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FORECLOSURES

However intuitive it may seem that the party who controls a mortgage should have the right to foreclose, the courts are casting doubt on that assumption. The issue has come to light in connection with mortgages in the Mortgage Electronic Registration System (MERS), which has commonly served as a mortgagee for purposes of tracking loans, and in doing so takes possession of the note associated with a mortgage. In this article the author reviews key decisions establishing the principle that when lenders make such assignments, they may retain possession of the mortgage itself, but they have no right to foreclose because they do not also hold the note.

In a Mortgage Foreclosure, Having Possession of the Mortgage Is Not Enough

By Jeffrey R. Metz

The recently decided case of *Citimortgage, Inc. v. Stosel*, N.Y. App. Div., No. 2010–06292, 11/15/11, 2011 WL 5588729 (2d Dep't 2011), illustrates a fundamental, but misunderstood, tenet: in order to have standing to prosecute a foreclosure action, the movant must demonstrate that it is the holder of the note or bond to which the mortgage is attendant.

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Background. In the case of a default in payment, the Court of Appeals of the State of New York has recognized that ''(i)t is fundamental that the holder of a note (or bond) and mortgage has two remedies: one at law in a suit on the debt as evidenced by the note, the other in equity to foreclose the mortgage.'' *Copp v. Sands Point Mar.*, 17 N.Y.2d 291, 293 (1966) (citations omitted). The note, the court continued, ''represents the primary personal obligation of the mortgagor, and the mortgage is merely the security for such obligation.'' *Id.* Therefore, a mortgage ''cannot exist independently of the debt or obligation'' *Bank of N.Y. v. Silverberg*, 86 A.D.3d 274, 280 quoting from *FGB Realty Advisers v. Parisi*, 265 A.D.2d 297, 298 (2d Dep't 1999).

The act of assignment reflects the interplay between the note and the mortgage. The appellate division has explained that ''[a]s a general matter, once a promissory note is tendered to and accepted by an assignee, the mortgage passes as an incident to the note.'' *Silverberg*, *supra*, 86 A.D.3d at 280 (citations omitted). But it is ancient law that when a mortgage secures a bond or other instrument, the assignment of a mortgage without the assignment of the underlying note is a nullity. See *Carpenter v. Longan*, 83 US 271, 274 (1873); *Merritt v. Bartholick*, 36 NY 44, 45 (1867). And this holds true even when the Mortgage Electronic Registration System (MERS) holds close to 60 million mortgage loans. *Silverberg*, *supra*, 86 A.D.3d at 283 citing to ''MERS? It

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May Have Swallowed Your Loan,'' Michael Powell and Gretchen Morgenson, *New York Times*, March 5, 2011.

What Is MERS? As explained by the court of appeals in *Matters of MERSCORP., Inc. v. Romaine*, 8 NY 3d 90, 96 (2006):

> 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.
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> The initial MERS mortgage is recorded in the County Clerk's office with ''Mortgage Electronic Registration Systems, Inc.'' named as the lender's nominee or mortgagee of record on the instrument. During the lifetime of the mortgage, the beneficial ownership interest or servicing rights may be transferred among MERS members (MERS assignments), but these assignments are not publicly recorded; instead they are tracked electronically in MERS's private system. In the MERS system, the mortgagor is notified of transfers of servicing rights pursuant to the Truth in Lending Act, but not necessarily of assignments for the beneficial interest in the mortgage.

In *Bank of N.Y. v. Silverberg*, 86 A.D.3d 274 (2d Dep't 2011) the appellate division was called upon to determine whether the Bank of N.Y. had the standing to foreclose on a mortgage where MERS ''was listed in the underlying mortgage instruments as a nominee and mortgagee for the purpose of recording but was never the actual holder or assignee of the underlying notes.'' *Id* at 275.

There, the defendants took out two loans from Countrywide Homes Loans, Inc. Both were secured with mortgages where MERS was the mortgagee for purpose of recording but the underlying notes remained with Countrywide. Nonetheless, both mortgages contained the following provision:

> ''[The Borrowers] understand and agree that MERS holds only legal title to the rights granted by [the Borrowers] in this Security Instrument, but, if necessary to comply with law or custom, MERS (as nominee for Lender and Lender's successors and assigns) has the right:
>
> ''(A) to exercise any or all of those rights, [granted by the Borrowers to Countrywide] including, but not limited to, the right to foreclose and sell the Property''; and
>
> ''(B) to take any action required of Lender including, but not limited to, releasing and canceling this Security Instrument.''

Id at 276.

The Countrywide loans were later consolidated. However, Countrywide was not a party to the agreement and the agreement, while providing MERS with the right to assign the mortgages, did not specifically provide it with the right to assign the notes. This was critical because the court found that any ''assignment of the notes was. . .beyond MERS's authority as nominee or agent of the lender.'' *Id* at 281.

Therefore, upon the assignment of the consolidated loan from MERS to the Bank of New York, the bank ''gained only that to which its assignor was entitled'' and therefore, ''did not acquire the power to foreclose by way of the. . .assignment.'' *Id*.

In so ruling, the appellate division contrasted the situation to the one it had before it in *Mortgage Elec. Registration System Inc. v. Coakley*, 41 A.D.3d 674 (2d Dept' 2007). There, MERS commenced an action to foreclose a mortgage in favor of a bank in order to secure a promissory note in excess of $1 million. Coakley sought dismissal of the action, arguing that MERS lacked standing to commence the foreclosure action.

Unlike the situation in *Silverberg*, the note in *Coakley* had actually been tendered to MERS prior to the foreclosure. Following settled law, the court concluded that ''at the time of the commencement of the action, MERS was the lawful holdover of the promissory note, and of the mortgage, which passed as an incident to the promissory note.'' *Id*. Parenthetically, the mortgage contained a provision expressly recognizing MERS's right to foreclose in the event of a default.

Citimortgage. These principles were reaffirmed in the recently decided matter of *Citimortgage, Inc. v. Stosel*, 2011 WL 558720 (2d Dep't 2011). In that case, *Citimortgage* commenced a foreclosure action against Stosel. Citimortgage sought summary judgment on its complaint and order of reference. Stosel cross-moved to dismiss the complaint on the grounds that Citimortgage lacked standing to prosecute the action. The motion court found in favor of Citimortgage but the second department reversed and found that Citimortgage lacked the requisite standing.

The court explained that standing in a foreclosure action is demonstrated by a showing that the movant ''is both the holder or assignee of the subject mortgage and the holder or assignee of the underlying note either by physical delivery or execution of a written assignment prior to the commencement of the action.'' (citations and internal quotation marks omitted).

The court also reaffirmed that an assignment of the mortgage alone is a nullity. The note or bond need to be assigned. Inasmuch as Citimortgage could not establish when or how it became the lawful holder of the note to which the mortgage was incident, Citimortage could not establish standing.

Conclusion. Because a mortgage does not act independently of the debt or obligation it secures, in order for an assignee to obtain standing to prosecute a foreclosure action, it must receive both the note and the mortgage.

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