) (emphasis in original).

⁸² See 11 U.S.C. § 544; 3 RESNICK, *supra* note 78, § 544.02[1] (explaining that trustee’s powers under section 544 are “strong-arm powers”).

⁸³ See AYER & BERNSTEIN, *supra* note 80, at 324-25.

⁸⁴ See *In re Sedona Cultural Park, Inc.*, No. AZ-06-1339-MoPaBr, 2007 WL 7540968, at *8 (B.A.P. 9th Cir. 2007) (“Under the majority rule Sections 541 and 544 are complementary, not conflicting, sources of Trustee’s rights and powers.”); *In re Granada, Inc.*, 92 B.R. 501, 504 (Bankr. D. Utah 1984) (“no requirement . . . that the property transferred be property of the debtor”) (emphasis in original); *In re Great Plains W. Ranch Co.*, 38 B.R. 899, 905 (Bankr. C.D. Cal. 1984) (Ayer, J.).

⁸⁵ See 11 U.S.C. § 544(a)(1)-(2) (conferring on trustee powers of “a creditor that extends credit to the debtor at the time of the commencement of the case” and obtains a judicial lien against the debtor’s property or execution against the debtor returned unsatisfied).

a purchaser exists.⁸⁶ Although mortgages generally are considered interests in real property,⁸⁷ and “real property” under § 544(a)(3) apparently encompasses all real-property interests, not just fee simple interests,⁸⁸ efforts to reach mortgages (as opposed to underlying real property) through § 544(a)(3) are rare. We located only one case in which a bankruptcy trustee tried to use § 544(a)(3) to reach mortgages, and in that case the court rejected the effort, concluding (without explanation) that it is “doubtful that Congress intended § 544(a)(3) to come into play when the underlying real property is not in dispute.”⁸⁹ Nevertheless, finding that Section 544(a)(3) reaches mortgages is consistent with scholarly understanding of the objective purpose of Congress in enacting the provision. For example, Thomas Jackson explains that the purposes was that “[w]here applicable law prescribed a form of notoriety as a condition for ‘full’ protection against competing claims, and where such notoriety of a particular interest had not been given prior to bankruptcy, that interest should be invalid against the trustee.”⁹⁰ State law makes unrecorded interests in mortgages vulnerable, so the purpose Jackson identifies would apply.

Apart from the question whether § 544(a)(3) reaches mortgages, its text is far from clear in other respects. Two schools of thought have emerged as to its scope. One interpretation is that § 544(a)(3) applies only when the debtor has transferred real property to someone else. In such a case, if the transferee fails to record its interest, the interest

⁸⁶ “*The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by . . . (3) a bona fide purchaser of real property, other than fixtures, from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser and has perfected such transfer at the time of commencement of the case, whether or not such a purchaser exists.*” 11 U.S.C. §544(a)(3).

⁸⁷ See RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 1.1 (1997) (“A mortgage is a conveyance or retention of an interest in real property as security for performance of an obligation.”); NELSON & WHITMAN, *supra* note 28, at 456.

⁸⁸ See *Belisle v. Plunkett*, 877 F.2d 512, 515 (7th Cir. 1989) (applying § 544(a)(3) to transfer of leasehold interest); *Missouri Breaks, LLC v. Burns*, 791 N.W.2d 33, 40-42 (N.D. 2010) (applying § 544(a)(3) to “working interest” in oil well, where “working interest” apparently is an interest in a leasehold interest). *But see In re BFA Liquidation Trust*, 331 B.R. 907, 913 (Bankr. D. Ariz. 2005) (distinguishing between “real property” and “an interest in real property” without further analysis).

⁸⁹ *In re Ascot Mortgage, Inc.*, 153 B.R. 1002, 1009 (Bankr. N.D. Ga. 1993).

⁹⁰ Thomas H. Jackson, *Avoiding Powers in Bankruptcy*, 36 STAN. L. REV. 725, 738 (1984).

usually would be vulnerable to a bona fide purchaser from the debtor, and thus to the trustee under § 544(a)(3). For example, if the debtor transfers real property to A and then enters bankruptcy, the bankruptcy trustee would stand in the position of a bona fide purchaser from the debtor. If A had failed to record its interest, the bona fide purchaser would defeat A's interest under most state recording laws, and so would the trustee.⁹¹ Under this interpretation, in a MERS, Inc., bankruptcy, § 544(a)(3) would apply only to mortgages that MERS, Inc. had assigned to someone else without recording — not to all mortgages recorded on MERS.

Another interpretation, favored by the majority of courts, is that the trustee takes *any* real property interest that the debtor *could* convey to a bona fide purchaser, without any requirement that the debtor have transferred that interest.⁹² In the context of a MERS, Inc. bankruptcy, that means that if MERS, Inc. could convey title to the mortgages recorded in its name to a bona fide purchaser, the MERS, Inc. bankruptcy trustee could bring those mortgages into the estate. This

⁹¹ The leading alternative to the majority view explained herein is that § 544(a)(3) permits the trustee only to avoid unrecorded transfers of real property interests away from the debtor. For a sample of the scholarly literature on the provision, see Callen Bair, *Twisting the Trustee's "Strong Arm": Constructive Notice in Section 544(a)(3) Adversary Proceedings*, 27 EMORY BANKR. DEV. J. 569, 608 (2011) (asserting that in applying § 544(a)(3), bankruptcy trustee should not be charged with constructive or inquiry notice beyond that provided by the execution and perfection of real property transfers); David Gray Carlson, *The Trustee's Strong-Arm Power Under the Bankruptcy Code*, 43 S.C. L. REV. 841, 893-912 (1992); Gregg C. Gumbert, *The Trustee as a Bona Fide Purchaser of Real Property: Making Sense of Section 544(a)(3)*, 15 BANKR. DEV. J. 121, 122 (1998) (concluding that "section 544(a)(3) should only be applied in bankruptcy cases in which unperfected transfers of real property were made by the debtor or unperfected security interests in real property were given by the debtor prior to bankruptcy"); Andrew Kull, *Restitution in Bankruptcy: Restitution and Constructive Trust*, 72 AM. BANKR. L.J. 265, 293-300 (1998) (arguing that § 544(a)(3) should not be applied to defeat constructive trusts); Jim D. Pappas, *The Impact and Treatment of Section 544(a)(3) of the Bankruptcy Code*, 21 IDAHO L. REV. 537, 539 (1985) ("In light of the Congressional intent and against the backdrop of the typical bankruptcy proceeding, the courts should be extremely reluctant to utilize traditional equitable rules when applying section 544(a)(3).").

⁹² *Belisle*, 877 F.2d at 516; *In re Paul J. Paradise & Assocs., Inc.*, 249 B.R. 360, 367 n.34 (Bankr. D. Del. 2000); *In re Granada, Inc.*, 92 B.R. 501, 504-05 (Bankr. D. Utah 1988) (describing trustee's power to avoid transfers as being "in addition to" its possession of rights and powers of bona fide purchaser); 4 NORTON BANKR. L. & PRAC. § 63:6 (2012) ("[A] minority of courts have held that the subsection applies only to real property transfers by the debtor to a third person. The majority of courts construe Code § 544(a)(3) broadly as giving the trustee bona fide purchaser status, even where there has been no transfer from the debtor to a third party.").

would apply to all mortgages recorded in MERS, Inc.'s name, regardless of whether MERS, Inc. had assigned them to someone else.

The textual basis for the majority interpretation is that “[t]he trustee shall have . . . the rights and powers of . . . a bona fide purchaser of real property . . . from the debtor . . . whether or not such a purchaser exists.”⁹³ According to the majority interpretation of this text, if a bona fide purchaser had paid to buy the mortgage from MERS, Inc. and had “perfected” (recorded) the interest when MERS, Inc. entered bankruptcy, and if doing so would defeat the unrecorded claim of the “true” owner (usually a securitization trustee),⁹⁴ then the mortgage could be brought into the bankruptcy estate.

It is critical to recognize that § 544(a)(3) speaks of a *hypothetical* purchaser of real property.⁹⁵ The bankruptcy trustee’s powers over real property interests are not measured by what transactions *have* taken place; they are measured by what transactions *could* take place. Thus, it is irrelevant whether MERS, Inc. has in fact sold zero, ten, or ten million mortgages to third parties, except to the extent that MERS, Inc.’s sales or lack thereof affect whether a hypothetical purchaser could take in good faith from MERS, Inc.

Because the majority view of § 544(a)(3) focuses on the debtor’s power to convey, rather than its “true” ownership of property, the majority view implies that § 544(a)(3) can be used to expand “legal title” to real property into “equitable ownership”⁹⁶ when the equitable owner’s interest is not recorded.⁹⁷

Judge Easterbrook’s decision in *Belisle v. Plunkett*⁹⁸ is frequently cited in this area. Plunkett formed several partnerships to purchase a leasehold interest in real property and used his partners’ money to purchase and record the interest in his own name.⁹⁹ Under local law, Plunkett’s “bamboozled” partners were the “true” owners, in the sense that they had equitable ownership of the property, and the law recognized this interest by impressing a constructive trust.¹⁰⁰

⁹³ 11 U.S.C. § 544(a)(3) (2012).

⁹⁴ As discussed *supra* Part I. A, the final stage of a mortgage securitization is the transfer into a special purpose vehicle, usually a trust.

⁹⁵ 11 U.S.C. § 544(a)(3) (2012) (“whether or not such a purchaser exists”).

⁹⁶ JASON H.P. KRAVITT ET AL., *SECURITIZATION OF FINANCIAL ASSETS* § 5.02[G] (2d ed. 2010).

⁹⁷ See *In re Granada*, 92 B.R. 501, 509 (Bankr. D. Utah 1988) (holding that bankruptcy trustee of debtor owner of bare legal title to real property prevailed over partnership that claimed unrecorded equitable ownership interest).

⁹⁸ 877 F.2d 512 (7th Cir. 1989).

⁹⁹ *Id.* at 513.

¹⁰⁰ *Id.* at 513.

Nevertheless, despite the partners' superior claim of equitable ownership, the trustee was able to bring the property into the estate under § 544(a)(3): "If a hypothetical bona fide transferee from the debtor would come ahead of the 'true' owner's rights, then the trustee takes ahead of the true owner."¹⁰¹

Thus, the bankruptcy trustee and not the partners took the leasehold interest, because "[a] bona fide purchaser of the leasehold interest, without notice of the earlier claim, would take ahead of a person who has not recorded his entitlement."¹⁰² Judge Easterbrook followed the logic of state recording laws: "Under most states' laws . . . the buyer in good faith of real property can obtain a position superior to that of the rightful owner, if the owner neglected to record his interest in the filing system. Section 544(a)(3) gives the trustee the same sort of position."¹⁰³

The approach Judge Easterbrook followed in *Belisle v. Plunkett*, that the rights of the trustee are measured by the rights of a bona fide purchaser, that this permits legal title to defeat unrecorded equitable ownership, and that this result is justified at least in part by the interest in encouraging recording, has been called the "majority"¹⁰⁴ approach and has been followed repeatedly.¹⁰⁵

¹⁰¹ *Id.* at 515 (emphasis added).

¹⁰² *Id.* at 514.

¹⁰³ *Id.* at 515 (emphasis in original).

¹⁰⁴ See *In re Seaway Express Corp.*, 912 F.2d 1125, 1128 (9th Cir. 1990); see also CHARLES JORDAN TABB, *THE LAW OF BANKRUPTCY* 426 (2d ed. 2010) (stating that the view that trustee's power under § 544(a)(3) defeats unrecorded equitable interests "now commands a clear majority of courts").

¹⁰⁵ See *Seaway Express*, 912 F.2d at 1129 (holding trustee prevailed over bank claiming unrecorded equitable interest in real property exchange for account in which bank had security interest; state law "permits perfection of an interest such as [the bank's]" and "provides clear procedures for attaining that goal"); *In re Tleel*, 876 F.2d 769, 772 (9th Cir. 1989) (holding that trustee prevailed over party assumed to be partner of debtor claiming interest in real property held in constructive trust, where partner "did not record his alleged interest"); *In re Roman Catholic Archbishop of Portland in Oregon*, 335 B.R. 868, 878 (Bankr. D. Or. 2005) (holding that trustee prevailed where it was claimed, and assumed true for purpose of decision, that debtor held real property in express trust for benefit of others; what determines avoidability is whether "there was constructive [i.e., record] notice of that interest at the time of bankruptcy"); *In re Reasonover*, 235 B.R. 219, 227 (Bankr. E.D. Va. 1999) ("The majority view, which this court finds more persuasive, fully support[s] the position that § 541(d) does not trump the trustee's avoidance powers."); *Patel v. Rupp*, 195 B.R. 779, 782 (Bankr. D. Utah 1996); *In re Ebel*, 144 B.R. 510, 514-16 (Bankr. D. Colo. 1992); *In re Granada, Inc.*, 92 B.R. 501, 504-05 (Bankr. D. Utah 1988); *In re Great Plains W. Ranch Co.*, 35 B.R. 899, 905 (Bankr. C.D. Cal. 1984) (holding that even under assumption that general partner debtor who was record owner of real property had defrauded limited partners out of purchase price and therefore held

When a debtor's bankruptcy estate is expanded under § 544(a)(3) to property that the debtor does not own prior to bankruptcy, usually there is some other claimant to the property who is harmed by the expansion — perhaps one who is quite sympathetic. When the property enters the bankruptcy estate, that person may in some sense have to share the value of the property with other creditors, which may seem unfair. For example, in many cases that follow the majority approach, the competing claimant was, or was assumed to be, the victim of fraud by the debtor.¹⁰⁶ When someone is defrauded out of the purchase price of real property, forcing that person to participate in a bankruptcy proceeding along with other, non-defrauded creditors — such as those who simply took a calculated business risk in dealing with the debtor — may seem harsh. Indeed, the majority approach to § 544(a)(3) has been criticized on this ground, and that is why some courts limit § 544(a)(3) to the avoidance of an “actual transfer” by the debtor, as described above.¹⁰⁷

Despite those arguments, courts and scholars have identified two related policies the majority interpretation helps to advance, and both policies disfavor the use of MERS as currently set up. The first is the policy of protecting those who act in reliance on “ostensible ownership.”¹⁰⁸ A fundamental problem of property law is that when an apparent owner of property who is not the true owner purports to sell the property to a good-faith purchaser, only one of the two innocent parties (the true owner or the buyer) can get the property.¹⁰⁹ Buyers,

property in constructive trust for limited partners, property nevertheless entered bankruptcy estate under section 544(a)(3); “the law of real property is built around the recording acts”).

¹⁰⁶ See, e.g., *Belisle*, 877 F.2d at 513 (stating issue in case as “May the trustee in bankruptcy bring into the estate property that the debtor holds in constructive trust for victims of fraud?”); *In re Great Plains W. Ranch Co*, 38 B.R. 899, 901 (Bankr. C.D. Cal. 1984) (“For purposes of this analysis, I am willing to assume that the record title holder did in fact defraud the plaintiffs. Nonetheless, I hold that the property belongs to the bankruptcy estate.”).

¹⁰⁷ See *In re Mill Concepts Corp.*, 123 B.R. 938, 940-44 (Bankr. D. Mass. 1991) (holding that the purpose of § 544(a)(3) is to permit trustee to prevail over the grantee of an unrecorded mortgage and effect is limited to that purpose). The *Restatement (Third) of Restitution and Unjust Enrichment* endorses this approach. See *RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT* at § 60 cmt. f (2011).

¹⁰⁸ See, e.g., THOMAS H. JACKSON, *THE LOGIC & LIMITS OF BANKRUPTCY LAW* 76 & n. 13 (1986) (arguing that strong-arm power under Bankruptcy Code “principally address[es] the evil of property interests with ostensible ownership problems”); Charles W. Mooney, *A Normative Theory of Bankruptcy Law: Bankruptcy as (Is) Civil Procedure*, 61 WASH. & LEE L. REV. 931, 1029 n.502 (2004) (citing Jackson approvingly).

¹⁰⁹ The view that the true owner should win can be based on the proposition that

aware that the land may have a true owner other than the seller and aware that they may lose to that owner, may be reluctant to transact and/or may incur excessive costs trying to determine true ownership. Recording helps solve this problem and thus is to be encouraged, both to avoid prejudice to individual innocent buyers and to lubricate commerce.¹¹⁰ Vindicating this policy through the Bankruptcy Code has been criticized on the ground that situations where the ostensible owner is not the true owner are a nonbankruptcy problem that ideally would be addressed by nonbankruptcy law,¹¹¹ but even critics have said that an objective purpose of § 544(a)(3) was to “address the evil of property interests with ostensible ownership problems that remained despite available curative measures under nonbankruptcy law.”¹¹²

The second policy underlying the majority interpretation of § 544(a)(3) is the special interest in encouraging real property recording. Section 544(a)(3)'s strong-arm powers for real property are, under the majority view, more expansive than the trustee's strong-arm powers over personal property. This difference has been explained by recognizing an especially strong interest in recording real property interests. As Judge Easterbrook put it, § 544(a)(3) exists not just to deal with the problem of “ostensible ownership,” but also to affirm the policy in favor of recording interests in real property. The partners in *Belisle* lost because “[a] bona fide purchaser from Plunkett would have

the apparent owner cannot pass good title, because he never had title in the first place and no one can pass what he does not have (in Latin, “nemo dat quod non habet”). The latter principle is sometimes shortened to “nemo dat.” Different systems adopt different approaches to the nemo-dat-versus-bona-fide-purchaser problem. The common law apparently has adopted the nemo dat principle for stolen goods, while civil law systems apparently have tended to favor the bona fide purchaser. Edward M. Cottrell, Comment, *Keeping the Barbarians Outside the Gate: Toward a Comprehensive International Agreement Protecting Cultural Property*, 9 CHI. J. INT'L L. 627, 644-45 (2009). Commercial law is said to follow nemo dat in general, but with specified exceptions — for example, for certain purchasers of negotiable instruments. See Steven L. Schwarcz, *Intermediary Risk in a Global Economy*, 50 DUKE L.J. 1541, 1573 (2001).

¹¹⁰ See Doug Rendleman, *Liquidation in Bankruptcy Under the '78 Code*, 21 WM. & MARY L. REV. 575, 611 (1980) (holding that strong-arm power under section 544(a)(3) “discourages secret liens, encourages creditors to record, and allows those who deal with the debtor to protect themselves by checking the record”).

¹¹¹ See Thomas H. Jackson, *Avoiding Powers in Bankruptcy*, supra note 90, at 739 (1984) (“Ostensible ownership may — and often does — create problems, but it does not do so in any way that harms a collective proceeding relative to a system of individual remedies.”). Jackson does recognize that “[c]uring nonbankruptcy problems in bankruptcy may be preferable to not curing them at all.” *Id.* at 741-42.

¹¹² See *id.* at 737.

taken ahead of the partners under local law. They neglected to record the partnerships' interest, though recording is easy."¹¹³

As explained in greater detail below, MERS has created an ostensible ownership problem because the incidents of true ownership of the mortgages recorded in MERS, Inc.'s name are claimed — often successfully — for MERS, Inc. And because MERS creates unrecorded interests in real property, it undermines the interest in real property recording. The policies underlying the majority interpretation of § 544(a)(3) apply to MERS, suggesting that MERS mortgages could enter MERS, Inc.'s bankruptcy estate.

It could be argued that § 541(d) of the Bankruptcy Code cuts against the majority interpretation of § 544(a)(3). Section 541(d) provides that “[p]roperty in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest . . . becomes property of the estate *under subsection (a)(1) or (2) of this section only to the extent of the debtor’s legal title to such property, but not to the extent of any equitable interest.*”¹¹⁴ Section 541(d) thus could be interpreted to mean that because MERS, Inc. has only legal and not equitable title to the mortgages recorded in its name, those mortgages could not become part of its bankruptcy estate. It has been said that most courts find that the strong-arm powers defeat this provision,¹¹⁵ but not all courts adopt this position.¹¹⁶

¹¹³ *Belisle v. Plunkett*, 877 F.2d 512, 515 (7th Cir. 1989). Easterbrook added: “The partners could, and in retrospect should, have refused to invest funds except through an escrow agent, who would have held the cash until good title had been recorded in the partnerships’ names.” *Id.*

¹¹⁴ 11 U.S.C. §541(d) (2012) (emphasis added).

¹¹⁵ See *In re Sedona Cultural Park*, No. AZ-06-1339 2007 WL 7540968, at *8 (B.A.P. 9th Cir. Apr. 13, 2007) (“The majority rule is that § 541(d) does not limit the trustee’s powers over real property under § 544(a)(3).”); *In re Seaway Express Corp.*, 912 F.2d 1125, 1128 (9th Cir. 1990) (same); *In re Reasonover*, 236 B.R. 219, 227 (E.D. Va. 1999) (“The majority view, which this court finds more persuasive, fully support[s] the position that § 541(d) does not trump the trustee’s avoidance powers”). See also ALAN N. RESNICK, ET AL., 5 COLLIER ON BANKRUPTCY 544.02[3] (16th ed. 2012) (“[T]he majority of courts conclude that section 541(d) is subject to the rights of the debtor to avoid an unperfected interest in property under other provisions of the Bankruptcy Code.”) (quoting *In re DVI, Inc.*, 306 B.R. 396, 401 (Bankr. D. Del. 2004), with approval as an accurate statement of the majority view). *Collier* makes this statement in a section titled “Property of the Debtor – Constructive Trust,” *id.*, but does not suggest that the limit on section 541(d) is tied to whether the property in question is held in constructive trust.

¹¹⁶ See, e.g., *In re Quality Holstein Leasing*, 752 F.2d 1009, 1013 (5th Cir. 1985) (“As a general rule, it must be held that section 541(d) prevails over the trustee’s strong-arm powers.”). *Quality Holstein Leasing* did not specifically address § 544(a)(3). For cases that reach the same conclusion after considering the interaction

The legislative history of § 541(d) gives some support to the idea that the provision would save MERS mortgages from the MERS, Inc. bankruptcy estate, because the history suggests that § 541(d) was intended to protect buyers in the secondary mortgage market from bankruptcy trustees, at least in some circumstances. As Senator DeConcini explained at the time of enactment, “The purpose of section 541(d) as applied to the secondary mortgage market is therefore to make certain that secondary mortgage market sales as they are currently structured are not subject to challenge by bankruptcy trustees and that purchasers of mortgages will be able to obtain the mortgages . . . which they have purchased from trustees.”¹¹⁷

However, the legislative history suggests that Section 541(d) was intended to protect an existing practice in which the original lender would sell the mortgage to a buyer but retain possession of the note and mortgage documents to service the mortgage.¹¹⁸ It does not follow that the provision was intended to protect any and all practices that participants in the secondary mortgage market might one day adopt, including the use of MERS. One case specifically involving competing claims to mortgages concludes (in dicta)¹¹⁹ that Congress intended “to protect the secondary mortgage market from intrusion by bankruptcy to the extent that title of a mortgage or security deed was left in the debtor’s name for a purpose, such as servicing that mortgage,” not “where there was no such servicing agreement . . . and the parties simply did not get around to recording the assignment.”¹²⁰

Whether § 541(d) covers only secondary-market mortgage transactions where the originator retains documents for servicing or not, the provision, enacted in 1978¹²¹ and amended in 1984,¹²² was not *specifically* intended to protect MERS, which originated in the

of § 541(d) and § 544(a)(3), see *In re Mortgage Lenders Network*, 380 B.R. 131, 140 (Bankr. D. Del. 2007); *In re Columbia Pac. Mortg. Co.*, 20 B.R. 259, 264 (Bankr. W.D. Wash. 1981).

¹¹⁷ 124 CONG. REC. S17403, S17413 (daily ed. Oct. 6, 1978) (statement of Sen. DeConcini).

¹¹⁸ See *In re Ascot Mortg., Inc.*, 153 B.R. 1002, 1007 (Bankr. N.D. Ga. 1993) (“[T]here is nothing to indicate that Congress intended to protect a transfer where there was no . . . servicing agreement between the seller and the purchaser of the mortgage and parties simply did not get around to recording the assignment.”).

¹¹⁹ The court in *Ascot Mortgage* ultimately concluded that Section 544(a)(3) did not apply to mortgages so the trustee’s claim failed. *Id.* at 1009.

¹²⁰ *Id.* at 1007.

¹²¹ See Pub. L. No. 95-598, § 541(d) (1978).

¹²² See Pub. L. No. 98-353, § 456(c) (1984) (amending section 541(d) to cover only §§ 541(a)(1) and (2)).

1990s.¹²³ The use of MERS potentially is more confusing to buyers and more damaging to real-property records than a lender-servicer's retention of documents, because the servicer has a substantial, ongoing connection to the mortgage and its owner. Servicers generally are responsible for negotiating with borrowers, prosecuting foreclosures, and remitting payments to owners;¹²⁴ these functions require the servicer to know who the mortgage owner is. Property records that disclose the servicer may be more likely to be useful to borrowers and potential mortgage buyers than property records that merely disclose the identity of MERS, Inc. Moreover, recent events have raised awareness of the importance of high-quality mortgage records. In that light, a court might well discount Senator DeConcini's assertion that mortgage recording is "irrelevant."¹²⁵

It is equally unclear as a textual matter that Section 541(d) covers MERS mortgages. Section 541(a) lists the property of which the estate is "comprised,"¹²⁶ and its seven numbered subdivisions generally are considered an exhaustive list of the ways property can enter the estate.¹²⁷ Section 541(d) applies only to property that enters through two of these seven subdivisions, §§ 541(a)(1) and (a)(2), and it does not specifically refer to § 544(a)(3). MERS mortgages probably do not fall within either § 541(a)(1) or § 541(a)(2). Section 541(a)(1) covers "all legal or equitable interests of the debtor in property as of the commencement of the case."¹²⁸ As discussed above,¹²⁹ the trustee's strong-arm powers extend beyond property interests of the debtor, so it does not appear that such interests would enter the estate under § 541(a)(1). Thus, it does not appear that property brought into the estate under the strong-arm power and not owned by the debtor, such as MERS mortgages, would fall under Section 541(a)(1). 541(a)(2) deals with community property and does not appear relevant.¹³⁰ Thus,

¹²³ See discussion *supra* Part I.A; Peterson, *Two Faces*, *supra* note 8, at 116 (idea for MERS dates to mid-1990s).

¹²⁴ See Adam J. Levitin & Tara Twomey, *Mortgage Servicing*, 28 YALE J. ON REG. 1, 23 (2011).

¹²⁵ 124 CONG. REC. S17403, S17413 (daily ed. Oct. 6, 1978) (statement of Sen. DeConcini).

¹²⁶ 11 U.S.C. § 541(a) (2012).

¹²⁷ See RESNICK ET AL., *supra* note 78, § 541.01 ("[S]ection 541(a) defines everything that is included in property of the estate.").

¹²⁸ 11 U.S.C. § 541(a)(1).

¹²⁹ See discussion *supra* Part II. A.

¹³⁰ 11 U.S.C. § 541(a)(2). There are no natural persons involved in the contest between the MERS, Inc. bankruptcy trustee and the securitization trusts, so the mortgages presumably are not community property.

the statutory text suggests that § 541(d) does not cover MERS mortgages, because they would not enter under §§ 541(a)(1) or (a)(2).¹³¹

However, it is not clear under just what provision of § 541 MERS mortgages *would* enter. Section 541(a)(3) seems like the most obvious candidate. Section 541(a)(3) encompasses “[a]ny interest in property that the trustee recovers under section . . . 550.”¹³² Section 550 in turn authorizes the trustee to recover property “to the extent that a transfer is avoided under section 544.”¹³³ Because MERS mortgages would not enter under an “avoided” transfer, it is not clear that § 541(a)(3) applies either. Nevertheless, courts have held that real-property interests that enter the bankruptcy estate through § 544(a)(3) do so through § 541(a)(3)¹³⁴ without finding that the trustee is avoiding a transfer away from the debtor. Other courts have sidestepped the issue, finding that § 541(d) does not apply to the trustee’s claim under § 544(a)(3) without specifying what provision, if any, of § 541(a) is involved.¹³⁵ Even though no provision of § 541(a) is a perfect fit for MERS mortgages, it is at least arguable that the mortgages would enter through § 541(a)(3) and thus would fall outside the scope of § 541(d).

In sum, although § 541(d) might prevent MERS mortgages from entering the MERS, Inc. bankruptcy estate, the text, history, and judicial interpretation of § 541(d) all cast doubt on that possibility.

¹³¹ Even so, some courts analyzing the issue have concluded that property not owned by the debtor but within the reach of the strong-arm power does fall within § 541(a)(1), and therefore § 541(d), at least when the bankruptcy trustee is not avoiding a transfer of property by the debtor. See *In re Mortgage Lenders Network*, 380 B.R. 131, 136 (Bankr. D. Del. 2007).

¹³² 11 U.S.C. § 541(a)(3).

¹³³ 11 U.S.C. § 550(a) (2012).

¹³⁴ See *In re Paul J. Paradise & Assocs., Inc.*, 249 B.R. 360, 367 (D. Del. 2000) (Sections 541(a)(3) and (a)(4) “includ[e] § 544’s strong-arm powers”); *In re Granada, Inc.*, 92 B.R. 501, 508-09 (Bankr. D. Utah 1988).

¹³⁵ See *Belisle v. Plunkett*, 877 F.2d 512, 515 (7th Cir. 1989) (finding that Section 541(d) “does not address whether property may be included under some other part of the Code”); *In re Sedona Cultural Park, Inc.*, No. AZ-06-1339-MoPaBr, 2007 WL 7540968, at *8 (B.A.P. 9th Cir. 2007) (“Under the majority rule Sections 541 and 544 are complementary, not conflicting, sources of Trustee’s rights and powers.”); *In re Ascot Mortg., Inc.*, 153 B.R. 1002, 1008 (Bankr. N.D. Ga. 1993) (“[Section 541(d)] apparently does not preclude inclusion when property is brought into the estate under § 544(a) through § 550”).

B. *There Is a Risk That MERS, Inc. Can Convey the Mortgages Recorded in its Name to a Bona Fide Purchaser, Either as Owner or as Agent*

MERS, Inc. holds title as a “nominee” for the mortgage lender and its successors and assigns.¹³⁶ It could be argued that no one could reasonably think that such a “nominee,” one designed merely to hold mortgages entered into a registration system, could sell the mortgages recorded in its name. But MERS, Inc. is presented to the world as much more than a registration system. MERS, Inc. and the members of MERS claim — often successfully — that the company can exercise all rights of the true owner of the mortgage, that MERS can convey ownership of mortgages, and that MERS owns constitutionally protected interests in mortgages and would be injured if its rights in the mortgages are impaired. As a result, a large body of precedent suggests that MERS, Inc. possesses broad authority to convey MERS mortgages either as agent or as a type of owner, and therefore that the mortgages would pass into MERS, Inc.’s bankruptcy estate if the company enters bankruptcy.

1. MERS, Inc. as Mortgage Owner

Surprising as it may seem, given that MERS is a registration system, MERS, Inc. has represented itself to mortgage borrowers as a “creditor”¹³⁷ and claimed outright ownership of both the mortgages recorded in its name¹³⁸ and the associated notes.¹³⁹

One might dismiss such bald claims of ownership as one-off assertions of rogue counsel, corporate slips of the tongue.¹⁴⁰ But MERS, Inc. has consistently described itself in owner-like terms and claimed owner-like rights when seeking to establish its right to participate in foreclosure proceedings. For instance, MERS, Inc. has claimed that it has a constitutionally protected property interest in the

¹³⁶ Mortgage, Ex. A to Affirmation of William C. Hultman, *In re Agard*, No. 10-77338-REG (Bankr. E.D.N.Y. Dec. 10, 2010).

¹³⁷ See *Trent v. MERS, Inc.*, 288 Fed. Appx. 571, 572 (11th Cir. 2008) (dismissing unfair business practice claim against MERS, Inc. based on its self-description as creditor on ground that MERS, Inc. “has the legal right to foreclose”).

¹³⁸ See *MERS v. Young*, No. 2-08-088-DV, 2009 WL 1564994, at *2-3 (Tex. App. June 4, 2009) (declining to accept MERS’s claim of ownership given state of record).

¹³⁹ See *Chase Manhattan Mortg. Corp. v. Smith*, No. C061069, 2007 WL 3225534, at *3 (Ohio Ct. App. Nov. 2, 2007) (“MERS was the mortgage holder . . . MERS also owned the note on the loan.”).

¹⁴⁰ See *Zacks*, *supra* note 8, at 557-58 (arguing that claims of ownership on MERS’s behalf are typically made by inadequately supervised local counsel and that MERS’s rules officially prohibit members from making such claims).

mortgages recorded in its name¹⁴¹ and that it has standing to lift the automatic bankruptcy stay because the stay impairs MERS, Inc.'s "right to foreclose,"¹⁴² causing injury in fact to MERS, Inc. MERS, Inc. often has claimed successfully to be a "real party in interest" in foreclosure proceedings, a status that typically requires — as the name suggests — a true interest in the proceedings.¹⁴³ MERS, Inc. has appeared as the true mortgagee in other capacities, for example litigating the issue of the priority of a MERS mortgage over a mechanic's lien.¹⁴⁴

*MERS, Inc. v. Bellistri*¹⁴⁵ is particularly noteworthy because MERS, Inc. argued that it has a property right in MERS mortgages, and the court agreed, holding that MERS, Inc. has a property right of the kind creditors can reach. In *Bellistri*, MERS, Inc. argued that its right to due process was violated when property subject to a MERS mortgage was sold at a tax sale without MERS' knowledge. The court agreed,¹⁴⁶ citing and quoting the U.S. Supreme Court's decision in *Sprint Communications Company v. APCC Services*.¹⁴⁷ In *Sprint*, the Supreme Court held that parties who are assigned claims for collection have a "property right (which creditors might attach)" in the assigned claims.¹⁴⁸ If MERS, Inc. in fact has the status it successfully claimed in *Bellistri*, creditors can reach the mortgages registered on the system. The Supreme Court of Indiana recently issued a decision that appears to hold that MERS has rights in a mortgage coextensive with those of a

¹⁴¹ *Renkemeyer v. MERS, Inc.*, No. 10-2415-JWL, 2010 WL 3878572, at *1, *2 (D. Kan. July 26, 2010) (addressing case where MERS, Inc. argued that its interest as holder of legal title "arises to the level of a protected property interest and that its absence would therefore violate due process" and homeowners argued that "MERS has no real interest in the mortgage as a mere nominee of the lender or the holder of the note," and finding for MERS, Inc. on grounds that it "claims an interest as nominee under the mortgage that is protected by the due process clause").

¹⁴² *See In re Freeman*, 446 B.R. 625, 629 (Bankr. S.D. Ga. 2010).

¹⁴³ *See MERS, Inc. v. Harris-Gordon*, No. L-10-1176, 2011 WL 1590082, at *1-2 (Ohio Ct. App. Apr. 22, 2011) (rejecting homeowner/borrower's claim that MERS was not "real party in interest").

¹⁴⁴ *Parkwest Homes LLC v. Barnson*, 238 P.3d 203, 205 (Idaho 2010).

¹⁴⁵ *MERS, Inc. v. Bellistri*, No. 4:09-CV-731 CAS, 2010 WL 2720802, at *14 (E.D. Mo. July 1, 2010).

¹⁴⁶ *Id.* at *13-14. ("MERS had a legal right to file suit to foreclose the mortgage under [state statute]. . . . The right to bring an action is a 'constitutionally recognized property interest.'").

¹⁴⁷ 554 U.S. 269 (2008).

¹⁴⁸ *Id.* at 289. The Court reached this conclusion even though the assignees in the case were mere "attorneys in fact" (in effect, collection agents) for the assignor. *Id.* at 272.

mortgage owner. In this case, *Citimortgage, Inc. v. Barabas*,¹⁴⁹ Citimortgage, which had taken an assignment of a first mortgage on property from MERS, Inc. sought to intervene in foreclosure proceedings brought by the mortgagee of the second mortgage.¹⁵⁰ The court found that MERS, Inc. was an agent of the original lender¹⁵¹ and that “[t]his agency relationship conferred various rights upon MERS, including rights that constitute protected property interests sufficient to entitle MERS—and Citimortgage standing in the shoes of MERS—to meet the first requirement [of standing],”¹⁵² namely an “interest in [the] property which is the subject of the action.”¹⁵³ Although the court did not specify just what MERS’s and Citimortgage’s rights were, the basis for the court’s ruling apparently was its finding that the two entities had coextensive rights: the court found that Citimortgage’s interest was “dependent [on] MERS’s interest”¹⁵⁴ because Citimortgage “stands in the shoes of [MERS].”¹⁵⁵ Because Citimortgage claimed to own the mortgage,¹⁵⁶ the court’s reasoning implies that MERS too had the rights of a mortgage owner. Although that conclusion seems absurd, it illustrates the difficulties presented by MERS’ various incarnations.¹⁵⁷

MERS, Inc. claims to assign a “beneficial” interest in mortgages even more frequently than it claims ownership interests to establish standing. Despite language in the MERS form security instruments providing that MERS, Inc. “holds only legal title” in MERS mortgages, the company’s form mortgage assignments purport to transfer “*the Assignor’s [i.e., MERS, Inc.’s] beneficial interest*” in the mortgage.¹⁵⁸

¹⁴⁹ 975 N.E.2d 805 (Ind. 2012).

¹⁵⁰ *Id.* at 811.

¹⁵¹ *Id.* at 814.

¹⁵² *Id.* at 814-15.

¹⁵³ *Id.* at 812.

¹⁵⁴ *Id.* at 813.

¹⁵⁵ *Id.*

¹⁵⁶ *Id.* at 811.

¹⁵⁷ The court recognized the problems here, stating that “the General Assembly may soon find it necessary to modernize the statutory script to accommodate this new and larger cast of characters.” *Id.* at 818.

¹⁵⁸ See, e.g., Assignment of Mortgage, Ex. F to Affirmation of William C. Hultman, *In re Agard*, Case No. 10-77338-REG (Bankr. E.D.N.Y. Dec. 10, 2010) (emphasis added). This particular assignment recites that MERS, Inc. is a nominee for First Franklin, the original lender on the mortgage. See *In re Agard*, 444 B.R. 231, 237 (Bankr. E.D.N.Y. 2011), *vacated in part*, *Agard v. Select Portfolio Servicing, Inc.*, Nos. 11-CV-1826 (JS), 11-CV-2366(JS), 2012 WL 1043690 (E.D.N.Y. Mar. 28, 2012). Our review of the cases retrieved by a search on “mers /s beneficial” on Aug. 6, 2011 in the ALLCASES database retrieved 136 instances in which MERS, Inc. purported to

Because under MERS' current rules every foreclosure on a MERS mortgage is supposed to entail an assignment from MERS, Inc. to the foreclosing party,¹⁵⁹ one can assume that there are tens or hundreds of thousands of these assignments in existence.

Mere registration systems do not own beneficial interests in mortgages, do not have constitutionally protected property interests in mortgages, do not suffer "injury in fact" when foreclosures are delayed, and are not "real parties in interest" in foreclosure proceedings. MERS, Inc. has never presented an explanation of its apparently contradictory claims to own on the one hand "only legal title" and on the other a "beneficial interest"¹⁶⁰ in the mortgages. If MERS, Inc. is an owner, it can sell what it owns. MERS, Inc.'s claims of ownership increase the likelihood that a court would hold that a buyer could purchase mortgages from MERS, Inc. in good faith.

2. MERS, Inc. as Agent: The Power to Exercise "Any or All" Rights of the Lender

Even if a court were inclined to ignore MERS, Inc.'s many claims of actual ownership of the mortgages recorded in its name, it still would confront the bankruptcy trustee's argument that the mortgages would enter the MERS, Inc. bankruptcy estate because of MERS, Inc.'s power to sell the mortgages as an agent for others. MERS, Inc. has claimed the right, as agent, to exercise "any or all" of the lender's rights in its form mortgages. MERS, Inc. has done so both in testimony to Congress and in countless cases litigated across the country.

The millions of mortgages recorded in MERS, Inc.'s name set forth the company's powers in the following language:

I [the borrower] understand and agree that MERS holds only legal title to the rights granted by me in this Security Instrument, but, if necessary to comply with law or custom,

transfer a beneficial interest in a mortgage or deed of trust and no instances in which MERS, Inc. claimed that its assignment did not transfer a beneficial interest.

¹⁵⁹ See MERSCORP, INC. RULES OF MEMBERSHIP, Rule 8 (July 2011).

¹⁶⁰ The distinction between "legal" and "beneficial" title to a mortgage might be challenged, but at least one state supreme court has recognized the distinction. See *Jackson v. MERS, Inc.*, 770 N.W.2d 487, 499 (Minn. 2009) ("[I]t is possible for a party to hold legal title in the security instrument — title that evidences apparent ownership but does not necessarily signify a beneficial interest — without holding an interest in the promissory note."). Because MERS, Inc. claims a beneficial interest in the mortgage, the metaphysics of the legal-beneficial distinction as applied to a mortgage need not detain us further.

MERS (as nominee for Lender and Lender's successors and assigns) has the right:

(A) to exercise any or all of those rights including, but not limited to, the right to sell the Property; and

(B) to take any action required of Lender including, but not limited to, releasing and canceling this Security Instrument.¹⁶¹

MERS, Inc. has pressed a broad interpretation of this language in Congress. In November 2010, MERS, Inc.'s then-President and CEO, R.K. Arnold testified that the MERS standard form mortgage "grants MERS broad rights, again as nominee for the lender and the lender's successors and assigns, 'to exercise any or all' of the interests granted by the borrower under the mortgage."¹⁶²

More commonly, MERS, Inc. embraces a broad view of "any or all" in court. The power to "exercise any or all" rights of the lender is central in the struggle between MERS and defaulting mortgage borrowers. In the typical foreclosure case involving a MERS mortgage, MERS, Inc. is seeking to foreclose in its own name or has assigned the mortgage to a securitization trustee or servicer that seeks to foreclose. If MERS, Inc. seeks to foreclose in its own name, the borrower argues that MERS, Inc. lacks standing to foreclose because it is a mere "nominee" and MERS, Inc. responds that it has standing to foreclose because it can exercise "any or all" rights of the lender and its successors and assigns.

In the more common case where MERS, Inc. has purported to assign the mortgage to a securitization trustee or servicer to foreclose,¹⁶³ the borrower claims that MERS, Inc.'s status as a "nominee" means that the company lacks authority to assign the mortgage, and MERS, Inc. rebuts the claim by pointing to the "any or all" language in the form mortgage signed by the borrower and recorded in the county land records.¹⁶⁴ However, despite the best efforts of the foreclosure defense

¹⁶¹ Mortgage, Ex. A to Affirmation of William C. Hultman, *In re Agard*, Case No. 10-77338-REG (Bankr. E.D.N.Y. Dec. 10, 2010) (emphasis added). Other form documents refer to "any or all interests" granted the lender, rather than "any or all rights" — a difference of no apparent relevance.

¹⁶² See Arnold Testimony, *supra* note 1, at 10.

¹⁶³ MERS changed its rules in July 2011 to forbid its members from initiating foreclosures or seeking relief from the bankruptcy stay on behalf of MERS, Inc. MERS POLICY BULLETIN 2011-5 (July 21, 2011), <http://www.mersinc.org/MersProducts/bulletins.aspx?mpid=1>.

¹⁶⁴ If the borrower is in bankruptcy, the dispute will be heard in the context of a motion to lift the automatic stay.

and consumer bankruptcy bars, courts conclude more often than not that MERS, Inc. has the better of the argument.¹⁶⁵ The “any or all” language in MERS, Inc.’s standardized mortgages empowers MERS, Inc. to do anything the original lender could do with the mortgage.

The rights of the lender include the power to sell the mortgage, so the power to sell the mortgage is included in “any or all” rights of the lender. Courts have affirmed exactly this conclusion, expressly finding that MERS, Inc. can sell mortgages. For example, in *Crum v. LaSalle Bank, N.A.*, the Alabama Court of Civil Appeals expressly held that the “any or all rights” language means that “MERS was authorized to perform any act on the lender’s behalf as to the property, including selling the note and the mortgage to a third party”¹⁶⁶ because the recorded instrument confers on MERS, Inc. “any or all of [the lender’s] interests in the mortgaged property.”¹⁶⁷ The United States District Court for the Southern District of Texas recently held that MERS’s standard form language “expressly gave MERS authority to sell

¹⁶⁵ Courts in Arizona, Arkansas, California, Georgia, Illinois, Massachusetts, Minnesota, Missouri, Nevada, New York, Ohio, Oregon, Texas, Utah, Virginia, Washington, and Wyoming have relied expressly on the “any or all” language in rejecting homeowner/borrowers’ contention that MERS, Inc. as a mere nominee did not have the right to assign or foreclose on mortgages. See *Kebasso v. BAC Home Loans Servicing, LP*, 813 F. Supp. 2d 1104, 1109 (D. Minn. 2011); *Beyer v. Bank of America*, 800 F. Supp. 2d 1157, 1161 (D. Or. 2011); *Silving v. Wells Fargo Bank*, 800 F. Supp. 2d 1055, 1067-68 (D. Ariz. 2011); *Chandler v. MERS, Inc.*, No. 3:10-CV-00740-RCJ-VPC, 2011 WL 3419819, at *1 (D. Nev. Aug. 2, 2011); *Kulovic v. BAC Home Loans Servicing, Inc.*, No. 4:10-CV-2058 CAS, 2011 WL 1483374, at *6 (E.D. Mo. Apr. 19, 2011); *Coley v. Accredited Home Lenders, Inc.*, No. 4:10CV01870 JLH, 2011 WL 1193072, at *3 (E.D. Ark. Mar. 29, 2011); *Perry v. Nat’l Default Servicing Corp.*, No. 10-CV-03167-LHK, 2010 WL 3325623, at *4 (N.D. Cal. Aug. 20, 2010); *Santarose v. Aurora Bank FSB*, No. H-10-720, 2010 WL 2232819, at *5 (S.D. Tex. June 2, 2010); *In re Marron*, 455 B.R. 1, 7 (Bankr. D. Mass. 2011); *In re Bryant*, 452 B.R. 876, 882 (Bankr. S.D. Ga. 2011); *In re Burnett*, 450 B.R. 589, 593 (Bankr. W.D. Va. 2011); *MERS, Inc. v. Barnes*, 940 N.E.2d 118, 124 (Ill. App. Ct. 2010) (quoting “any or all interests” language in support of holding that MERS could foreclose in its own name); *Deutsche Bank Nat’l Trust Co. v. Pietranico*, 928 N.Y.S.2d 818, 828 (Sup. Ct. 2011); *Deutsche Bank Nat’l Trust Co. v. Greene*, No. E-10-00, 2011 WL 1590296, at *2 (Ohio Ct. App. Apr. 22, 2011); *Commonwealth Property Advocates v. MERS, Inc.*, 263 P.3d 397, 402 (Utah Ct. App. 2011), *reh’g denied*, Aug. 10, 2011, *cert. denied*, 263 P.3d 397 (Utah 2011); *Rhodes v. HSBC Bank USA N.A.*, No. C11-5303RJB, 2011 WL 3159100, at *3 (W.D. Wash. July 26, 2011); *In re Martinez*, No. 09-21124, 2011 WL 996705, at *5 (Bankr. D. Wyo. Mar. 16, 2011).

¹⁶⁶ *Crum v. LaSalle Bank, N.A.*, 55 So. 3d 266, 260 (Ala. Civ. App. 2009); see also *Freddie Mac v. Brooks*, No. 3:11CV313-WHA, 2011 WL 3794683, at *3-4 (M.D. Ala. Aug. 25, 2011).

¹⁶⁷ *Crum*, 55 So. 3d at 269. *Crum* rejected a homeowner/borrower’s argument that the recipient of an assignment from MERS “had not acquired the power to undertake foreclosure proceedings.” *Id.* at 268.

or transfer its rights and interests,”¹⁶⁸ so that MERS could assign a mortgage and deed of trust. Our review turned up nothing in MERS, Inc.’s membership rules that prohibits MERS, Inc. from selling mortgages or otherwise limits the “any or all” language on which MERS, Inc. and the members of MERS rely.¹⁶⁹

Even if MERS, Inc. does not exercise the power to sell mortgages, it does exercise its power to convey interests in the mortgages every day by making mortgage assignments. Under MERS’s current rules, an assignment from MERS, Inc. is a prerequisite to foreclosure on a MERS mortgage.¹⁷⁰ Indeed, MERS, Inc. must claim the power to assign mortgage in order to function on a nationwide basis, as many states apparently require a foreclosing party to show a chain of mortgage assignments in order to foreclose.¹⁷¹ The common meaning of “assignment” is a “transfer of rights or property,”¹⁷² so when MERS, Inc. assigns the mortgage, the natural assumption is that MERS, Inc. transfers a right or property interest in the mortgage it is assigning. Certainly, its own form assignment documents, with their claims to assign a “beneficial interest,” support this assumption.¹⁷³ Most courts agree that MERS, Inc. and the members of MERS are right, and that MERS, Inc. can pass good title to the mortgages recorded in its name.¹⁷⁴ Indeed, many courts have gone farther and held that MERS

¹⁶⁸ Penrod v. Bank of New York Mellon, 824 F. Supp. 2d 754, 758 (S.D. Tex. 2011).

¹⁶⁹ See MERSCORP, INC. RULES OF MEMBERSHIP (Mar. 2012).

¹⁷⁰ See MERS SYSTEM RULES OF MEMBERSHIP, Rule 8 (Mar. 2012).

¹⁷¹ Our research indicates that this is true at least of Alabama, Arkansas, Connecticut, Kansas, Massachusetts, New York, Ohio, Oregon, and Texas. See Research Memorandum from Ronny Clausner, Student, U.C. Davis School of Law, to John Patrick Hunt, Jan. 18, 2012 (on file with authors); see also David R. Greenberg, *Neglected Formalities in the Mortgage Assignment Process and the Resulting Effects on Residential Foreclosures*, 83 TEMP. L. REV. 253, 266-71 (2010) (observing that courts in Ohio, Massachusetts, and New York require that a foreclosing party demonstrate a valid assignment in order to foreclose). Some states go farther and require that the chain of assignments be recorded, not just demonstrated. See OHIO REV. CODE ANN. § 86.735 (West 2012); MICH. COMP. LAWS § 600.3204 (West 2012); MINN. STAT. § 580.02 (West 2012); OR. REV. STAT. § 86.735(1). Although these requirements apply to nonjudicial foreclosure, that is the leading form of foreclosure in those states.

¹⁷² BLACK’S LAW DICTIONARY 136 (9th ed. 2009). *Black’s Law Dictionary* has been recognized as a source in MERS litigation. See *Citimortgage v. Barabas*, 975 N.E.2d 805, 813 (Ind. 2012) (definition of “nominee”); *Butler v. Deutsche Bank Trust Co. Ams*, CIV. A. 12-10337-DPW, 2012 WL 3518560, at *8 (D. Mass. Aug. 14, 2012) (same); *U.S. Bank, N.A. v. Howie*, 280 P.3d 225, 231 (Kan. Ct. App. 2012) (same).

¹⁷³ See *supra* note 158 and accompanying text.

¹⁷⁴ See, e.g., *Trotter v. Bank of New York Mellon*, 275 P.3d 857, 862-63 (Idaho 2012) (refusing to consider borrower’s argument that MERS could not assign interests

also possesses authority to assign the promissory notes associated with the mortgages.¹⁷⁵

The “any or all” language upon which MERS, Inc. and MERS’s members so heavily rely is, of course, the same language that a hypothetical purchaser of the mortgage would see upon reviewing the public record. The hypothetical purchaser considering a purchase from MERS, Inc. would see that MERS, Inc., although it “holds only legal title” to the mortgage, may “exercise any or all” of the lender’s rights. If the hypothetical purchaser turns to the caselaw to understand how this standard language has been understood,¹⁷⁶ the buyer would rapidly learn that MERS, Inc. and the members of MERS agree that MERS, Inc. can indeed do anything that the lender itself could do, and that more generally a legal titleholder apparently can make a transfer that is good against the “true” owner.¹⁷⁷ Under MERS’s

in deeds of trust); *Bertrand v. SunTrust Mortg., Inc.*, No. 09-857-JO, 2011 WL 1113421, at *4 (D. Or. Mar. 23, 2011) (holding that MERS form mortgage “grants MERS the power to initiate foreclosure and to assign its beneficial interest under the Deed of Trust”); *In re Marron*, 455 B.R. 1, 5 (Bankr. D. Mass. 2011) (holding that, under Massachusetts law, MERS is deemed to hold mortgage in trust for note owner and has power to assign it); *In re Martinez*, 444 B.R. 192, 206 (Bankr. D. Kan. 2011) (holding that MERS was an agent of the lender and noteholder, so the lender “had the right to enforce the Note and Mortgage through its agent, MERS, or on its own (by directing its agent to assign the mortgage to it)”); *In re Tucker*, 441 B.R. 638, 645-46 (Bankr. W.D. Mo. 2010); *Ferguson v. Avelo Mortg., LLC*, No. B223447, 2011 WL 2139143, at *5 (Cal. Ct. App. June 20, 2011) (MERS had authority to enforce mortgage, and accordingly so did a party to which it assigned the mortgage); *see also Perry v. Nat’l Default Servicing Corp.*, No. 10-CV-03167-LHK, 2010 WL 3325623, at *4 (N.D. Cal. Aug. 20, 2010); *Baisa v. Indymac Fed. Bank*, No. CIV. 09-1464 WBS JMF, 2009 WL 3756682, at *4 (E.D. Cal. Nov. 6, 2009). Although *Perry* and *Baisa* involved deeds of trust, they have been cited in cases involving “true” mortgages without any distinction being made. *See In re Marron*, 455 B.R. at 5; and MERS, Inc.’s form assignment does not appear to be different in states where “true” mortgages predominate.

¹⁷⁵ *See, e.g., Edelstein v. Bank of New York Mellon*, 286 P.3d 249, 260 (Nev. 2012) (Nev. 2012) (holding MERS can assign mortgage and note under Nevada law); *Taylor v. Deutsche Bank*, 44 So. 3d 618, 622-23 (Fla. Dist. Ct. App. 2010) (finding that MERS’s assignment of mortgage assigned note with it); *Deutsche Bank v. Greene*, No. E-10-006, 2011 WL 1590296, at *3 (Ohio Ct. App. Apr. 22, 2011). Some courts reach a functionally similar result by holding that MERS, Inc. can assign the mortgage and that that is sufficient because no separate assignment of the note is needed. *See Ferguson v. Avelo Mortg., LLC*, 126 Cal. Rptr. 3d 586, 593-94 (Cal. Ct. App. 2011).

¹⁷⁶ *Cf. RESTATEMENT (SECOND) OF CONTRACTS* § 211(2) (1981) (providing that form contract language should be given a uniform interpretation wherever reasonable).

¹⁷⁷ *See 8A AMERICAN JURISPRUDENCE 2D BAILMENTS* § 62 (2011) (“[I]f the bailor entrusts written evidence of title or a power of disposition to the bailee . . . an unauthorized transfer by the bailee normally will bind the bailor; in such a case, the bailor will be estopped from asserting title as against an innocent transferee.”).

own theory, MERS, Inc. has the same power to sell the mortgage as the original lender.¹⁷⁸

When an agent has plenary power to deal with the property of its principal — the status claimed by MERS, Inc. — the property may enter the agent's bankruptcy estate. For example, the general partner of a limited partnership is an agent empowered to deal with the partnership's property. At least one court has suggested that upon bankruptcy of such a general partner, the real property would enter the general partner's bankruptcy estate under § 544(a)(3), even if the partnership's interest is accurately recorded.¹⁷⁹ Because MERS does not record even the current identity of the mortgage owner, it presents a stronger case for real property's passing into the bankruptcy estate. For example, many state statutes provide that when a recorded instrument discloses only that a party holds title to land as a "trustee," without identifying the beneficiary, a purchaser can cut off the beneficiary's interest and is under no duty to ascertain the terms of the trust for itself.¹⁸⁰

The form documents, statements to Congress, and litigating positions of MERS, Inc. and the members of MERS establish that these parties claim that MERS, Inc. can sell mortgages. It appears that most courts agree, explicitly or implicitly finding that MERS, Inc.'s form mortgages and membership agreements do confer on MERS, Inc. the power to sell mortgages. In other words, they find that MERS, Inc. has actual authority to sell. But even if MERS, Inc. lacked actual authority to sell mortgages, the bankruptcy trustee still could prevail. A purchaser would not be limited to arguing that MERS, Inc. possesses actual authority to sell, so neither is the bankruptcy trustee. The bankruptcy trustee could rely on theories of apparent or inherent authority and estoppel, arguing that MERS's members have held MERS, Inc. out to the world as an entity that can do whatever the lender itself can do with a mortgage, including selling it, and should not be allowed to deny MERS's authority to sell mortgages when it is convenient for them to do so. These theories are not presented in foreclosure litigation, where the defaulting borrower seeks to deny, rather than affirm, MERS's powers. Thus, foreclosure decisions that

¹⁷⁸ It might be argued that the "necessary to comply with law or custom" language limits MERS, Inc.'s authority to sell mortgages, but none of the courts citing the "any or all" language has construed this "necessary to comply" clause as limiting MERS, Inc.'s authority.

¹⁷⁹ See *In re Granada*, 92 B.R. 501, 508 (Bankr. D. Utah 1988).

¹⁸⁰ See AMY MORRIS HESS ET AL., *THE LAW OF TRUSTS AND TRUSTEES* § 45 n.26 (3d ed. 2007).

conclude that MERS lacks *actual* authority to sell mortgages do not close off the trustee's ability to pursue the mortgages in a bankruptcy proceeding.

C. *MERS, Inc. as Hybrid Owner-Agent Under Section 544(a)(3)*

It is hard to avoid the conclusion, reached by others,¹⁸¹ that MERS's conduct has been self-contradictory. As convenient in the circumstances, MERS, Inc. has purported to assume the form sometimes of a passive nominee,¹⁸² sometimes of a robust agent, and sometimes of a true owner.

If a bankruptcy trustee sought to bring the MERS mortgages into MERS, Inc.'s bankruptcy estate, parties resisting the motion undoubtedly would present MERS, Inc. as nothing but the pallid, insubstantial tender of a registration system. They would argue that the company is a mere agent and that § 544(a)(3) does not cover sales of real property by agents on behalf of others. They also would point to Bankruptcy Code § 541(b)(1), which provides, "Property of the bankruptcy estate does not include . . . powers the debtor may exercise solely for the benefit of another."¹⁸³

¹⁸¹ See Peterson, *Two Faces*, *supra* note 8, at 113 ("Like Janus, MERS is two-faced: impenetrably claiming to both own mortgages and act as an agent for others who also claim ownership."); Weber, *supra* note 8, at 240 ("[T]he MERS model propagates a false dichotomy where MERS as the nominee or agent of the mortgagee can claim to be the mortgagee when that status is to its benefit, while simultaneously disclaiming that role as it sees fit."); Zacks, *supra* note 8, at 552 ("MERS's arguments to courts are so numerous and contradictory as to make pinning down one core theory of standing impossible."); *id.* at 585-88 (describing MERS as "more akin to a many-tentacled squid" than to Janus, and documenting inconsistencies in MERS's positions about whether it possesses promissory notes, is the beneficial owner of notes, has standing individually or as a nominee, and whether MERS, Inc. assigns notes and mortgages, whether MERS, Inc. receives consideration in exchange for assignments).

¹⁸² See *MERS, Inc. v. Nebraska Dep't of Banking*, 704 N.W.2d 784, 787 (Neb. 2005) (affirming MERS, Inc.'s position that it "[is] not a mortgage banker . . . because it only holds legal title to members' mortgages in a nominee capacity").

¹⁸³ It does not appear that any reported case has addressed the relationship between § 541(b)(1) and § 544(a)(3) of the Bankruptcy Code. Nor has any case addressed whether mortgages are "powers" covered by § 541(b)(1), which is usually applied to trust-law matters such as powers of appointment and the power to bring a representative action on behalf of trust beneficiaries. See *In re McCann*, 318 B.R. 276, 286 (Bankr. S.D.N.Y. 2004). This in itself makes reliance on the provision by MERS's proponents questionable. In any event, it is unclear that § 541(b)(1) restricts the strong-arm powers at all, rather than limiting what property enters the estate in its capacity as successor to the debtor. The 1898 Bankruptcy Act presents the strong-arm powers (§ 70a(5)) as cumulative to the "powers which [the debtor] might have exercised for its own benefit, but not those which he might have exercised for some

Confronted with the argument that § 544(a)(3) does not apply to MERS mortgages because MERS, Inc. is “just an agent,” the court would have to resolve the status of this novel, hybrid entity. It would have to do so with little guidance, as there is no authority bearing on how §§ 544(a)(3) and 541(b)(1) apply to an entity that purports to hold legal title to real property interests as an agent, on how the provisions apply to an hybrid owner/agent such as MERS, Inc., or on how they apply to an entity that purports to circumvent state mortgage recording statutes on a national basis.

1. Policies Underlying Section 544(a)(3): Avoiding “Ostensible Ownership” Problems and Encouraging Use of the Recording System

In applying Section 544(a)(3) to MERS, Inc., a court would ask how the reasons given for the expansive strong-arm power under Section 544(a)(3) apply to the company and its operations. Section 544(a)(3) grants the trustee greater powers than those possessed by creditors, and apparently it does so in part to promote the interest in public land recording.¹⁸⁴ To the extent that widespread use of MERS has degraded public title records,¹⁸⁵ the policy underlying § 544(a)(3) supports applying the provision for the benefit of MERS, Inc.’s creditors.

For example, a party dealing with MERS, Inc. as an agent that is empowered to sell or encumber real property for an undisclosed principal faces uncertainty. If the identity of the principal were recorded, the prospective purchaser would be on notice of the relationship and could use the land records to determine how to confirm the agent’s authority to enter into the transaction. This usually is not the case in MERS transactions. Although using MERS does not hide the *existence* of mortgages, MERS obscures the identity of its principal¹⁸⁶ because the system informs the borrower only that

other person,” § 70a(3), and Congress apparently did not intend to change the meaning of § 70a(3) when it reenacted and reorganized the provision in the 1978 Bankruptcy Act. See *In re Herrell*, 210 B.R. 386, 389-90 (Bankr. M.D. Fla. 1997). Moreover, § 541(b)(1) is strictly limited to powers the debtor can exercise *solely* for the benefit of another. See 5 COLLIER ON BANKRUPTCY ¶ 541.17 (16th ed. 2011) (“[I]f the power in question may be exercised for the benefit of another entity, but is capable of conferring benefit on the debtor also, it becomes property of the estate.”). If MERS, Inc. may benefit from the exercise of mortgage powers, the provision will not apply.

¹⁸⁴ See discussion *supra* Part II. A.

¹⁸⁵ See Peterson, *Foreclosure*, *supra* note 8, at 1400-04 (describing “atrophy of the land title infrastructure” due to MERS).

¹⁸⁶ It is unclear how useful land title records were in determining mortgage ownership in the pre-MERS era. Compare *id.* (arguing that MERS threatens to render a

MERS, Inc. is a nominee for the original lender “and its successors and assigns.”¹⁸⁷ In the usual case, the original lender will no longer have any interest in the mortgage and thus will not be the party on whose behalf MERS, Inc. holds title, but it will be the only party whose identity is disclosed.

A party contemplating a purchase from MERS, Inc. as agent would be able only to determine that MERS, Inc. is an agent, not for whom it is an agent. This permits various types of fraud. For example, the original lender, having securitized the mortgage, could purport to sell the mortgage to a new party through MERS and direct MERS, Inc. to record an assignment. The second buyer’s only defense against this tactic is MERS, Inc.’s internal controls. These allegedly have been quite deficient,¹⁸⁸ and in any event purchasers should not be charged with monitoring them. Recording that MERS, Inc. holds title as a common agent for the lender “and its successors” creates ostensible ownership problems and degrades the quality of public land records — exactly the problems that the broad scope of § 544(a)(3) is meant to address.¹⁸⁹

2. Creditors’ Ability to Reach Property Held for Principal

The court might also look to precedents addressing when creditors can reach property of another in the hands of a debtor. In doing so, it should bear in mind that the trustee’s rights to real property under § 544(a)(3) as a hypothetical bona fide purchaser may exceed those of an ordinary judgment creditor.¹⁹⁰ If these authorities are persuasive as

useful public mortgage recording system useless), with e-mail from Dale A. Whitman, James E. Campbell Endowed Professor Emeritus of Law, University of Missouri School of Law, to “propertyprof” listserv (Mar. 16, 2012, 12:53 a.m.) (“For at least 25 years, and probably much longer, no one could reliably determine who held a mortgage loan by making a title search.”). See also *MERSCORP, Inc. v. Romaine*, 861 N.E.2d 81, 88 (N.Y. 2007) (Kaye, J., dissenting in part) (cited in Peterson, *supra* note 8, at 157-58) (“[T]he MERS system will render the public record useless . . .”).

¹⁸⁷ See *Mortgage, Ex. A to Affirmation of William C. Hultman at 1, In re Agard*, No. 10-77338-REG (Bankr. E.D.N.Y. Dec. 10, 2010).

¹⁸⁸ See New York Complaint, *supra* note 40, ¶¶ 47-53 (alleging MERS, Inc.’s failure to supervise certifying officers); INTERAGENCY REVIEW, *supra* note 9, at 11 (reporting that servicers failed to assess MERS’s internal controls); White, *supra* note 9, at 486-88 (detailing evidence that MERS did not track mortgage transfers accurately because it relied on its members to make entries in MERS database without supervising the members).

¹⁸⁹ See also *HESS ET AL.*, *supra* note 180, § 46 (listing states that permit bona fide purchasers to avoid trusts where trust details are not recorded).

¹⁹⁰ See RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 60 (stating that rights of bona fide purchaser are superior to those of judicial lienholder as against

applied to MERS, then the trustee could reach MERS mortgages on behalf of MERS, Inc.'s creditors, but the inverse is not necessarily true.

One common situation where an agent holds property on behalf of a principal is that of a consignment sale of goods, where a consignor entrusts its goods to a consignee for sale. In the typical arrangement, the consignee holds no title to consigned goods and would breach its agency agreement with the consignor if it used the proceeds of a consignment sale to pay its own creditors rather than remitting the funds to the consignor.¹⁹¹ Nevertheless, if the consignee enters bankruptcy, its assets pass to the bankruptcy estate rather than being returned to the consignor unless the consignment relationship is recorded.¹⁹² The agent's bankruptcy exposes the principal's property to creditors' claims. Although filing an appropriate statement under the U.C.C. protects the consignor from this result, whether MERS, Inc.'s filing practices satisfy state recording law is doubtful.¹⁹³

restitution claimant).

¹⁹¹ See, e.g., Eric R. Roper, *Consignment Agreements*, in PATENTS, COPYRIGHTS, TRADEMARKS, AND LITERARY PROPERTY (Patents, Copyrights, Trademarks, and Literary Property Course Handbook Ser. 297, 1990) (explaining that consignment agreements establish a relationship in which the consignor is the principal and the consignee is the agent, and providing a sample agreement according to which consignee is to pay all proceeds of sale, net of commission, to consignor within a specified period of time).

¹⁹² See *In re WFG LLC*, No. 09-11265, 2010 WL 4607614, at *2 (Bankr. E.D. Tenn. Nov. 3, 2010) (holding that consigned property returned to consignor shortly before bankruptcy may be brought back into bankruptcy estate for distribution to creditors); Steven O. Weise, *Personal Property Secured Transactions*, 66 BUS. LAW. 1165, 1166 (2011) (explaining that consignments become part of bankruptcy estate unless consignor makes U.C.C. filing to protect interest).

¹⁹³ See discussion *supra* Part II. B.2. Consignment sellers may present an especially strong case that it is fair for creditors to reach property held for another, because there is an especially high risk of confusing lenders: the Uniform Commercial Code treats as consignments only situations where the consignee is a merchant that "deals in goods of the kind" and "is not generally known by creditors to be substantially engaged in selling the goods of others." U.C.C. § 9-102(a)(20) (2012). Because MERS, Inc. does not regularly sell mortgages — although it does regularly convey them and claim the right to sell them — there may be less chance of confusion than in the case of a consignment seller. Nevertheless, the consignment-sales example establishes that it is possible for property held by an agent to enter the agent's bankruptcy estate. If MERS, Inc. is less than a consignment seller, it seems to be much more than a bank providing a safe deposit box or a storage facility providing a locker. It would make little sense to expose the property in the care of such custodians to creditors' claims, but that is precisely because those entities, unlike MERS, Inc., have and claim no authority to sell or assign the property in their hands.

3. Estoppel to Deny MERS, Inc.'s Authority to Convey Mortgages

Even in cases where creditors ordinarily could not reach property held for another, principles of estoppel still operate. If the principal has induced a lender to treat the agent as the “true” owner of property, the principal will be estopped to deny the lender’s claims to the property upon the agent’s insolvency.¹⁹⁴ MERS members that are complicit in MERS, Inc.’s claims of mortgage ownership, such as those who made such claims on MERS’s behalf or acquiesced in the making of the claims,¹⁹⁵ may be estopped to deny MERS, Inc.’s true ownership of the mortgages if the company enters bankruptcy.

MERS, Inc.’s unusual — not to say bizarre — status as a hybrid owner-agent creates problems. A contest under § 544(a)(3) would, at least in form,¹⁹⁶ pit MERS, Inc.’s creditors, such as state law enforcement officials, counties, or private plaintiffs, against MERS’s users. The trustee would seek the mortgages on behalf of the creditors; the users would seek to hold on to the mortgages they paid for. The users are the ones who more or less voluntarily dealt with the system whose dual nature created the problem. It seems quite optimistic on their part to assume that they would win simply by emphasizing the agency aspect of MERS’s dual nature and deemphasizing the ownership aspect, thus exploiting the very ambiguity that caused the problems. Such an assumption is even more optimistic given that the creditors by hypothesis would be tort plaintiffs and public officials seeking to collect money MERS, Inc. owes because of some form of wrongdoing,¹⁹⁷ not parties that voluntarily extended credit to the company.

¹⁹⁴ See 8 C.J.S. *Bailments* § 112 (“In the absence of statute or estoppel, the bailor’s title to the bailed property is good as against claims of the bailee’s creditors.”) (emphasis added); *id.* § 113 (stating that in case of sale or transfer by bailee, “[i]f the conduct of the bailor has been such as reasonably to lead the third party to believe that the title to the property was in the bailee, the bailor is to set up his or her title against such third party”); Recent Case, *Bailments – Estoppel of Bailor*, 10 TEX. L. REV. 498, 498 (1932) (“It is a well settled rule that a *bona fide* purchaser for value of a chattel from one having mere possession as a bailee does not acquire title. However, the owner may by his own voluntary conduct confer upon his bailee such an apparent right to the property and *indicia* of ownership that the owner will be estopped to set up his title against a *bona fide* purchaser for value from the bailee.”).

¹⁹⁵ See discussion *supra* Part I. C.

¹⁹⁶ Again, we claim no special insight into the many strategic issues that undoubtedly would be involved in a MERS, Inc. bankruptcy. Parties might take positions for reasons that are not obvious to us.

¹⁹⁷ See discussion *supra* Part I. C.

4. Countervailing Policy Arguments: MERS Is Efficient, and in Any Event “Too Big to Fail”

To be sure, a court might weigh the argument that MERS saves time and money that otherwise would be spent on recording mortgage assignments.¹⁹⁸ Beyond MERS’s putative efficiency benefits, it might be argued that MERS, Inc. is too big to fail.¹⁹⁹ Precisely *because* of the disruption that could follow any ruling that MERS mortgages enter MERS, Inc.’s bankruptcy estate, perhaps no court would ever make such a ruling.²⁰⁰ Indeed, Kenneth Kettering has made a similar argument about securitization itself. He finds fault with the legal foundations of securitization in general — arguing that the practice inherently involves fraudulent transfers²⁰¹ — but concludes that these faults are irrelevant in practice because the courts would be unwilling to risk disrupting the economy by recognizing and acting on the issue he identifies.²⁰²

The risk posed by MERS, however, is different from that posed by securitization generally because the system concentrates so much in one place: it puts all the eggs in one basket. If a judge finds that a single securitization is a fraudulent transfer, that finding clouds other transactions to varying degrees but might not affect any other deal

¹⁹⁸ See Korngold, *supra* note 11, at 742; Peterson, *Foreclosure*, *supra* note 8, at 1404-06.

¹⁹⁹ Cf. ANDREW ROSS SORKIN, TOO BIG TO FAIL (2010) (describing government’s frantic efforts to save large financial institutions, often without scrupulous attention to letter of law). For a sampling of the law review literature reviewing the dubious legality of aspects of the executive and administrative branches’ emergency reactions to the financial crisis, see Timothy A. Canova, *Financial Market Failure as a Crisis in the Rule of Law: From Market Fundamentalism to a New Keynesian Regulatory Model*, 3 HARV. L. & POL. REV. 369, 391-92 (2009); Steven M. Davidoff & David Zaring, *Regulation by Deal: The Government’s Response to the Financial Crisis*, 61 ADMIN. L. REV. 463, 512-23 (2009); Eric A. Posner & Adrian Vermeule, *Crisis Governance in the Administrative State: 9/11 and the Financial Meltdown of 2008*, 76 U. CHI. L. REV. 1613, 1628-31 (2009).

²⁰⁰ Decisions about whether to permit post-sale challenges to foreclosure based on widespread procedural defects in foreclosure present a similar issue, because allowing such challenges potentially places title at risk on many pieces of property. In *U.S. Bank v. Ibanez*, 941 N.E.2d 40, 44 (Mass. 2011), and *Bevilacqua v. Rodriguez*, 955 N.E.2d 884 (Mass. 2011), the Massachusetts Supreme Judicial Court did cast doubt on the validity of title to property purchased at nonjudicial foreclosure sales. For views about whether these cases will be influential elsewhere, see White, *supra* note 9, at 492 (“[C]hain-of-title issues are unlikely to lead to large numbers of post-sale challenges.”); Renuart, *supra* note 9, at 79 (arguing that after *Ibanez*, “property title trouble is likely in Georgia and Nevada, and to a lesser extent in California”).

²⁰¹ Kettering, *supra* note 43, at 1581-85.

²⁰² Kettering, *supra* note 43, at 1562-63.

directly. MERS, by contrast, is a single system operated by a single entity that could enter a single bankruptcy presided over by a single judge. A bankruptcy judge's order granting a motion to bring MERS mortgages into the MERS, Inc. bankruptcy estate could cover a large fraction of the thirty million mortgages recorded on MERS.²⁰³ Even if one were to indulge the plausible but contestable intuition that the judicial system *taken as a whole* is unwilling to risk the economic disruption that would follow from a finding that the MERS, Inc. bankruptcy trustee owns the mortgages recorded on MERS, rogue decisions can and do happen. A central problem in MERS's design is that the concentration of most American mortgages in the hands of a single private entity means that a single decision can create enormous problems.

The risk that a single court might reach the outcome described in this Article is even greater because MERS has ambiguities built into its structure and is based on largely untested legal theories at the intersection of commercial, real property, and bankruptcy law. Even if a court *might* be persuaded by MERS's efficiency and *might* find that the entity is in any event too big to fail, it still seems imprudent to risk the possibility that a bankruptcy court would find that some significant percentage of thirty million mortgages belong to MERS, Inc.'s bankruptcy trustee and not to investors.

D. The Proposition that "the Mortgage Follows the Note" Does Not Remove the Risks Posed by MERS, Inc. Bankruptcy

It might be argued that MERS, Inc. cannot sell the mortgages to which it owns legal title, because MERS, Inc. does not have an interest in the associated promissory notes, so that selling the mortgage would "split the mortgage and the note"²⁰⁴ or violate the proposition "the mortgage follows the note."

²⁰³ If different states' laws compel different results under § 544(a)(3), a specific judicial ruling could order the return only of mortgages located in particular states.

²⁰⁴ A number of courts have found or suggested that recording the mortgage with MERS splits mortgage and note. In these situations, mortgage and note are already split, so there is no issue of "splitting the mortgage and the note" in bankruptcy. See, e.g., *MERS, Inc. v. Estrella*, 390 F.3d 522, 525 (7th Cir. 2004) ("[MERS] is a nominee only, holding title to the mortgage but not the note."); *Rinegard-Guirma v. Bank of America, N.A.*, No. 10-1065-PK, 2010 WL 3945476, at *4-5 (D. Or. Oct. 6, 2010) (noting authority suggesting that MERS splits mortgage and deciding that it was "at least initially persuaded" that plaintiff claiming improper foreclosure based on MERS deficiencies "has a likelihood of success on the merits"); *Edelstein v. Bank of New York Mellon*, 286 P.3d 249, 259 (Nev. 2012) ("Designating MERS as the beneficiary does . . . effectively 'split' the note and the deed of trust at inception"); *Jackson v.*

There is substantial authority for the proposition that the MERS, Inc. bankruptcy trustee would not have to split mortgage and note. If MERS, Inc. can transfer the mortgage, the note could follow the mortgage into the trustee's hands.²⁰⁵ The approach to this issue articulated in the *Restatement (Third) of Property: Mortgages*²⁰⁶ and recognized in many courts²⁰⁷ is that the note follows the mortgage

Mortg. Elec. Registration Sys., Inc., 770 N.W.2d 487, 494 (Minn. 2008) (“MERS has essentially separated the promissory note and the security instrument”); CitiMortgage, Inc. v. Bischoff, No. 255-4-09, at 3 (Rutland Super. Ct. Vt. Oct. 28, 2009) (stating that to be a holder of an instrument requires holding the note and the note must be payable to the person in possession of the note). Other courts have held that using MERS does not split mortgage and note because MERS is an agent for the lender and its successors. *See, e.g.*, U.S. Bank v. Howie, 280 P.3d 225, 233 (Kan. Ct. App. 2012). Even if a court holds that use of MERS splits mortgage and note, it does not automatically follow that the mortgage is unenforceable, as the court may find that the instruments can be reunified if MERS assigns the mortgage to the noteholder. *Edelstein*, 286 P.3d at 259-60.

²⁰⁵ *See, e.g.*, *In re Veal*, 450 B.R. 897, 904-05, 916-17 n.33 (B.A.P. 9th Cir. 2011) (distinguishing between mortgage assignment that purported to assign note and mortgage assignment that did not purport to assign note); *Edelstein*, 286 P.3d at 260 (“MERS, as agent (nominee) for [original lender’s] successors and assigns, can transfer the note on behalf of the successors and assigns.”); *Debrunner v. Deutsche Nat’l Bank Trust Co.*, 204 Cal. App. 4th 433, 442 (2012) (giving effect to mortgage assignment that purported to assign note).

²⁰⁶ *See* RESTATEMENT (THIRD) OF PROP.: MORTGAGES, § 5.4(b) (“Except as otherwise required by the Uniform Commercial Code, a transfer of a mortgage also transfer the obligation the mortgage secures unless the parties to the transfer agree otherwise.”). MERS, Inc. claims to be authorized to transfer both mortgage and note. The commentary explains that the phrase “except as otherwise required by the Uniform Commercial Code” refers to the fact that the right to enforce a negotiable instrument can be transferred only by delivery. *Id.* cmt. b. This does not appear to cover the transfer of beneficial ownership. Even a negotiable note could follow the mortgage in that the right to the money would be transferred, even if the right to enforce is not. *See* U.C.C. § 3-203, cmt. 1; PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE, REPORT OF THE PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE: APPLICATION OF THE UNIFORM COMMERCIAL CODE TO SELECTED ISSUES RELATING TO MORTGAGE NOTES 8 (2011) (“[A] change in ownership of the note does not necessarily bring about a concomitant change in the identity of the person entitled to enforce the note.”); *see also* NELSON & WHITMAN, *supra* note 28, at 394; Phillip C. Ransdell, Note, *Mortgages – Effect of Assignment without Assigning the Debt – Formalities Necessary to Transfer the Mortgagee’s Title to the Mortgaged Property*, 36 N.C. L. REV. 225, 229 (1958).

²⁰⁷ *See* *Smith v. Cmty. Lending, Inc.*, 773 F. Supp. 2d 941, 944 (D. Nev. 2011) (“clear” that “interest in the note may follow the deed of trust as a matter of law”); *Armocost v. HSBC Bank USA*, No. 10-CV-274-EJL-LMB, 2011 WL 825151, at *11 (D. Idaho Feb. 9, 2011) (report and recommendation of magistrate judge) (assignment of mortgage with intent to assign note may effect assignment of note); *In re Martinez*, No. 09-21124, 2011 WL 996705, at *4 n.12 (Bankr. D. Wyo. March 16, 2011) (“when the ownership of a mortgage is assigned to another, the obligation secured by the

unless the parties to the transaction provide otherwise. In the *Restatement's* formulation, there is no contradiction between “the mortgage follows the note” and “the note follows the mortgage”: the idea is that transferring one transfers the other.²⁰⁸ The Nevada Supreme Court recently expressly adopted the *Restatement* approach to mortgage and note transfer, finding it “more consistent with reason and public policy” than the traditional view that mortgage and note could never be separated.²⁰⁹

MERS, Inc.’s members implicitly have agreed that MERS, Inc. can transfer the note along with the mortgage, because they have pressed this very argument successfully before courts across the country.²¹⁰

mortgage is likewise transferred” unless parties agree otherwise); *Crum v. LaSalle Bank, N.A.*, 55 So. 3d 266, 270 (Ala. Civ. App. 2009); *Debrunner*, 204 Cal. App. 4th at 442; *U.S. Bank, N.A. v. Flynn*, 897 N.Y.S.2d 855, 859 & n.1 (N.Y. Sup. 2010) (finding that New York’s “long standing rule that a transfer of a mortgage without a concomitant transfer of the debt is void” is “at odds with the generally prevailing common law rule that a transfer of the mortgage also transfers the debt unless the parties otherwise agree or such transfer is precluded by an applicable provision of the Uniform Commercial Code”); see also DAVID A. SCHMUDDE, A PRACTICAL GUIDE TO MORTGAGES AND LIENS 189 (2004) (stating that “[i]f the parties agree, the note can be separated from the mortgage, but this requires affirmative express action”; describing such a situation as “rare”).

²⁰⁸ See RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 5.4 cmt. c (stating that transfer of note is “ordinarily what parties desire and expect” when mortgage transferred).

²⁰⁹ *Edelstein*, 286 P.3d at 260.

²¹⁰ *In re Williams, Bankr. No. 09-41548*, 2012 WL 695832, at *3 (D. Kan. 2012) (citing Kansas statute providing that mortgage assignment carries with it the associated debt); *Smith v. Cmty. Lending, Inc.*, 773 F. Supp. 2d 941, 944 (D. Nev. 2011) (“MERS may directly transfer the interest in the deed of trust itself, and the interest in the note may follow the deed of trust as a matter of law.”); *Cannon v. JPMorgan Chase Bank*, No. 4:11-CV-458, 2011 WL 6838615, at *5 (E.D. Tex. Nov. 16, 2011) (stating that “transfer of an obligation secured by a note also transfers the note,” where the court apparently means that transfer of beneficial interest in a deed of trust transfers the associated note); *Eskridge v. Fed. Home Loan Mortg. Corp.*, No. W-10-CA-285, 2011 WL 2163989, at *5 (W.D. Tex. Feb. 24, 2011) (finding MERS assignment of deed of trust sufficient to transfer note); *In re Corley*, 447 B.R. 375, 383 (Bankr. S.D. Ga. 2011) (“Georgia law provides that upon a transfer of a deed to secure debt, the accompanying indebtedness is also transferred.”); *Crum*, 55 So. 3d at 270; *Deutsche Bank Nat’l Trust Co. v. Greene*, No. E-10-006, 2011 WL 1590296, at *3 (Ohio Ct. App. April 22, 2011) (finding that MERS’s “assignment of the mortgage, in conjunction with interlocking references in the mortgage and the note, transferred the note as well”); *Bank of New York v. Dobbs*, No. 2009-CA-000002, 2009 WL 2894601, at *3-4 (Ohio App. Sept. 8, 2009) (holding MERS assignment of mortgage sufficient to transfer note). Cases not involving MERS also sometimes hold that the note does or can follow the mortgage. See *Armacost v. HSBC Bank USA*, No. 10-CV-274-EJL-LMB, 2011 WL 825151, at *11-12 (D. Idaho Feb. 9, 2011) (suggesting that assignment of deed of trust may be sufficient to assign note); *Fed. Home Loan Mortg. Corp. v.*

They do this in foreclosures where the foreclosing party cannot produce the promissory note²¹¹ and seeks to cure the deficiency by producing a mortgage assignment from MERS, Inc. and claiming that the mortgage assignment carries the note with it.²¹² To be sure, many

Schwartzwald, 957 N.E.2d 790, 800-01 (Ohio Ct. App. 2011) (assignment of mortgage sufficient to assign note); *Deutsche Bank Nat'l Trust Co. v. Hansen*, No. 2010 CA 00001, 2011 WL 899625, at *8 (Ohio Ct. App. Mar. 10, 2011) (standing to foreclose where mortgage "assignment on its face purports to transfer the mortgage and note"). Occasionally, the homeowner's argument gives the court occasion to endorse MERS's ability to transfer note along with mortgage. See *Vega v. CTX Mortg. Co.*, 761 F. Supp. 2d 1095, 1099 (D. Nev. 2011) ("MERS-style assignment of a deed of trust would in fact be perfectly legitimate and effective under the Restatement to transfer the beneficial interest in a promissory note."), *dismissed on other grounds*, 814 F. Supp. 2d 1085, 1087 (D. Nev. 2011).

²¹¹ This appears to be a widespread problem. See Shaun Barnes et al., *In-House Counsel's Role in the Structuring of Mortgage-Backed Securities*, 2012 WIS. L. REV. 521, 528 ("[O]ver the years procedural standards in mortgage securitization appear to have deteriorated along with loan-underwriting standards. As a result, in some, if not many or most, cases, notes were neither indorsed nor delivered to the SPV or its agent in accordance with the delivery instructions. Moreover, it appears that mortgage loan servicers seeking to enforce notes on behalf of the SPV did not always bother to take physical possession of the notes in accordance with state law."); White, *supra* note 9, at 473-76 (concluding after review of evidence that "there is substantial evidence of a significant breakdown in the system of endorsement and delivery of mortgage notes in the pre-2007 period").

²¹² See cases cited *supra* note 175. The practice of claiming that a MERS assignment carries the note along with it is one reason that the fact that MERS, Inc. presumably would not be able to produce the promissory note to a hypothetical purchaser should not be fatal to the trustee's claim. Cf. *In re Ascot Mortgage*, 153 B.R. 1002, 1009 (Bankr. N.D. Ga. 1993) (stating that because "any purported purchaser of the debtor's interest" in mortgages "would have constructive knowledge that the [d]ebtor could not produce and transfer the original notes," the trustee could not take the mortgages under § 544(a)(3)). As the common tactic of relying on a MERS mortgage assignment rather than possession of the promissory note shows, the good faith and commercial reasonableness in the mortgage industry has not required production of the promissory notes in connection with mortgage transfers. See U.C.C. § 1-201(20) (defining good faith as "the observance of reasonable commercial standards of fair dealing"). For further evidence that the mortgage industry has operated without requiring production of notes, see Dale A. Whitman, *How Negotiability Has Fouled up the Secondary Mortgage Market, and What to Do About It*, 37 PEPP. L. REV. 737, 758 (2010) ("While delivery of the note might seem to be a simple matter of compliance, experience during the past several years has shown that, probably in countless thousands of cases, promissory notes were never delivered to market investors or securitizers, and, in many cases, cannot presently be located at all."); Garrett Wotkyns, *A New Front in the Foreclosure Epidemic: Consumers Fight Back*, in CORPORATE LAW, at 479 (PLI Corporate Law and Practice Course Handbook Ser. No. 1789, 2010) (asserting (without attribution) that "[s]ome estimate" that over 99% of residential foreclosure actions are filed with lost note affidavits); Bob Ivry, *Banks Lose to Deadbeat Homeowners as Loans Sold in Bonds Vanish*, BLOOMBERG.COM (Feb. 22,

courts have heeded borrowers' objections to this tactic and found that MERS, Inc. cannot transfer promissory notes in this context.²¹³ But the

2008) (quoting Florida legal aid attorney as saying that 80 percent of 300 cases she had handled in past year involved lost-note affidavits); sources cited *supra* note 211. Some courts have endorsed the practice of foreclosing with lost-note affidavits. See *Gibson v. Wells Fargo Bank*, No. 1:10-cv-304, 2011 WL 221188, at *3 (E.D. Va. Jan. 19, 2011); *U.S. Bank, N.A. v. Fraum*, No. LLICV075002610S, 2008 WL 4033640, at *1 (Conn. Super. Ct. Aug. 6, 2008). Indeed, the founding document of MERS embraces the goal of “immobilizing loan files,” thus “eliminat[ing]” “the cost of relocating and recertifying documents.” See INTERAGENCY TECHNOLOGY TASK FORCE, *supra* note 23, at III-6. A separate reason that failure to produce the note should not be fatal to the trustee’s claim is that note ownership can be transferred without delivery under the current U.C.C. See *supra* note 206 and accompanying text.

²¹³ Many courts have held that a MERS mortgage assignment cannot transfer the note unless the assignee holds the note. In other words, the note does not follow the mortgage. See *Rinegard-Guirma v. Bank of America, N.A.*, No. 10-1065-PK, 2010 WL 3945476 (D. Or. Oct. 6, 2010), at *4 (noting that “other courts have held that MERS does not have authority to transfer the note” and finding that homeowner was likely to succeed in challenge to securitization trustee’s authority to foreclose); *Saxon Mortg. Servs. v. Hillery*, No. C-08-4357 EMC, 2010 WL 5170180, at *5 (N.D. Cal. Dec. 9, 2008) (finding purported assignment by MERS invalid; although court assumed MERS has authority to transfer security instrument, no evidence that MERS held or had authority to assign note); *In re Lippold*, 457 B.R. 293, 298-99 (Bankr. S.D.N.Y. 2011) (finding MERS, Inc. lacked authority to transfer note); *In re Weisband*, 427 B.R. 13, 19-20 (Bankr. D. Ariz. 2010) (holding that MERS’s mortgage assignment did not give assignee standing to appear in borrower’s bankruptcy proceeding because note was not properly endorsed to assignee and MERS lacked an interest sufficient to confer standing); *In re Wilhelm*, No. 08-20577, slip op. at 23-24, (Bankr. D. Idaho July 7, 2009) (finding purported assignments by MERS ineffective where deeds did not authorize MERS to transfer promissory notes); *U.S. Bank, N.A. v. Alexander*, 280 P.3d 936, 940-41 (Okla. 2012) (“To commence a foreclosure action in Oklahoma, a plaintiff must demonstrate it has a right to enforce the note [A]n assignment of the mortgage . . . is of no consequence.”); *Eaton v. Federal Nat’l Mortg. Ass’n*, 969 N.E.2d 1118, 1134 (Mass. 2012) (finding MERS assignment insufficient to confer power to foreclose); *U.S. Bank, N.A. v. Kimball*, 27 A.3d 1087, 1092-93 (Vt. 2011); *Bank of N.Y. v. Silverberg*, 86 A.D.3d 274, 283 (N.Y. App. Div. 2011) (holding MERS lacked authority to assign power to foreclose because it was not holder or assignee of the notes); *Bellistri v. Ocwen Loan Servicing, Inc.*, 284 S.W.3d 619, 621 (Mo. Ct. App. 2009) (finding MERS’s attempt to transfer mortgage and “any and all notes secured by the mortgage” ineffective because MERS was not the noteholder and there was no evidence that the noteholder authorized MERS to transfer the note); *HSBC Bank v. Miller*, 889 N.Y.S.2d 430, 432 (N.Y. App. Div. 2009) (finding MERS assignment of mortgage ineffective where purported assignee could not prove it held the note; “[t]he assertion that the note follows the mortgage is unsupported by any law”). Courts have also stated in non-MERS cases that assignment of a mortgage does not carry the note along with it. See *In re Veal*, 450 B.R. 897, 915-16 (B.A.P. 9th Cir. 2011) (stating that general common-law rule is that “the transfer of a mortgage without the transfer of the obligations it secures renders the mortgage ineffective and unenforceable in the hands of the transferee,” although “some states may have altered this rule by statute”). Still other courts have announced prerequisites to foreclosure that would not be satisfied

policy argument for finding that MERS can transfer the note along with the mortgage is stronger in the context of a MERS, Inc. bankruptcy, where the mortgage owners would be pitted not against defaulting borrowers, but against law enforcement officials and involuntary creditors of MERS, Inc. who have proved in a lawsuit that MERS, Inc. wronged them. In their zeal to defeat defaulting homeowners, MERS's members have gone a long way toward establishing the proposition that "the note follows the mortgage." This proposition suggests that the MERS, Inc. bankruptcy trustee could bring both mortgage *and* note into the bankruptcy estate without splitting the instruments.²¹⁴

It is far from clear that MERS can transfer notes by assigning mortgages. But any honest account must admit that MERS's members have had a good deal of success in arguing that MERS does have this power. Their very success in turn opens the door to the possibility that MERS, Inc. could pass ownership of the notes along with ownership of the mortgages to its trustee in bankruptcy.

III. BANKRUPTCY OF MERS VERSUS BANKRUPTCY OF THE TRUSTEE OF AN EXPRESS TRUST

It might be argued that MERS mortgages would not pass into the bankruptcy estate because MERS, Inc. either is, or is like, the trustee of an express trust, and property interests held in trust do not enter the trustee's bankruptcy estate. After all, the trustee of an express trust exercises owner-like powers²¹⁵ and often possesses actual and/or apparent authority to sell trust property.²¹⁶ Yet it is treated as

by a MERS assignment. *See, e.g., In re Miller*, 666 F.3d 1255 (10th Cir. 2012) (requiring proof of negotiation or transfer of note, or of "qualified holder" status).

²¹⁴ Because the MERS corporate entities and members have pressed the case that "the note follows the mortgage" in trying to enforce the mortgage, it could be argued that the precedents they have created do not apply when ownership rather than enforcement is at issue. But the idea that parties probably want to keep mortgage and note together applies to ownership as well as enforcement, and the *Restatement* does not distinguish between the contexts. RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 5.4 cmt. b (stating the "principle . . . that the mortgage follows the note, applies" when "ownership" is "transferred by a document of assignment" or when a "transfer of the right to enforce" is "made by delivery" of a negotiable instrument).

²¹⁵ *See* RESTATEMENT (THIRD) OF TRUSTS §85(1)(a) (2005) ("In administering a trust, the trustee has, except as limited by the statute or the terms of the trust, all of the powers over trust property that a legally competent, unmarried individual has with respect to individually owned property . . .").

²¹⁶ *See, e.g., In re Estate of Maxedon*, 946 P.2d 104, 107 (Kan. Ct. App. 1997) (holding that trustee possessed implied power to sell non-wasting real property assets of trust as a reasonable and necessary power in light of trust's purpose to supply

axiomatic by trust scholars and practitioners that property of an express trust — real or otherwise — will not enter the estate if the trustee becomes bankrupt.²¹⁷ “Trust property does not enter the trustee’s bankruptcy estate,” the argument goes, “and MERS, Inc. is like a trustee, so MERS mortgages would not enter the bankruptcy estate.”

In evaluating this objection, one starts with the proposition that an actual purchaser in good faith from the trustee does in fact prevail over the trust beneficiary and cut off the beneficiary’s equitable interest.²¹⁸ Thus, if § 544(a)(3) means that the bankruptcy trustee is in the same position as a good-faith purchaser of real property, as most courts have held,²¹⁹ then the bankruptcy trustee would prevail even over the beneficiary of an express trust.²²⁰ Indeed, Andrew Kull argues that the majority interpretation of § 544(a)(3) is wrong precisely *because* it causes real property held in trust to enter the bankruptcy estate.²²¹ Whatever the merits of this argument about the proper scope of § 544(a)(3), as a matter of positive law the majority rule remains just that: the majority rule.

Indeed, a number of courts have said that the differences among constructive, resulting, express, and charitable trusts are irrelevant to

income to settlor’s family members).

²¹⁷ See, e.g., RESTATEMENT (THIRD) OF TRUSTS § 42 cmt.c (“[T]he trustee’s personal creditors or trustee in bankruptcy may not reach either the trust property or the trustee’s nonbeneficial interest therein.”). The *Restatement* does not specifically discuss the application of § 544(a)(3) to real property held in trust.

²¹⁸ See, e.g., GEORGE GLEASON BOGERT & GEORGE TAYLOR BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 881 (2d ed. 1995) (explaining that transfer of the legal estate in property to a bona fide purchaser for value cuts off all equities in the same property, including that of a trust beneficiary). Whether the MERS, Inc. bankruptcy trustee would take in good faith is addressed *supra*, Part II. B.

²¹⁹ See discussion *supra* Part II. A.

²²⁰ See, e.g., RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 60 cmt. f (“[T]he hypothetical status of bona fide purchaser allows the trustee to claim unencumbered title to real property held by the debtor in express trust”).

²²¹ See Kull, *supra* note 91, at 295 (1998) (majority interpretation of section 544(a)(3) would permit trustee to “distribute to creditors real property that is subject to an express trust,” so “[i]t is far, far, easier to believe no such change was intended” by addition of § 544(a)(3)); see also RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 60 cmt. f (characterizing majority view of § 544(a)(3) as a “radical” interpretation under which it is “impossible to explain why § 544(a)(3) . . . would not permit the bankruptcy trustee to take property subject to an express trust in the hands of a debtor/trustee, free of the interest of a beneficiary”). Kull is a Reporter for the *Restatement* and presumably the author of these comments. See also *In re Mill Concepts Corp.*, 123 B.R. 938, 947 (D. Mass. 1991) (rejecting majority interpretation of § 544(a)(3) in part to “bring about the same results . . . [for] trusts of all varieties”).

the application of § 544(a)(3).²²² Because the bankruptcy trustee defeats a constructive-trust claimant in the garden-variety case in which a court follows the majority view of § 544(a)(3),²²³ courts that say that the particular form of trust makes no difference are suggesting indirectly that real property interests held in express trusts are vulnerable.

Turning to cases that expressly consider what happens when the trustee of an express trust enters bankruptcy and that entity's bankruptcy trustee seeks to use § 544(a)(3) to reach the trust's recorded interest in real property, little can be said for sure because the issue apparently has come up only rarely.²²⁴ It does seem that courts generally are unwilling to push the majority interpretation of § 544(a)(3) to its logical conclusion and find that the bankruptcy trustee takes real property held in a recorded express trust,²²⁵ although real property held in an unrecorded trust does appear vulnerable to the bankruptcy trustee.²²⁶

In *re Cutter*, a recent case from the Ninth Circuit Bankruptcy Appellate Panel, is instructive. In this case involving a self-settled spendthrift trust, the panel held that creditors could reach real property that the debtor had transferred to an express trust in a recorded transfer because the debtor retained the power to deplete the trust and use all its assets for his own benefit.²²⁷ In a footnote at the end of the opinion, the panel rejected the bankruptcy trustee's alternative theory that he could have reached the assets under § 544(a)(3) even if the trust had been legitimate. The panel's concern

²²² See *In re Sedona Cultural Park*, No. AZ-06-1339-MoPaBr, 2007 WL 7540968, at *3 n.6 (B.A.P. 9th Cir. 2007); *In re Roman Catholic Archbishop of Portland in Oregon*, 335 B.R. 868, 878 (Bankr. D. Or. 2005).

²²³ See discussion *supra* Part II. A.

²²⁴ See *In re Cutter*, 398 B.R. 6, 21-22 (B.A.P. 9th Cir. 2008); *In re Mortg. Lenders Network, USA, Inc.*, 380 B.R. 131, 136-37 (Bankr. D. Del. 2007); *In re Roman Catholic Archbishop*, 335 B.R. at 876-78; *In re Granada, Inc.*, 92 B.R. 501, 503-04 (Bankr. D. Utah 1988); *In re Columbia Pac. Mortg., Inc.*, 20 B.R. 259, 263-64 (Bankr. W.D. Wash. 1981).

²²⁵ See *In re Cutter*, 398 B.R. at 21.

²²⁶ See *Roman Catholic Archbishop*, 335 B.R. at 877-78; *In re Granada*, 92 B.R. at 507 (holding that real property claimed to be held in unrecorded express trust passed into bankruptcy estate under § 544(a)(3)); *In re Columbia Pacific*, 20 B.R. at 263 (assuming *arguendo*, apparently, that real property held in unrecorded express trust would enter estate, but finding that participation interests in mortgages are not real property). *But see In re Mortgage Lenders Network*, 380 B.R. 131,139 (Bankr. D. Del. 2007) (rejecting majority view of § 544(a)(3) and holding that mortgages held in unrecorded express trust did not pass into bankruptcy estate).

²²⁷ *In re Cutter*, 398 B.R. at 22.

was that “[i]f Trustee were correct, anytime a trustee of any trust (such as a charitable trust) filed bankruptcy, his or her estate could obtain title to the corpus or assets of the trust under § 544(a)(3), simply because third party purchasers could have obtained valid title to those assets from the debtor (as trustee of the trust) prepetition.”²²⁸

As *Cutter* suggests, the reluctance to apply § 544(a)(3) to real property held in trust seems to arise not from any flaw in the argument that the majority view of § 544(a)(3) makes the section applicable to real property held in express trust, but because of solicitude toward express trusts themselves. If decisions refusing to apply § 544(a)(3) to express trusts are based on protecting the institution of express trust rather than simply on analysis of the Bankruptcy Code, then the relevant question is whether MERS would benefit from the same solicitude.

With that in mind, we turn to the proposition that MERS, Inc. would be treated like a trustee. We start with the possibility that it would be claimed that MERS, Inc. is the trustee of an express trust. Although no one would be surprised at any effort to cast MERS, Inc.’s protean form into yet another incarnation, it bears mention that MERS, Inc. has gone fifteen years without being called the trustee of an express trust, that MERS, Inc.’s rules and form documents do not call MERS, Inc. a trustee, and that MERS, Inc. apparently has not been called a trustee in litigation.²²⁹

Any attempt to recharacterize MERS, Inc. as a trustee would face formidable obstacles. The settlor’s intent to create a trust must be “definite and particular.”²³⁰ The settlor would be the party granting the property interest — the mortgage borrower who grants the mortgage to MERS, Inc. in return for the loan funds,²³¹ and it seems difficult to

²²⁸ *Id.* at 22 n.20. The panel also implicitly rejected the majority view of § 544(a)(3). *Id.* (stating that trustee’s theory would “circumvent[] section 541(b)(1)’s explicit exclusion from estate ‘any power that the debtor may exercise solely for the benefit of an entity other than the debtor’ and section 541(d)’s provision that property to which a debtor holds only legal title becomes property of the estate only to the extent of such legal title ‘but not to the extent of any equitable interest in such property that the debtor does not hold.’”). The majority view of § 544(a)(3) is precisely that the provision can be used to expand legal title into equitable ownership because it measures the trustee’s powers by what can be conveyed, not by what is owned.

²²⁹ In addition, MERS’s website states that MERS, Inc. does not “replace the role of the trustee in Deed of Trust states.” *Join MERS*®, MERS, <http://www.mersinc.org/join-mers/faq-join-mers>. MERS, Inc.’s role in a deed of trust is that of beneficiary, not trustee.

²³⁰ See HESS ET AL., *supra* note 230, § 46.

²³¹ See Mortgage, Ex. A to Affirmation of William Hultman, *In re Agard*, Case No.

discern the borrower's "definite and particular" intent to create a trust for the benefit of MERS's members from the MERS form mortgage. Nor is it clear that the class of "Lender and its successors and assigns,"²³² who would be the trust beneficiaries, is "certain as to membership," as trust law requires.²³³ Continuous supervision of an agent by a principal is said to be inconsistent with finding that the agent is a trustee,²³⁴ and MERS, Inc. is in the curious position of an agent that acts *only* through its principals,²³⁵ suggesting a degree of control much higher than mere "supervision" of the agent. Most fundamentally, the creation *vel non* of a trust is a question of state law and therefore may be resolved differently in each state.²³⁶ It seems imprudent simply to have assumed — or simply to assume going forward — that this novel entity would be treated as a trust everywhere in the U.S. when convenient and not otherwise.

Assuming that MERS, Inc. is not a trustee and given that MERS is a novel structure that has not created the kind of settled expectations that express trusts have created, one might expect a court to turn to the underlying policy considerations raised by MERS and by express trusts as a group in deciding whether to treat MERS, Inc. the same way it would treat a trustee. One inclined to criticize MERS might point out that its purpose was (and effect apparently has been) to eliminate the existence of recorded chains of mortgage assignments across the United States. At the same time, MERS solved or appeared to solve a very real business problem afflicting most of the mortgage finance industry. Express trusts as a group have neither of these characteristics. Whether a court finds the express-trust analogy persuasive might well turn on its assessment of the conflicting policies relating to MERS.

IV. POTENTIAL SOLUTIONS

To some extent, MERS, Inc.'s predicament is a symptom of a tracking entity that just got too greedy. MERS, Inc. did not inherently

10-77338-REG (Bankr. E.D.N.Y. Dec. 10, 2010).

²³² *Id.*

²³³ See BOGERT & BOGERT, *supra* note 218, at §162.

²³⁴ See HESS ET AL., *supra* note 230, at § 15 n.1 (3d ed. 2007) ("An agent is subject to control of the principal, whereas a trustee is not subject to the control of the beneficiary.") (citing RESTATEMENT (SECOND) OF AGENCY § 14B cmts. e to h (1958)).

²³⁵ Given that MERS, Inc. has no employees of its own and apparently acts only through officers who are employees of its principals, its control by its principal is unparalleled. See Hultman Depo., *supra* note 3, at 69.

²³⁶ HESS ET AL., *supra* note 230, § 45.

need to claim the power to foreclose on mortgages in its own name or various other rights and powers as principal and agent that MERS, Inc. or the members of MERS have from time to time asserted. A modest agent-based recording utility that sticks to recording might, to the extent such a device is permitted under state law,²³⁷ avoid much of the risk that the mortgages it records would enter its bankruptcy estate.

But an agent-based national recording utility that is not going to foreclose in its own name must at least claim the authority to assign (convey) legal title to mortgages, because many states require a chain of assignments as a prerequisite for foreclosure.²³⁸ There is no avoiding the risk that a court might find that this power to convey could reasonably be interpreted by a third party acting in good faith as the power to sell. Even if the probability of such a finding is low, recording a very large number of mortgages with the same utility — so that a single court's finding could affect, say, thirty million mortgages — seems to introduce tremendous risk into the system. This appears to be a fundamental design issue with concentrating ownership of a large number of mortgages in a single entity that can enter bankruptcy, at least under current law.

Suggestions to improve MERS while MERS, Inc. holds title to mortgages, though valuable, thus are problematic. For example, one commenter has suggested simply opening up MERS to public scrutiny so that members of the public could determine who owns mortgages recorded on MERS.²³⁹ Although this would deal with the single most telling substantive objection to MERS — that it shrouds mortgage ownership in secrecy²⁴⁰ — simply making MERS more transparent would not in itself remove the bankruptcy risk or cause MERS to come into compliance with all state recording statutes.²⁴¹ Accordingly, this approach would not solve the outstanding legal problems with MERS,

²³⁷ See *supra* note 36 (discussing recent cases that apparently are inconsistent with MERS, Inc.'s holding title to mortgages or being named beneficiary under deed of trust as a nominee agent).

²³⁸ See sources cited *supra* note 171.

²³⁹ See Robert E. Dordan, *Mortgage Electronic Registration Systems (MERS), Its Recent Legal Battles, and the Chance for a Peaceful Existence*, 12 LOY. J. PUB. INT. L. 177, 207 (2010).

²⁴⁰ Lack of transparency probably enables fraud and inhibits correction of good-faith errors in the system, see White, *supra* note 9, at 495, but even apart from that, some commentators have argued that borrowers have a genuine interest in knowing the identity of the loan owner to negotiate workouts. See *id.* at 496.

²⁴¹ See, e.g., *Bain v. Metropolitan Mortg. Gp., Inc.*, 285 P.3d 34, 36-37 (holding MERS, Inc. is not a lawful beneficiary of a deed of trust under Washington law unless it holds the associated note).

although it might motivate courts to look more favorably upon the system.

Another change to the current operation of MERS that would reduce the risk discussed in this Article would be to change MERS's role to that of a tracking utility that does not appear in title records and does not purport to take any form of title to the mortgages, legal or otherwise. MERS, Inc., could stop taking title to new mortgages²⁴² and could relinquish the mortgages to which it currently holds title by assigning them to securitization trustees or servicers.²⁴³ In this scenario, mortgage securitization participants presumably would either incur the cost and burden of recording mortgage assignments or, if willing to bear greater risks in return for lower up-front costs, rely on the general principle that "the mortgage follows the note,"²⁴⁴ at least in states that follow the rule.²⁴⁵

Turning from changes to MERS itself, the way forward that would require the least political will would be for the present users of MERS to work with state and local officials to upgrade land title systems to accommodate electronic recording. Upgraded systems could permit parties to record mortgage assignments quickly and at low cost per assignment, and commentators have noted a "consistent trend" in this direction.²⁴⁶ This approach requires relatively modest changes to pre-existing state law,²⁴⁷ and the Uniform Real Property Electronic Recording Act, intended to lay the legal groundwork for digital recording, already has been enacted in about half the states.²⁴⁸ This

²⁴² Apparently, MERS still takes new mortgage assignments even though it no longer forecloses in its own name.

²⁴³ Some bankruptcy risk would remain, at least for some period of time. The bankruptcy trustee may reverse certain property transfers that are undertaken shortly before bankruptcy or that qualify as fraudulent conveyances. See 11 U.S.C. §§ 544(b), 547, 548.

²⁴⁴ Mortgage transfers probably can be structured so that the U.C.C. provides that "the mortgage follows the note," although it is not totally clear how this provision interacts with existing state recording statutes. Our related work in progress addresses these issues in more depth.

²⁴⁵ Such an approach might be risky in Oregon, for example, as that state's courts have strictly enforced the requirement of a recorded chain of assignments as a prerequisite to foreclosure. See *Niday v. GMAC Mortg., LLC*, 284 P.3d 1157, 1161 (Or. Ct. App. 2012), *pet'n for review granted*, No. 506055 (Or. Sept. 27, 2012).

²⁴⁶ Emily Bayer-Pacht, *The Computerization of Land Records: How Advances in Recording Systems Affect the Rationale Behind Some Existing Chain of Title Doctrine*, 32 CARDOZO L. REV. 337, 357 n.118 (2010).

²⁴⁷ See Dale A. Whitman, *Digital Recording of Real Estate Conveyances*, 32 J. MARSHALL L. REV. 227, 227-28 (1999).

²⁴⁸ See *Real Property Electronic Recording Act*, UNIFORM LAW COMMISSION,

approach does not require states to relinquish authority over recording but it does require money for up-front costs, and it is unclear whether upgrading the land title recording system is a priority for industry participants.

Another, more ambitious, set of ideas involves various approaches to federalizing land title law. For example, Congress could establish a federal title recording system that would accept electronic filings.²⁴⁹ A recent Federal Reserve white paper has embraced this concept and suggested it to Congress.²⁵⁰ An even more ambitious approach would be to create a single electronic national mortgage registry with a single mortgage/note document, and require ownership and servicing data to be updated promptly as a condition of mortgage enforceability.²⁵¹

Federalizing title law, even just for mortgages, could face political resistance from the states. To federalize title law, it seems that Congress²⁵² would have to preempt state recording and mortgage enforcement law or states would have to amend their recording statutes to give effect to records in the new federal system. Congressional preemption *may* be unworkable given states' historic control over land title law and the intimate relationship of land title to state territoriality and sovereignty.²⁵³ Nevertheless, existing critiques of MERS focus on its opacity and dubious legal foundation, rather than on abstract ideas of state authority or sovereignty.²⁵⁴ The idea of a national, authoritative, transparent recording system with a solid legal

[http://www.uniformlaws.org/Act.aspx?title=Real Property Electronic Recording Act](http://www.uniformlaws.org/Act.aspx?title=Real+Property+Electronic+Recording+Act) (last visited Aug. 10, 2012).

²⁴⁹ See Marsh, *supra* note 8, at 24-26 (2011).

²⁵⁰ U.S. HOUSING MARKET, *supra* note 18, at 24-25.

²⁵¹ See White, *supra* note 9, at 497-99.

²⁵² It is conceivable that an administrative agency could have the authority to preempt state law in this way. Analysis of the many political and legal issues presented by such a course of action is beyond the scope of this Article.

²⁵³ See, e.g., Idaho v. Coeur d'Alene Tribe of Idaho, 521 U.S. 261, 282 (1997) (holding that to "diminish" Idaho's control over lands and waters in its territory would cause "offense to Idaho's sovereign authority and its standing in the Union"); Katherine Florey, *State Courts, State Territory, State Power: Reflections on the Extraterritoriality Principle in Choice of Law and Legislation*, 84 NOTRE DAME L. REV. 1058, 1058-60 (2009) (explaining territorial nature of states' sovereign powers).

²⁵⁴ See, e.g., Peterson, *Two Faces*, *supra* note 8, at 155-61 ("Even those who prefer minimalist government must recognize that in a democratic republic, divestment of this responsibility [for title recording] from government to industry should occur only with the consent of elected representatives of the people."); Plaintiffs' Response and Brief in Opposition to Defendants' Motion To Dismiss at 1, Dallas County v. MERSCORP, Inc., No. 3:11-CV-02733-O (N.D. Tex. March 30, 2012) (asserting that MERS has "rendered the public record of interests in real estate not simply opaque, but unreliable.").

foundation deserves serious consideration, and if such a system is created, policymakers should consider housing it in an entity that is not subject to the Bankruptcy Code, such as an agency of the federal government.

Laws could also be changed on the state level. State recording statutes could be amended through the uniform-law process to accept recording of assignments on a transparent (and possibly regulated) version of MERS or on a new federal title system. Presumably the existing Uniform Real Property Electronic Recording Act could be amended to meet this purpose.

Finally, the specific concerns raised in this Article could be addressed by amending the Bankruptcy Code. Section 544(a)(3) as currently drafted is unclear and troublesome,²⁵⁵ and Congress could decide that the interest in recording that § 544(a)(3) apparently embodies simply is less important than the interest in promoting a liquid national mortgage market. However, the Bankruptcy Code touches many constituencies beyond the mortgage industry, and efforts to amend it are often quite controversial.²⁵⁶ Any amendment to promote national recording systems would have to be narrowly and carefully drafted to succeed without a lengthy struggle.

An authoritative, transparent national electronic registry that rests on a solid legal foundation²⁵⁷ seems to be the leading idea for reform at the moment. Although a final decision to move ahead with such a system should await a rigorous analysis of costs and of objections that state and local officials may raise, the benefits seem clear: It could solve the logistical problems with local recording that motivated creation of MERS, provide transparency MERS currently lacks, and enjoy the legitimacy of express authorization, all while avoiding the bankruptcy risk MERS's members currently face.

²⁵⁵ See discussion *supra* Part II. A.

²⁵⁶ See, e.g., Jonathan C. Lipson, *Debt and Democracy: Towards a Constitutional Theory of Bankruptcy*, 83 NOTRE DAME L. REV. 605, 688-89 (2008) (describing intense controversy surrounding enactment of Bankruptcy Abuse Prevention and Consumer Protection Act of 2005); Jeffrey Toobin, *The Professor*, THE NEW YORKER, Sept. 17, 2012 (recounting participant Elizabeth Warren's recollection that "the bankruptcy wars" over what became the 2005 Act "went on for a decade.").

²⁵⁷ Others have pointed to the importance of such a foundation in the securities industry's transition from paper documents. See White, *supra* note 9, at 470 ("[T]he recording and transfer of corporate debt and stock securities successfully shifted to an electronic system in the 1970's, with legal support from Article 8 of the Uniform Commercial Code and relevant Securities and Exchange Commission rules.").

CONCLUSION

MERS must have seemed like a promising way for the mortgage securitization industry to avoid dealing with thousands of county recorders to perform each of the several assignments of each mortgage in each transaction. But the system, which may not have been built on a sound legal foundation, is struggling in the foreclosure crisis. Although MERS, Inc. and the members of MERS may be winning the ground war against defaulting borrowers, the system faces a risk of insolvency due to private and public lawsuits and enforcement actions. Unfortunately for investors and policymakers charged with financial stability, the MERS companies' efforts to win the foreclosure wars have increased the risk that MERS mortgages would enter the MERS, Inc. bankruptcy estate.

Even without this added risk, the basic character of MERS as an agent-based national workaround of state real property recording laws presents a bankruptcy risk that may be unacceptable. Policymakers should consider a national substitute for MERS that rests on a solid foundation of explicit legal authorization, and they should consider housing it an entity that is not subject to the Bankruptcy Code, such as a government department. In any event, policymakers should take the bankruptcy risk inherent in a national agent-based title recording system into account when thinking about how to move forward in modernizing the U.S. real property finance infrastructure.