

Resources

California Court Affirms the Power of MERS to Assign Promissory Notes and Invoke the Tender Rule

July 1, 2011

One result of the foreclosure crisis over the past few years is a wave of “wrongful foreclosure” cases seeking to set aside or delay foreclosure proceedings on the applicable property. When Mortgage Electronic Registration Systems, Inc. (MERS), has been involved in that foreclosure process, MERS often finds itself at the center of the challenge. Borrowers often assert that MERS or other involved parties lacked the requisite standing to initiate foreclosure or to assign an interest in the underlying debt because they were not in possession of the applicable promissory note. Such judicial attacks undermine MERS’s essential purpose as an intermediary agent between lenders, servicers, and investors, for which the assignment of debt and the initiation of foreclosure proceedings are critical.¹ The cases targeting MERS have had varying degrees of success in different states, usually depending upon the particular state’s foreclosure law.

On June 1, 2011, however, the California Court of Appeal dealt a mortal blow to such attacks under California law. See *Ferguson v. Avelo Mortg., LLC*, 2011 WL 2139143, 5, ___ Cal. Rptr. 3d ___ (Cal. Ct. App. 2d Dist. 2011). In *Ferguson*, MERS was named as the original beneficiary in a deed of trust, and it thereafter assigned its beneficial interest in the deed and the loan to defendant Avelo Mortgage, LLC (“Avelo”). The borrower later defaulted on the loan, and Avelo purchased the property at the resulting foreclosure sale. After the sale, the borrower purported to execute a quitclaim deed of the property to the plaintiffs (*Ferguson*).

Ferguson brought an action to quiet title against Avelo, to which Avelo successfully demurred by asserting the tender rule,” which requires a party seeking to challenge a completed foreclosure sale to first “tender” or pay off the full amount of the indebtedness owed on the property. On appeal, *Ferguson* argued that Avelo could not invoke the tender rule, because neither MERS nor Avelo was the holder of the promissory note underlying the deed of trust. According to *Ferguson*, without possession of the note, MERS could not assign any interest in the note to Avelo. As a result, *Ferguson* argued, Avelo had no authority to enforce the loan obligation, and the sale was “illegal.”

In rejecting *Ferguson*’s argument and affirming the trial court’s judgment, the Court of Appeal affirmed several propositions of law that had been addressed only sparingly, if at all, by the California courts. First, the court reaffirmed the holding in *Gomes v. Countrywide Home Loans, Inc.*, 192 Cal. App. 4th 1149 (Cal. Ct. App. 4th Dist. 2011), that where a deed of trust names MERS as the nominee of the lender and grants MERS the right to foreclose, MERS’s authority to initiate foreclosure proceedings is beyond judicial challenge. Next, the court rejected *Ferguson*’s argument that because MERS did not own the underlying note, it had no interest in the mortgage to assign.

The *Ferguson* court then broke new legal ground in California by holding—as several federal courts had already ruled—that because the beneficiary of a deed of trust may initiate foreclosure in California without possessing the note, the beneficiary may also invoke the tender rule without possessing the note. The court finally tied it all together by holding that an assignee of MERS’s beneficial interest, in this case Avelo, may invoke the tender rule against a challenge to a foreclosure sale, even though neither MERS nor its assignee possessed the note.

California’s statutory scheme for non-judicial foreclosure played an important role in the court’s analysis because it expressly authorizes the trustee, beneficiary, mortgagee, or any of their authorized agents to commence the foreclosure process. See Cal. Civ. Code §§ 2924, 2924b. The *Ferguson* court followed a case in which a New York trial-level court similarly held that “a written assignment of the note and mortgage by MERS...confers good title to the assignee and is not defective for lack of an ownership interest in the note.” *US Bank, N.A. v. Flynn*, 897 N.Y.S.2d 855, 859 (N.Y. Sup. Ct. Suffolk Co. 2010). The Alabama Court of Civil Appeals has held the same. See *Crum v. LaSalle Bank, N.A.*, 55 So.3d 266, 270 (Ala. Civ. App. 2009).

In contrast, the Court of Appeals of Michigan recently held that, notwithstanding nearly identical language in a mortgage granting MERS the right to foreclose, MERS *could not* initiate a non-judicial foreclosure under Michigan law. See *Residential*

Funding Co, LLC v. Saurman, ___ N.W.2d ___, 2011 WL 1516819 (Mich. Ct. App. 2011). The *Saurman* court interpreted the Michigan statutory scheme to hold that the language of the mortgage gave MERS an interest in the “property” but not an interest in the underlying “note,” as required for standing to initiate foreclosure. See *id.* (interpreting Mich. Comp. Laws § 600.3204). That case is now on appeal to the Michigan Supreme Court. Likewise, the Court of Appeals of Indiana recently held that “MERS, as mere nominee and holder of nothing more than bare legal title to the mortgage, did not have an enforceable right under the mortgage.” *Citimortgage, Inc. v. Barabas*, ___ N.E.2d ___, 2011 WL 1873452, 5 (Ind. Ct. App. 2011). And the bankruptcy court in Idaho held in 2009 that an assignment from MERS was insufficient to convey standing to foreclose absent further evidence of MERS’s authority to transfer the note at issue. See *In re Wilhelm*, 407 B.R. 392, 405 (Bankr. D. Idaho 2009).

In summary, MERS’s standing as the lender’s nominee to initiate foreclosure proceedings, and its authority to assign an interest in the underlying promissory note, is “all over the map,” both literally and figuratively. But, following *Ferguson*, the issue is finally settled as a matter of law in California, where MERS may continue to enable lenders, servicers, and investors to enforce mortgage loans.

Should you have any questions about this alert or need additional information, please contact contact Richard E. Gottlieb, Director of the Firm’s Financial Industry Group, at 312-627-2196.

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¹ MERS is a national electronic registry that tracks the transfer of ownership interests and servicing rights in mortgage loans. MERS generally serves as an agent for lending banks to facilitate the assignment of the lenders’ interests between MERS, lenders, loan servicers, and investors. While MERS is listed as the grantee or nominal beneficiary of the mortgage or deed of trust in the official records maintained at county registries, the lenders retain the promissory notes and the servicing rights to the mortgages. The lenders can then package and sell these loans to investors and assign the servicing rights to loan servicers, without having to record the transaction in the public record and without losing standing to initiate the foreclosure process.

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