New York's U.S. Bankruptcy Court Rules MERS's Business Model Is Illegal

United States Bankruptcy Judge Robert Grossman has ruled that MERS's business practices are unlawful. He explicitly acknowledged that this ruling sets a precedent that has far-reaching implications for half of the mortgages in this country. MERS is dead. The banks are in big trouble. And all foreclosures should be stopped immediately while the legislative branch comes up with a solution.

For some weeks I have been arguing that MERS is perpetrating foreclosure fraud all across the nation. Its business model makes it impossible to legally foreclose on any mortgaged property registered within its system -- which includes half of the outstanding mortgages in the US. MERS was a fraud from day one, whose purpose was to evade property recording fees and to subvert five centuries of property law. Its chickens have come home to roost.

Wall Street wanted to transform America's housing sector into the world's biggest casino and needed to undermine property rights to make it easier to run the scam. The payoffs were bigger for lenders who could induce homeowners to take mortgages they could not possibly afford. The mortgages were packaged into securities sold-on to patsy investors who were defrauded by the "reps and warranties" falsely certifying the securities as backed by top grade loans. In fact the securities were not backed by mortgages, and in any case the mortgages were sure to go bad. Given that homeowners would default, the Wall Street banks that serviced the mortgages needed a foreclosure steamroller to quickly and cheaply throw families out of the homes so that they could be resold to serve as purported collateral for yet more gambling bets. MERS -- the industry's creation -- stepped up to the plate to facilitate the fraud. The judge has ruled that its practices are illegal. MERS and the banks lose; investors and homeowners win.

Here's MERS's business model in brief. Real estate property sales and mortgages are supposed to be recorded in local recording offices, with fees paid. With the rise of securitization, each mortgage might be sold a dozen times before it came to rest as the collateral behind a mortgage backed security (MBS), and each of those sales would need to be recorded. MERS was created to bypass public recording; it would be listed in the county records as the "mortgagee of record" and the "nominee" of the holder of mortgage. Members of MERS could then transfer the mortgage from one to another without all the trouble of changing the local records, simply by (voluntarily) recording transactions on MERS's registry.

A mortgage has two parts, the "note" and the "security" (not to be confused with the MBS) or "deed of trust" that is usually just called the "mortgage". The idea behind MERS was that the "note" would be transferred from seller to purchaser, but the "mortgage" would be held by MERS. In fact, MERS recommended that the "note" be held by the mortgage servicer to facilitate foreclosures, but in practice it seems that the notes were often lost or destroyed (which is why all those Burger King Kids were hired to Robo-sign "lost note affidavits").

At each transfer, the note and mortgage are supposed to be "assigned" to the new owner; MERS claimed that because it was the "mortgagee of record" and the "nominee" of both parties to every transaction, there was no need to assign the "mortgage" until foreclosure. And it argued that since the old adage is that the "mortgage follows the note" and that both parties intended to assign the notes (even if they did not get around to doing it), then the Bankruptcy Court should rule that the assignments did take place in some sort of "virtual reality" so that there is a clear chain of title that allows the servicers to foreclose.

The Judge rejected every aspect of MERS's argument. The Court rejected the claim that MERS could be both holder of the mortgage as well as nominee of the "true" owner. It also found that "mortgagee of record" is a vague term that does not give one legal standing as mortgagee. Hence, at best, MERS is only a nominee. It rejected MERS's claim that as nominee it can assign notes or mortgages -- a nominee has limited rights and those most certainly do not include the right to transfer ownership unless there is specific written instruction to do so. In scarcely veiled anger, the Judge wrote:

"According to MERS, the principal/agent relationship among itself and its members is created by the MERS rules of membership and terms and conditions, as well as the Mortgage itself. However, none of the documents expressly creates an agency relationship or even mentions the word "agency." MERS would have this Court cobble together the documents and draw inferences from the words contained in those documents."

Judge Grossman rejected MERS's arguments, saying that mere membership in MERS does not provide "agency" rights to MERS, and agreeing with the Supreme Court of Kansas that ruled "The parties appear to have defined the word [nominee] in much the same way that the blind men of Indian legend described an elephant -- their description depended on which part they were touching at any given time."

He went on to disparage MERS's claim that since in legal theory the "mortgage follows the note", the Court should overlook the fact that MERS separated them. He stopped just short of saying that by separating them, MERS has irretrievably destroyed the clear chain of title, although he hinted that a future ruling could come to that conclusion:

"MERS argues that notes and mortgages processed through the MERS System are never "separated" because beneficial ownership of the notes and mortgages are always held by the same entity. The Court will not address that issue in this Decision, but leaves open the issue as to whether mortgages processed through the MERS system are properly perfected and valid liens. See Carpenter v. Longan, 83 U.S. at 274 (finding that an assignment of the mortgage without the note is a nullity); Landmark Nat'l Bank v. Kesler, 216 P.3d 158, 166-67 (Kan. 2009) ("[I]n the event that a mortgage loan somehow separates interests of the note and the deed of trust, with the deed of trust lying with some independent entity, the mortgage may become unenforceable")."

That would mean not only the end of MERS, but also the end of the banks holding unenforceable mortgages because they were not, and cannot be, "perfected". MERS and the banks screwed up big time, and there is no "do over" -- there is no valid lien on the property, so owners have got their homes free and clear.

There have been numerous court rulings against MERS -- including decisions made by state supreme courts. What is significant about the US Bankruptcy Court of New York's ruling is that the judge specifically set out to examine the legality of MERS's business model. As the judge argued in the decision, "The Court believes this analysis is necessary for the precedential effect it will have on other cases pending before this Court". In the scathing opinion, Judge Grossman variously labeled MERS's positions as "stunningly inconsistent" with the facts, "absurd, at best", and "not supported by the law". The ruling is a complete repudiation of every argument MERS has made about the legality of its procedures.

What is particularly ironic is that MERS actually forced the judge to undertake the examination of its business model. The case before the judge involved a foreclosed homeowner who had already lost in state court. The homeowner then approached the US Bankruptcy Court to argue that the foreclosing bank did not have legal standing because of MERS's business practices. However, by the "Rooker-Feldman" doctrine (or res judicata), the US Bankruptcy Court is prohibited from "looking behind" the state court's decision to determine the issue of legal standing. Hence, Judge Grossman ruled in the bank's favor on that particular issue.

Yet, MERS's high priced lawyers wanted to push the issue and asked for the Judge to rule in favor of MERS's practices, too. So while MERS won the little battle over one foreclosed home, it lost the war against the nation's homeowners. The Judge ruled against MERS on every single issue of importance. And it was MERS's stupid arrogance that brought it down.

As I predicted two weeks ago, MERS would be dead within weeks. Judge Grossman has driven the final stake through its black heart. The half of America's homeowners whose mortgages are registered at MERS have been handed a "get out of jail free" card. Wall Street has no right to foreclose on their property. The tide has turned. It won't be easy, but homeowners in those states with judicial foreclosures now have Judge Grossman on their side. Those in the other states (just over half) will have a tougher time because they can lose their home before they ever get to court. But the law is still on their side -- foreclosure by members of MERS is theft -- so class action lawsuits may be the way to go.

MERS is dead, but can the banks survive? There are two separate issues. First, there are the "reps and warranties" given by the mortgage securitizers (Wall Street investment banks) to the investors (pension funds, GSEs, PIMCO, and so on). We now know that a quarter to a third of the mortgages bundled to serve as backing for the securities did not meet stated quality. Worse, we also know that the banks knew this -- they hired third parties to undertake "due diligence" to check quality. This was not done to protect the investors, rather, the purpose was to strengthen the bargaining position of the securitizers, who were able to reduce the prices paid for the mortgages. Now, the investors are suing the banks for restitution--forcing them to cover the losses and buy-back the bad mortgages at original price. To add insult to injury, even the NYFed is suing them. That is a lot like having your parents sue you for their inadequate parental oversight of your behavior.

The second issue is that the mortgages backing the securities were supposed to be placed in Trusts (affiliates of the securitizing banks), with the Trustee certifying not only that the mortgages met the reps and warranties but also that the documents were up to snuff and safely

locked away. We know they were not. As mentioned above, MERS told the servicers to hold the notes, and many or most of them were destroyed or lost. Further, the notes were separated from the mortgages -- making them null and void. In any case, they are not at the Trusts. This means the MBSs are not backed by mortgages, meaning the MBSs are unsecured debt. MERS's business model ensures that. So, again, the banks must take back the fraudulent securities -- paying off the investors.

What can Wall Street do? Well, I suppose the "help wanted" signs are already up at MERS and Wall Street banks: "Needed: Burger King Kids to Robo-sign forged quasi-professional-looking docs". The problem is that even with tens of thousands of Robo-Kids, Wall Street will not be able to pull off a vast criminal conspiracy on the necessary scale. Think about it: 60 million mortgages, each sold ten times, means 600 million transactions and assignments that have to be forged. MERS's documentation was notoriously sloppy, relying on voluntary recording by members. The Robo-Kids would have to go back through a decade of records to manufacture a paper trail that would convince now-skeptical judges that there is a clear chain of title from the first recording in the public record through to the foreclosure. It ain't going to happen.

The only other hope is that Wall Street can call in its campaign contribution chips and get Congress to retroactively legalize fraud. That is what they do in those dictatorships that protestors are now bringing down in the Middle East. Is Washington willing to take that risk, just to please its Wall Street benefactors?

The court document is available here. It is terrific reading.

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