

FORECLOSURE MORASS

On April 21, 2011, the Michigan Court of Appeals published a decision which may impact REALTORS® listing foreclosed properties and REALTORS® representing buyers who are purchasing or have purchased a foreclosed property. The decision involves two cases: *Residential Funding Co., LLC v Saurman*, Court of Appeals No. 290248 and *Bank of New York Trust Company v Messner*, Court of Appeals No. 291443 (the “Decision”). The Decision does **NOT** affect the status of all foreclosed properties in Michigan.

In the Decision, the Mortgage Electronic Registration Systems, Inc. (“MERS”), published and posted foreclosures for two (2) properties. Each foreclosure proceeded with a sheriff’s sale followed by the expiration of a redemption period. MERS then quitclaimed its interest to the lenders who held the notes. The lenders then sought to evict the foreclosed owners of the properties. The owners claimed that MERS did not have the authority to initiate a foreclosure by advertisement in Michigan.

The MERS system was described in the Decision as follows:

In 1993, the MERS system was created by several large participants in the real estate mortgage industry to track ownership interests in residential mortgages. Mortgage lenders and other entities, known as MERS members, subscribe to the MERS system and pay annual fees for the electronic processing and tracking of ownership and transfers of mortgages. Members contractually agree to appoint MERS to act as their common agent on all mortgages they register in the MERS system.

In order for a party to foreclose a mortgage by advertisement in Michigan, it must be the owner of the indebtedness (*i.e.*, the promissory note secured by the mortgage) or be the servicing agent of the mortgage.

In the Decision, two Court of Appeals Judges determined that MERS was neither the owner of the indebtedness nor the servicing agent of the mortgage. Thus, MERS lacked the authority to foreclose the mortgages on the defendants' properties. The Decision concluded that the foreclosure proceedings in both cases were "void *ab initio*," *i.e.*, legally never happened.

What Foreclosed Properties Are Affected?

Properties affected by the Decision are only those where MERS has initiated foreclosure proceedings by advertisement (a "MERS Foreclosure"). It does NOT apply to any foreclosure where a lender or its servicer initiated the foreclosure by advertisement.

Many REALTORS® may try to determine whether a property has been the subject of a MERS Foreclosure. In reviewing the mortgage, they may well see language to the effect that the mortgage was granted to MERS as a "nominee." This language within the mortgage does not mean that the foreclosure was automatically a MERS Foreclosure. Many mortgages with this language will be foreclosed either by a lender who received an assignment from MERS prior to the foreclosure or by a servicer for the lender. Any REALTOR® attempting to determine whether a property

has been subject to a MERS Foreclosure would be well advised to consult with an attorney or the title agency who is providing insurance for the property.

What Is The Impact?

The Decision could immediately cause problems in two (2) situations. First, pending sales on properties in which the lender-owner obtained legal title through a MERS Foreclosure will not be able to close as title insurance companies will not insure over the now questionable title of the lender-owner. This is easy to understand, inasmuch as the Decision concludes that the foreclosure sale by which the lender-owner obtained legal was void *ab initio*, *i.e.*, legally never happened.

Second, the Decision could prevent the sale and closing of properties which were obtained through a MERS Foreclosure during at least the last 5 years. In other words, assume that the Smiths purchased 123 Elm Street from a lender in 2007 after the lender obtained legal title to the property through a MERS Foreclosure. The title agency in reviewing the chain of title could conclude, based on the Decision, that there is a “hole” in the chain of title. Again, this hole arises by reason of the fact that the MERS Foreclosure in 2007 was void *ab initio*. The current sale of the property cannot close as title insurance would be unavailable both to the new owners and their lender.

What Is The Fix And How Long Will It Take?

It would appear that there are three (3) possible fixes in these situations, none of which are likely to happen any time soon.

The lenders in the Decision may file an application for leave to appeal to the Michigan Supreme Court. If the Michigan Supreme Court accepted the application, heard the case and reversed the Decision and found that MERS had the authority to foreclose the mortgage in Michigan by advertisement, the problem would be solved. However, in the absence of any acceleration of the process of appeal, such a Supreme Court decision could take up to a year.

Second, a new foreclosure could be instituted by the lender or its servicer. This cure for the problem could take more than seven months (*i.e.*, four weeks to publish the notice of foreclosure and a six-month redemption period) unless the redemption period could be shortened through abandonment.

Finally, the problem with a MERS Foreclosure could be fixed by obtaining a quit claim deed from the foreclosed owner and any junior lienors. Obviously, any request for such a deed would probably trigger a request for consideration for the deed.

As an aside, it should be noted that the beneficiaries of the Decision, *i.e.*, those persons whose properties were foreclosed through a MERS Foreclosure, will have only a short term benefit. The debt they have not paid will not go away. Ultimately, unless they pay their debt the property will be foreclosed again.

What To Do?

REALTORS® who currently have REO listings, particularly those subject to pending sales, should neither panic based on the assumption that the

Decision affects all of their listings, nor do nothing based on an assumption that the Decision will not affect any of those listings. Instead, REALTORS® should inventory their REO listings to determine which, if any, are the subject of a MERS Foreclosure. The most practical method for checking is probably through contact with the title agency who is providing title insurance for the listing. If this option is not available, the REALTOR® could preliminarily make a determination by seeing whether MERS was the successful bidder at the foreclosure sale as indicated by their being named the grantee on the sheriff's deed. This is not foolproof evidence, but it is a start. Obviously, any doubts as to whether a listing was obtained through a MERS Foreclosure should be resolved through an opinion from the REALTORS®' attorney.

If a REALTOR® determines that a listing was obtained by the lender-seller through a MERS Foreclosure, the REALTOR® should verify with the title agency providing title insurance for the listing that it will not presently insure any sale of the listing. Thereafter, the REALTOR® should advise its client, the lender-seller, that the property is not currently marketable due to the Decision.

If a REALTOR® is representing a buyer on a REO property for which there is a pending sale, the REALTOR® will also need to make a determination as to whether title to the REO property was obtained through a MERS Foreclosure. If that is confirmed to be the case, then the REALTOR® should advise the buyer accordingly, *i.e.*, the sale presently cannot be closed because the lender-seller cannot provide marketable title or an owner's title insurance policy. The REALTOR® should

recommend that the buyer obtain the advice of legal counsel as to how to proceed either with respect to preserving their right to purchase the property or terminating the transaction.

REALTORS® who are taking new REO listings should determine from the outset whether title to those listings were obtained through a MERS Foreclosure. If that is the case, a REALTOR® may wish to decline the listing inasmuch as the Decision renders its title unmarketable. A REALTOR® working with buyers who are interested in purchasing REO properties should make those buyers aware of the Decision. Presumably, the buyers will wish to make a determination as to whether a listed REO property is subject to the Decision prior to wasting any time or resources pursuing a property.

Finally, REALTORS® may be contacted by former clients who bought a REO property and are concerned after hearing about the Decision. These former clients will probably want the REALTOR® to tell them whether their particular property is subject to the Decision. REALTORS® should resist the temptation to be helpful, other than to recommend to the buyers that they contact their title insurer or their attorney to determine whether their property was the subject of a MERS Foreclosure and the ramifications, if any, if the property was the subject of a MERS Foreclosure.

There are undoubtedly other issues and questions which will arise as a result of the Decision. However, REALTORS® should have at least a basic knowledge

of the Decision and its impact both to govern their own business and to represent sellers and buyers.