SHORT FORM ORDER

SUPREME COURT - STATE OF NEW YORK

Present:

HON. THOMAS A. ADAMS,
Supreme Court Justice

TRIAL/IAS, PART 25
NASSAU COUNTY

DEUTSCHE BANK NATIONAL TRUST COMPANY AS TRUSTEE FOR THE REGISTERED HOLDERS OF MORGAN STANLEY ABS CAPITAL I INC. TRUST 2007-HE7 MORTGAGE PASS-THROUGH CERTIFICATES, SERIES 2007-HE7,

Plaintiff(s),

-against-

NELSON VASQUEZ, EDIS VASQUEZ, PETRO, INC., COMMISSIONERS OF THE STATE INSURANCE FUND, "JOHN DOE #1" through "JOHN DOE #12" et al,

Defendant(s).

MOTION DATE: 1/17/12
INDEX NO.: 4924/11
SEQ. NO. 2

Motion by defendants Nelson and Edis Vasquez pursuant to CPLR 2221 for reargument of this court's order dated September 7, 2011 which denied defendants' application to vacate a default in timely answering the complaint is granted, and upon reargument the prior order is vacated and the motion is granted and defendants' default is excused and defendants' proposed answer annexed to the original moving papers as Exhibit "F" is deemed timely served.

This action in foreclosure is brought by plaintiff Deutsche Bank National Trust Company as Trustee for the Registered Holders of Morgan Stanley ABS Capital I Inc., Trust 2007-HE7, Mortgage Pass Through Certificates, Series 2007-HE7. The plaintiff Trust holds securities backed by mortgages, one of which secures the subject property located in Hempstead, New York, at 664 Willis Street. The property was purchased by defendants Nelson Vasquez and Edis Vasquez in 2006, and was originally encumbered by a mortgage in the sum of $435,100.00 in favor lender New Century Mortgage Corporation (New Century).

Acting as nominee for New Century, Mortgage Electronic Registration Systems, Inc. (hereafter MERS) recorded the mortgage in January of 2007 with the Nassau County Clerk, and on November 16, 2009, again acting as nominee for New Century, electronically assigned the mortgage to the plaintiff Trust. The MERS signature affixed to the Assignment is dated January 19, 2011. The County Clerk recording receipt for the Assignment is dated March 30, 2011. The first default in payment occurred September 1, 2010.

Regarding the authority of the nominee MERS, the Mortgage states:

> "MERS" is Mortgage Electronic Registration Systems, Inc. MERS is a separate corporation that is acting *solely as nominee* for Lender and Lender's successors and assigns . . . FOR PURPOSES OF RECORDING THIS MORTGAGE, MERS IS THE MORTGAGEE OF RECORD (italic emphasis supplied).

Defendants defaulted in timely answering the complaint, and on the prior application sought leave to vacate their default and serve a late answer. By order dated September 7, 2011 this court denied the motion holding that defendants failed to establish a reasonable excuse for the default and failed to offer a meritorious defense. They now seek reargument.

The motion for reargument is designed to afford a party "an opportunity to establish that the court overlooked or misapprehended relevant facts or misapplied [a] controlling principle of law" (*Foley v. Roche*, 68 AD2d 558, 567 [1st Dept 1979]).
As this court has overlooked a principle of law, which is discussed below, the motion for reargument is granted and the merits of the prior motion are examined.

When moving to extend the time to answer or to compel the acceptance of an untimely answer, defendants must establish a reasonable excuse for the default and demonstrate a meritorious defense to the action (*Maspeth Federal Sav. and Loan Assoc. v. McGown*, 77 AD3d 890, 891 [2d Dept 2010]). On the prior motion defendants asserted "law office failure" to excuse the delay in serving an answer, and as a proposed meritorious defense, asserted, *inter-alia*, that plaintiff lacked standing to bring this action, as the Trust was not an assignee or a holder of the Mortgage Note at the time this action was commenced.
DISCUSSION - STANDING

It is well established that "foreclosure of a mortgage may not be brought by one who has no title to it and absent transfer of the debt, the assignment of the mortgage is a nullity" (*Kluge v. Fugazy*, 145 AD2d 537, 538 [2d Dept 1988]). In answer to defendants' prior motion, the plaintiff Trust for the first time produced a copy of the Adjustable Rate Note dated December 8, 2006 by which defendants Nelson and Edis Vasquez promised to pay $435,100.00 "to the order" of the New Century Mortgage Corporation, the Lender. Plaintiff produced only a copy the Note which is not indorsed, either to plaintiff or in blank, and thus has not been negotiated. Negotiation is necessary to render plaintiff a "holder" as defined by the Uniform Commercial Code.

At the outset, it us useful to review the governing statutes for the rules of transfer

regarding negotiable instruments. Pursuant to UCC § 3-202 negotiation is defined as the "the transfer of an instrument in such form that the transferee becomes a holder". If the instrument is payable "to order", as is the Note here, it is negotiated "by delivery with any necessary indorsement". Only a "bearer" instrument can be negotiated by delivery without an indorsement (UCC § 3-202).

The types of indorsements are governed by UCC § 3-204, and include "special" indorsements and "blank" indorsements. A special indorsement specifies the person "to whom or to whose order" the instrument is payable (UCC § 3-204[1]). In contrast, an indorsement in blank "specifies no particular indorsee and may consist of a mere signature" (UCC § 3-204[2]).

The Note offered in support by plaintiff was payable "to the order" of New Century and was not indorsed, neither specially nor in blank. Accordingly it does not evidence the requisite negotiation by the lender and thus does not establish a prima facie showing that the plaintiff Trust is a "holder" of the Note.

Inadequate documentation raises serious issues of public policy and it has been said that it is "of the utmost importance that the attorneys practicing before [the] Court maintain integrity in preparing the documentation of . . . mortgage obligations" as doing otherwise "causes risk that '[t]he debtor and his/her family may lose their home, and the debtor and other creditors may lose significant equity in foreclosure.' " (*In re Obasi*, WL 6336153, *8 [Bkrtcy SDNY 2011]). Real Property Actions and Proceedings Law practice commentary explains:

> submissions of faulty documentation, unauthorized or missing assignments of notes and/or mortgages, improper notarizations, conflicts of interest and inadequate review of loan documentation by so-called robo-signers, prompted Chief Judge Lippman to state that "[w]e cannot allow the courts in New York State to stand by idly and be party to what we know is a deeply flawed process, especially when that process involves basic human needs--such as a family home--during this period of economic crisis," which resulted in the issuance on October 20, 2010 by the Office of Court Administration of Administrative Order 548/10 requiring counsel in residential foreclosures to file an affirmation certifying that counsel has taken reasonable steps, including inquiry with lenders and careful review of papers filed to verify the accuracy of documentation

(Rudolph de Winter, Practice Commentaries, RPAPL § 1301, 2011).

DOCUMENTATION

A foreclosure plaintiff has the requisite standing to commence a mortgage foreclosure action if "it is both the holder or assignee of the subject mortgage and the *holder or assignee* of the underlying note at the time the action is commenced" (*Bank of New York v. Silverberg*, 86 AD3d 274, 279 [2d Dept.2011][emphasis supplied]). In this action plaintiff does not allege that it is an assignee of the Note, but instead, as previously referenced, produced a copy of the original Note between defendants and New Century. They argue that delivery of the unindorsed Note was sufficient to confer standing. On the prior motion the court overlooked the necessity of proper indorsement required to transfer ownership and render the transferee a holder.

The requirement of negotiation to effect a legal transfer and establish standing is fundamental and well recognized, if not always explicitly stated. (*compare First Trust Nat. Assoc. v. Meisels*, 234 AD2d 414 [2d Dept 1996] with *HSBC Bank USA v. Hernandez*, __AD3d__, 2012 WL 579706 [2d Dept 2012]). Standing is established where the plaintiff is "both the assignee of the mortgage and, by indorsement, the holder of the underlying note at the time the foreclosure action was commenced" (*First Trust Nat. Assoc. v. Meisels*, 234 AD2d 414, *supra*). When the note secured by the mortgage is a negotiable instrument it "requires indorsement on the instrument" or "on a paper so firmly affixed thereto as to become a part thereof" in order to effectuate a valid assignment of the instrument (*Slutsky v. Blooming Grove Inn* 147 AD2d 208, 212 [2nd Dept., 1989], *cf.*, UCC 3–202[3], [4]; *see also*, *HSBC Bank USA, Nat. Assoc. v. Miller*, 26 Misc3d 407 [Sup. Ct. Sullivan County 2009]; *HSBC Bank USA, Nat. Assoc. v. Miller*, 26 Misc.3d 407, 412 [Sup. Ct. Sullivan County 2009]). So vital is the indorsement, as a foundation of negotiable instruments law, that "mere possession of a promissory note endorsed in blank (just like a check) provides presumptive ownership of that note by the current holder" (*Deutsche Bank Nat. Trust Co. v. Pietranico*, 33 Misc.3d 528, 545 [Sup. Ct. Suffolk County 2011]). The indorsement must predate commencement of the foreclosure action. (*HSBC Bank USA, Nat. Assoc. v. Miller, supra: Deutsche Bank Nat. Trust Co. v. McRae*, 27 Misc.3d 247, 251 [Sup. Ct. Allegany County 2010]).

In *Deutsche Bank Nat. Trust Co. v. McRae,* the plaintiff, to establish standing, submitted an additional copy of a note which was different from the one attached to the complaint. The court rejected it, stating:

> Plaintiff submitted a **second** copy of the Note, which for the first time contained . . . an endorsement in blank by First Franklin Financial Corporation. The endorsement in blank, however, is **undated**. In stark contrast, the copy of the Note attached to the complaint **bears no such endorsements**. Obviously, the endorsements . . . post-date the commencement of this case . . . and are ineffective.

(*Deutsche Bank Nat. Trust Co. v. McRae*, *supra* [emphasis original]).

Documentation often has been addressed in the context of an application in bankruptcy court to lift the automatic stay of a foreclosure, where state substantive law governs the inquiry (*In re Escobar*, 457 BR 229, 239 [Bkrtcy EDNY 2011]). Relying upon *Bank of New York v. Silverberg* (86 AD3d 274, *supra*]), *Escobar* required an assignment of the note to the plaintiffs in bankruptcy or a properly indorsed note evidencing negotiation as proof of status as owner or holder of the note at issue (*In re Escobar*, 457 BR 229, 239 [Bkrtcy EDNY 2011], *supra*). *Escobar* held that the movants "met this burden of proof through their uncontroverted affidavit testimony that they are holders of the Notes by virtue of possession of the original notes executed with endorsements in blank . . ." (*In re Escobar*, *supra* at p 241). *In re Agard* held that under New York law the movant can prove holder status "by providing the Court with proof of a written assignment of the Note, or by demonstrating that [the movant] has physical possession of the Note endorsed over to it" (*In re Agard*, 444 BR 231, 246 [Bkrtcy EDNY 2011]).

The court finds that absence of an indorsement on the subject Note constitutes a meritorious defense regarding plaintiff's standing, and now turns to the reasonable excuse required of defendants for their default. On the prior motion, counsel for defendants asserted that he believed he had mailed the answer but was "confused" on that issue, and had not done so.

Law office failure, in the discretion of the court, may be considered a reasonable excuse. Indeed, in the bankruptcy context, which is equitable in nature, the equitable powers of the court may be called upon (*Deutsche Bank Nat. Trust Co. v. Luden*, 91 AD3d 701 [2d Dept 2012]). In *Luden*, the Second Department found circumstances similar to those here acceptable where the attorney prepared an answer which the defendants signed " but, unbeknownst to the defendants, the attorney failed to file and serve the answer until some two months later" (*supra*).

In the exercise of this court's discretion and in light of the proposed defense regarding standing, and the further issues discussed below, this court is prompted to accept the proffered excuse, and not sit "idly by" in this foreclosure action in which the defendants have touched upon serious issues of public policy and standing. Accordingly, the prior order is vacated and upon reargument the proposed answer is deemed timely served nunc pro tunc. Plaintiff shall have thirty days after service of a copy of this order to respond to counterclaims.

Also influencing this court's determination on reargument are the repeated issues regarding standing which revolve around proper assignments, particularly of mortgage notes, which have ensued following creation of the MERS system and the birth of mortgage backed securities.

MERS

Courts have struggled with the MERS system since it was created in 1993. In *Matter of MERSCORP v. Romaine* (8 NY3d 90, 96 [2006]), the Court of Appeals addressed the first MERS issue and held that the Suffolk County Clerk was obligated to record and index MERS mortgages, assignments and discharges thereof. The court touched upon MERS history, in relevant part 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.

(*Matter of MERSCORP. v. Romaine,* 8 NY3d 90, 96 [2006]). The process dispenses with public recording of interim transfers; "instead they are tracked electronically in the MERS's private system" (*Matter of MERSCORP. v. Romaine,* 8 NY3d 90, 96 [2006]).

In other words, MERS is privately retained by financial institution to keep records of secondary market mortgage transfers displacing the official public record keepers, e.g., the various state County Clerks. MERS' records, unlike official public documents, are not entitled to a presumption of regularity (see, Prince, Richardson on Evidence [Farrell, 11th ed.] § 3–120), nor are they transparent to non members or the mortgagor. MERS has no ownership interest in the principal or interest of the various holdings, cannot collect interest or principal, and generally remains listed as nominee and/or mortgagee for the original lender in the public record for the life of the mortgage regardless of the number of assignments in the secondary market. MERS claims authority to assign mortgages, and to foreclose upon a default, based upon the agreements between it and its clients as well as the original mortgagor (*see in general In re Agard*, 444 B.R. 231, 248-249 [Bkrtcy EDNY 2011], and cases cited therein).

Much judicial scrutiny has been give to the impact and effect MERS private agreements on the legal sphere of foreclosure, with judicial opinions ranging from full recognition of MERS standing to foreclose on properties in default, and authority to the assign not only mortgages and servicer agreements, but also promissory notes (*see Deutsche Bank Nat. Trust Co. v. Pietranico*, 33 Misc.3d 528, 545 [Sup. Ct. Suffolk Cty. 2011]).

In high contrast is a line of cases represented by *In re Agard* (444 B.R. 231, 245–46

[Bankr.E.D.N.Y.2011]) where MERS is limited to recording mortgage assignments as nominee of the original lender "with no other legal power or standing".

Indeed, in a terse description the court found the allegations of the parties and documentation they provided at odds, to wit:

> it is notable in this case that the Assignment of Mortgage was by MERS, as nominee for First Franklin, the original lender.
>
> By the Movant's and MERS's own admission, at the time the assignment was effectuated, First Franklin no longer held any interest in the Note.
>
> The documentation provided to the Court in this case ... is stunningly inconsistent with what the parties define as the facts of this case.

(*In re Agard* , 444 B.R. 231, 254, *supra*). *Agard* is informative for the breadth of authority it reviews in considering the issues generated by the MERS system, some presaged by then Chief Judge Judith Kaye and Judge Ciparick in *MERSCORP, Inc. v. Romaine* (NY3d 90 [2006]). *Agard* rejected the parties contention that the Note and Mortgage traveled together in all transfers effectuated by MERS, stating:

> By MERS's own account, the Note in this case was transferred among its members, while the Mortgage remained in MERS's name. MERS admits that the very foundation of its business model as described herein requires that the Note and Mortgage travel on divergent paths. Because the Note and Mortgage did not travel together, Movant must prove not only that it is acting on behalf of a valid assignee of the Note, but also that it is acting on behalf of the valid assignee of the Mortgage.

(*In re Agard* , 444 B.R. 231, 247, *supra*).

As noted, The Court of Appeals of the State of New York held that the Suffolk County Clerk was "compelled to record and index mortgages, assignments of mortgage and discharges of mortgage" naming MERS "the lender's nominee or mortgagee of record" (*MERSCORP, Inc. v. Romaine*, 8 NY3d 90 [2006]). Judge Ciparick, concurring, sought "to highlight the narrow breadth" of the holding, to frame those issues not decided and identify policy concerns needing attention, stating:

> if MERS succeeds in its goal of monopolizing the mortgage nominee

> market, it will have effectively usurped the role of the county clerk that inevitably would result in a county's recording fee revenue being substantially diverted to a private entity . . . MERS's success will arguably detract from the amount of public data available concerning mortgage ownership . . . that are used to analyze trends in lending practices . . . once an assignment of the mortgage is made, it can be difficult, if not impossible, for a homeowner to find out the true identity of the loan holder

(*MERSCORP, Inc. v. Romaine*, 8 NY3d 90, 100, *supra* [Ciparick, J. concurring]).

In a prescient partial dissent, former Chief Judge Judith Kaye, emphasized the very foundation and purpose of the Recording Act, which is to "protect the rights of innocent purchasers ... without knowledge of prior encumbrances and to establish a public record which would furnish potential purchasers with notice . . . of previous conveyances". She noted the incongruity presented between the business and public interests, one a system "developed as a tool for banks and title companies" and the other "venerable real property laws regulating the market" (*MERSCORP, Inc. v. Romaine*, 8 NY3d 90, 101 *supra* [Kaye, J. dissenting] [internal quotations deleted]).

Judge Kay identified important issues which remained unresolved such as those "concerning the underlying validity of the MERS mortgage instrument—in particular, whether its failure to transfer beneficial interest renders it a nullity under real property law, whether it violates the prohibition against separating the note from the mortgage, and whether MERS has standing to foreclose on a mortgage . . . " (*MERSCORP, Inc. v. Romaine*. *supra* at p 102 n1).

The Second Department had cause recently to address one of those issues, whether MERS had authority to assign the power to foreclose. In *Bank of New York v. Silverberg* (86 AD3d 274 [2d Dept 2011]), where a consolidation agreement gave MERS the right to assign the mortgages but did not "specifically" give it the right to assign the underlying notes, the court held that "because MERS was never the lawful holder or assignee of the notes . . . MERS was without authority to assign the power to foreclose to the plaintiff" (*Bank of New York v. Silverberg*, 86 AD3d 274, 281, 283 [2d Dept 2011]). Regarding the impact of this failure of documentation on MERS recording of "approximately 60 million mortgage loans", the court stated that it was "mindful" of the possible impact of its decision on the mortgage industry, yet notwithstanding such impact,

> the law must not yield to expediency and the convenience of lending institutions. Proper procedures must be followed to ensure the reliability of the chain of ownership, to secure the dependable transfer of property, and to assure the enforcement of the rules that govern real property.

(Bank of New York v. *Silverberg*, 86 AD3d 274, 283 *supra*).

The court notes that it has not overlooked plaintiff's contention that this motion is untimely. The court clerk's return of defendants' timely motion for reargument for correction of a scrivener's error using January 2011 when January 2012 was intended and correcting the return date is deemed timely.

Dated: MAY 0 8 2012

J.S.C.