

**IN THE UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF TEXAS  
DALLAS DIVISION**

**DALLAS COUNTY, TEXAS,**

Plaintiff,

vs.

**MERSCORP, INC.; MORTGAGE  
ELECTRONIC REGISTRATON SYSTEMS,  
INC.; STEWART TITLE GUARANTY  
COMPANY; STEWART TITLE COMPANY;  
BANK OF AMERICA, NATIONAL  
ASSOCIATION; and ASPIRE FINANCIAL,  
INC. D/B/A TEXASLENDING.COM,**

Defendants.

**CIVIL ACTION No. 3:11-cv-02733-O**

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**CLASS ACTION COMPLAINT**

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TO THE HONORABLE JUDGE OF THE COURT:

COMES NOW Dallas County, Texas, on behalf of itself (“Plaintiff”) and all other similarly situated Texas counties “(Class Members”) complaining of MERSCORP, INC.; MORTGAGE ELECTRONIC REGISTRATON SYSTEMS, INC.; STEWART TITLE GUARANTY COMPANY; STEWART TITLE COMPANY; BANK OF AMERICA, NATIONAL ASSOCIATION; and ASPIRE FINANCIAL, INC. d/b/a TEXASLENDING.COM (collectively, “Defendants”), and would show the Court as follows:

**I.  
STATEMENT OF THE CLAIMS**

1. Defendants are members of the mortgage finance industry. Plaintiff and Class Members generally allege that the Defendants violated Texas statutes when Defendants falsely

denominated Mortgage Electronic Registration Systems, Inc. (“MERS”) as a “beneficiary” of deeds of trust or “lender” in releases or assignments filed of record in the deed records of Plaintiff and Class Members. Plaintiff and Class Members also allege that Defendants violated Texas law when they failed to properly record releases, transfers, assignments, and/or other actions relating to deeds of trust in which MERS was identified as a or the “beneficiary.”

2. Plaintiff and Class Members allege that each Defendant was an active participant in the misconduct alleged, and that each Defendant was a co-conspirator in such misconduct.

## **II. PARTIES**

3. Plaintiff is Dallas County, Texas (“Dallas County, Texas” or “Plaintiff”).

4. Defendant MERSCORP, INC. (“MERSCORP”) is a Delaware corporation. MERSCORP is a nonresident who engages in business in this state, but it does not maintain a regular place of business in this state or a designated agent for service of process. Plaintiff’s claims against MERSCORP arise out of MERSCORP’s activities in Texas. Pursuant to section 17.004(d) of the Texas Civil Practice & Remedies Code MERSCORP will be served by serving its counsel of record in this action. At all times material hereto Defendant MERSCORP has engaged in business in Dallas County, Texas or committed a tort, in whole or in part, in Dallas County, Texas and the claims made herein arise out of such activities in Dallas County, Texas. And, until November 10, 2010, MERSCORP was registered to do business in the State of Texas.

5. Defendant MORTGAGE ELECTRONIC REGISTRATON SYSTEMS, INC. (“MERS”) is a Delaware corporation and wholly-owned subsidiary of Defendant MERSCORP. MERS engages in business in Dallas County, Texas but does not maintain a regular place of business in this state or a designated agent for service of process for proceedings that arise out of MERS’s business done in this state. MERS will be served by serving its counsel of record in this

action. At all times material hereto Defendant MERS has engaged in business in Dallas County, Texas or committed a tort, in whole or in part, in Dallas County, Texas and the claims made herein arise out of such activities in Dallas County, Texas.

6. Defendant STEWART TITLE GUARANTY COMPANY (“Stewart”) is a Texas corporation with its principal place of business in Houston, Harris County, Texas. Stewart will be served by serving its counsel of record in this action.

7. Defendant STEWART TITLE COMPANY (“Stewart Title”) is a Texas corporation with its principal place of business in Houston, Texas. Stewart will be served by serving its counsel of record in this action.

8. Defendant BANK OF AMERICA, NATIONAL ASSOCIATION (“BOA”) is a Delaware corporation that will be served by serving its counsel of record in this action.

9. Defendant ASPIRE FINANCIAL, INC. d/b/a TEXASLENDING.COM (“Aspire”) is a Texas corporation with its principal place of business located at 4100 Alpha Road Suite 400 Dallas, Dallas County, Texas 75244. Aspire will be served by serving its counsel of record in this action.

### **III. JURISDICTION AND VENUE**

10. Subject matter Jurisdiction herein is based upon 28 U.S.C. § 1332(d)(2)(A) because the amount in controversy exceeds the sum or value of \$5,000,000, exclusive of interest and costs, and this a class action in which at least one member of the class is a citizen of a State different from at least one defendant.

11. The Court has *In personam* jurisdiction over each Defendant because each Defendant is either a citizen of the State of Texas or is subject to jurisdiction under the Texas Long Arm Statute, TEX. CIV. PRAC. & REM. CODE § 17.041 *et seq.*

12. Venue is based upon 28 U.S.C. § 1391(a) or (b).

**IV.  
AGENCY AND CORPORATE VEIL/ALTER-EGO**

13. At all times material hereto, each Defendant was acting by and through its actual, apparent, ostensible, or by estoppel agents and/or employees.

14. Plaintiff moves the Court pierce the MERSCORP and MERS corporate veils and impose liability upon each Defendant shareholder in MERSCORP and MERS for the actionable conduct of MERSCORP and MERS alleged herein. As demonstrated by the facts set forth herein: recognizing the corporate existence of MERSCORP and MERS separate from their shareholders, including MERSCORP as a shareholder in MERS and Stewart and BOA as shareholders in MERSCORP, would cause an inequitable result or injustice, or would be a cloak for fraud or illegality; MERSCORP and MERS were undercapitalized in light of the nature and risk of their business; and the corporate fiction is being used to justify wrongs, as a means of perpetrating fraud, as a mere tool or business conduit for others, as a means of evading existing legal obligations, to perpetrate monopoly and unlawfully gain monopolistic control over the real property recording system in the State of Texas, and to circumvent statutory obligations.

**V.  
CLASS ALLEGATIONS**

15. The Class Members that Plaintiff seeks to represent consists of every Texas county in which a deed of trust has been filed identifying MERS as a “beneficiary.”

16. The Class Members that Plaintiff seeks to represent also consists of every Texas county in which any record has been filed in such Class Member’s deed records that identifies MERS in such a fashion as to cause MERS to be identified in such Class Member’s deed records as the “Grantor,” excluding records as to which MERS itself actually holds in the property the interest that MERS purports to be granting.

17. **Numerosity.** A class action is appropriate in this case because the Class is so numerous that joinder of all members is impracticable. There are 254 Texas counties, including Plaintiff.

18. **Commonality.** A class action is appropriate in this case because there are questions of law and fact common to the Class, including but not limited to:

- a. whether MERS actually has a beneficial interest in the properties subject to the deeds of trust filed in Plaintiff and Class Members' counties and in which Defendants identified MERS as a/the beneficiary of such deeds of trust;
- b. whether the identification of MERS as a "beneficiary" of a deed of trust in which it has no beneficial interest is a violation of Texas law subjecting MERS and those acting in concert with it to a statutory penalty of \$10,000 for each such filing;
- c. whether Defendants, or any of them, violated Texas law when they failed to record releases, transfers, assignments, or other actions relating to deeds of trust filed in Plaintiff and Class Members' deed records;
- d. whether MERS may convey in its own name an interest in property as to which MERS owns no interest, thereby denominating itself, or causing itself to be denominated as the "Grantor" in such instruments and in the deed records of Plaintiff and the other Class Members; and
- e. whether the Defendants and others acting in concert with them engaged in an unlawful conspiracy to violate the recording statutes and other laws of the State of Texas.

19. The questions of law and fact common to the Class predominate over any questions affecting only individual members.

20. **Typicality.** The claims of the representative Plaintiff are typical of the claims of the Class Members.

21. **Adequacy.** The representative Plaintiff will fairly and adequately protect the interests of the Class Members.

22. In the absence of class certification, there is a risk that inconsistent or varying adjudications with respect to individual Class Members would establish incompatible standards of conduct for the Defendants or adjudications in dozens of separate cases with respect to individual Class Members would, as a practical matter, be dispositive of the interests of the other members not parties to the individual adjudications, or would substantially impair or impede their ability to protect their interests.

23. The questions of law or fact common to Class Members predominate over any questions affecting only individual Class Members, and a class action is superior to other available methods for fairly and efficiently adjudicating the controversy. Moreover, Defendants have conducted themselves in such a fashion that the final injunctive relief requested herein, or corresponding declaratory relief, is appropriate respecting the class as a whole.

## **VI. FACTS**

24. On January 27, 2011, the Financial Crisis Inquiry Commission (“FCIC”) issued its final report on the causes of the financial collapse of 2008. According to the FCIC:

The profound events of 2007 and 2008 were neither bumps in the road nor an accentuated dip in the financial and business cycles we have come to expect in a free market economic system. This was a fundamental disruption—a financial upheaval, if you will—that wreaked havoc in communities and neighborhoods across this country.

As this report goes to print, there are more than 26 million Americans who are out of work, cannot find full-time work, or have given up looking for work. About four million families have lost their homes to foreclosure and another four and a half million have slipped into the foreclosure process or are seriously behind on their mortgage payments. Nearly \$11 trillion in household wealth has vanished, with retirement accounts and life savings swept away. Businesses, large and small, have felt the sting of a deep recession. There is much anger about what has transpired, and justifiably so. Many people who abided by all the rules now find themselves out of work and uncertain about their future prospects.

The collateral damage of this crisis has been real people and real communities. The impacts of this crisis are likely to be felt for a generation. And the nation faces no easy path to renewed economic strength.

**We conclude this financial crisis was avoidable.** The crisis was the result of human action and inaction, not of Mother Nature or computer models gone haywire. The captains of finance and the public stewards of our financial system ignored warnings and failed to question, understand, and manage evolving risks within a system essential to the well-being of the American public. Theirs was a big miss, not a stumble. While the business cycle cannot be repealed, a crisis of this magnitude need not have occurred. To paraphrase Shakespeare, the fault lies not in the stars, but in us.

Despite the expressed view of many on Wall Street and in Washington that the crisis could not have been foreseen or avoided, there were warning signs. The tragedy was that they were ignored or discounted. There was an explosion in risky subprime lending and securitization, an unsustainable rise in housing prices, widespread reports of egregious and predatory lending practices, dramatic increases in household mortgage debt, and exponential growth in financial firms' trading activities, unregulated derivatives, and short-term "repo" lending markets, among many other red flags. Yet there was pervasive permissiveness; little meaningful action was taken to quell the threats in a timely manner.

The prime example is the Federal Reserve's pivotal failure to stem the flow of toxic mortgages, which it could have done by setting prudent mortgage-lending standards. The Federal Reserve was the one entity empowered to do so and it did not. The record of our examination is replete with evidence of other failures: financial institutions made, bought, and sold mortgage securities they never examined, did not care to examine, or knew to be defective; firms depended on tens of billions of dollars of borrowing that had to be renewed each and every night, secured by subprime mortgage securities; and major firms and investors blindly relied on credit rating agencies as their arbiters of risk. What else could one expect on a highway where there were neither speed limits nor neatly painted lines?

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**We conclude there was a systemic breakdown in accountability and ethics.** The integrity of our financial markets and the public's trust in those markets are essential to the economic well-being of our nation. The soundness and the sustained prosperity of the financial system and our economy rely on the notions of fair

dealing, responsibility, and transparency. In our economy, we expect businesses and individuals to pursue profits, at the same time that they produce products and services of quality and conduct themselves well.

Unfortunately—as has been the case in past speculative booms and busts—we witnessed an erosion of standards of responsibility and ethics that exacerbated the financial crisis. This was not universal, but these breaches stretched from the ground level to the corporate suites. They resulted not only in significant financial consequences but also in damage to the trust of investors, businesses, and the public in the financial system.

For example, our examination found, according to one measure, that the percentage of borrowers who defaulted on their mortgages within just a matter of months after taking a loan nearly doubled from the summer of 2006 to late 2007. This data indicates they likely took out mortgages that they never had the capacity or intention to pay. You will read about mortgage brokers who were paid “yield spread premiums” by lenders to put borrowers into higher-cost loans so they would get bigger fees, often never disclosed to borrowers. The report catalogues the rising incidence of mortgage fraud, which flourished in an environment of collapsing lending standards and lax regulation. The number of suspicious activity reports—reports of possible financial crimes filed by depository banks and their affiliates—related to mortgage fraud grew 20-fold between 1996 and 2005 and then more than doubled again between 2005 and 2009. One study places the losses resulting from fraud on mortgage loans made between 2005 and 2007 at \$112 billion.

Lenders made loans that they knew borrowers could not afford and that could cause massive losses to investors in mortgage securities. As early as September 2004, Countrywide executives recognized that many of the loans they were originating could result in “catastrophic consequences.” Less than a year later, they noted that certain high-risk loans they were making could result not only in foreclosures but also in “financial and reputational catastrophe” for the firm. But they did not stop.

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In an interview with the Commission, Angelo Mozilo, the longtime CEO of Countrywide Financial—a lender brought down by its risky mortgages—said that a “gold rush” mentality overtook the country during these years, and that he was swept up in it as well: “Housing prices were rising so rapidly - at a rate that I’d never seen in my 55 years in the business - that people, regular people, average people got caught up in the mania of buying a house, and



flipping it, making money. It was happening. They buy a house, make \$50,000 . . . and talk at a cocktail party about it . . . Housing suddenly went from being part of the American dream to house my family to settle down - it became a commodity. That was a change in the culture. . . It was sudden, unexpected.”

25. The bubble that was the genesis of the Financial Crisis of 2008, burst when the collapse of the primary and secondary mortgage markets triggered a liquidity shortfall in the U.S. banking system. This collapse was a direct result of the financial system’s commoditization, packaging, securitization, and sale of tens of millions of mortgages throughout the United States—activities in which Defendants actively participated. Without the fiction of the MERS System, and the other activities of the Defendants alleged herein, these activities would not have been possible.

**A. The U.S. Mortgage System**

26. In the most common residential lending scenario, there are two parties to a real property mortgage – the mortgagee, *i.e.*, a lender, and the mortgagor, *i.e.*, a borrower. When a mortgage lender loans money to a home buyer, it obtains two documents: (1) a promissory note in the form of a negotiable instrument from the borrower and (2) a “mortgage” or “deed of trust”<sup>1</sup> granting the mortgage lender a security interest in the property as collateral to repay the note. The mortgage, as distinguished from the note, establishes the lien on the property securing repayment of the loan. For the lien to be perfected and inoculate the property against subsequent efforts by the mortgagor to sell the property or borrow against it, however, the mortgage

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<sup>1</sup> The law of the state in which property is located generally will determine whether a “mortgage” or a “deed of trust” is used to pledge real property as security on a note. In lien theory states such as Texas, a “deed of trust” is often used and only creates a lien on the property — the title remains with the borrower. The lien is removed when all the payments have been made. *See Taylor v. Brennan*, 621 S.W.2d 592, 593 (Tex. 1981). In title theory states, a “mortgage” is generally used, and it conveys ownership to the lender. A clause in the mortgage provides that title reverts back to the borrower when the loan is paid. In common parlance, the term “mortgage” is generally used to refer to the instrument creating the security interest, whether formally denominated as a “mortgage” or a “deed of trust.” Unless noted, the terms “mortgage” and “deed of trust” are used interchangeably herein.

instrument must be filed in the deed records of the county in which the property is located.

**1. The Public Recording System**

27. The origins and reasons for public recordation of mortgage interests in the United States dates back to at least the middle of the 17<sup>th</sup> Century. According to one commentator:

One of the most striking features of Anglo-American law is the requirement to file notice in public files of a nonpossessory secured transaction in order to enforce the transaction in the court against third parties. The transaction of interest first developed during the early seventeenth century. English mortgage law developed for real estate. Originally, the parties structured mortgages with the secured-mortgagee in possession of the landed collateral, not the debtor-mortgagor. But by the early seventeenth century, the English had developed the technique of leaving the debtor-mortgagor in possession of the land to work off the loan.

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Not all legal systems have the filing requirement. Roman law recognized the transaction, but did not require a filing. The Napoleonic Code banned the transaction. The modern explanation of these three different legal rules involves the secret lien. When debtors retain possession of the personalty serving as collateral under the nonpossessory secured transaction, subsequent lenders and purchasers have no way of discovering the prior ownership interest of the earlier secured creditors unless the debtor's honesty forces disclosure. Without that disclosure, the debtor could borrow excessively offering the same collateral as security several times, possibly leaving some of the debtor's creditors without collateral sufficient to cover their loan upon the debtor's financial demise. Roman law solved the problem by providing a fraud remedy against the debtor. The Napoleonic Code solved the problem by banning the transactions. Anglo-American law solved the problem by requiring a filing. Potential subsequent lenders and purchasers could then become aware of the debtor's prior obligation by examining the public files and protect themselves by taking the action they deemed appropriate, either not lending or charging higher interest.<sup>2</sup>

28. Mortgage recordation in Texas is governed by Chapter 12 of the Texas Property Code. Section 12.001 of the Property Code provides, in part, "An instrument concerning real or

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<sup>2</sup> George Lee Flint, Jr. and Marie Juliet Alfaro, *Secured Transactions History: The First Chattel Mortgage Act in the Anglo-American World*, 30:4 William Mitchell Law Review 1403, 1404-05.

personal property may be recorded if it has been acknowledged, sworn to with a proper jurat, or proved according to law.” Although recordation of a security instrument in real property is not mandatory, once a security interest is recorded, “[t]o release, transfer, assign, or take another action relating to an instrument that is filed, registered, or recorded in the office of the county clerk, a person must file, register, or record another instrument relating to the action in the same manner as the original instrument was required to be filed, registered, or recorded.”<sup>3</sup>

29. Once properly filed, a mortgage is “notice to all persons of the existence of the instrument,” protects the mortgagee’s (lender’s) security interest against creditors of the mortgagor, and places subsequent purchasers on notice that the property is encumbered by a mortgage lien. Unless the mortgage is recorded, the “mortgage or deed of trust is void as to a creditor or to a subsequent purchaser for a valuable consideration without notice.”<sup>4</sup>

30. Until recently, when a loan secured by a mortgage was sold, the assignee would record the assignment of the mortgage to protect the security interest. If a servicing company serviced the loan and the servicing rights were sold—an event that could occur multiple times during the life of a mortgage loan—multiple assignments were recorded to ensure that the proper servicer and/or note-holder appeared in the land records in the County Clerk’s office.<sup>5</sup> This basic model has been followed throughout the United States for over three hundred years to provide the public with notice of the ownership of, and liens encumbering, real property throughout the United States. Defendants and others similarly situated have changed all of this and collapsed the public recordation system throughout Texas and the United States.

31. The MERS business plan, as envisioned and implemented by Wall Street, is based

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<sup>3</sup> TEX. LOC. GOV’T CODE § 192.007.

<sup>4</sup> TEX. PROP. CODE § 13.001(a).

<sup>5</sup> Some sources estimate that mortgage loans or servicing rights are transferred an average of five times or more during the life of a mortgage — transfers which would necessitate recordation.

in large part on amending the traditional model of recording security interests in real property and changes thereto and introducing a third party into the equation—MERS. The motivation for creating MERS was Wall Street’s desire to alleviate the “inconvenience” of the public recording system and create its own privately owned shadow electronic recording system - the MERS System – to increase the velocity and ease with which mortgages could be bought and sold. In the words of one court, the MERS System was designed “as a replacement for our traditional system of public recordation of mortgages.”<sup>6</sup> The MERS System fails to comply with Texas law.

## **2. Mortgage Origination**

32. In order to fully understand the genesis of the MERS System, one must consider the historical context in which it was created.

33. For most Americans, a mortgage is the largest and most serious financial obligation ever undertaken. Mortgages are originated by a variety of financial institutions.

34. Depository institutions, which accept deposits from the public and lend that money to households and businesses, are one type of originator. Depository institutions include commercial banks as well as credit unions, savings and loan associations, and mutual savings banks. Depository institutions are regulated by a set of federal and/or state agencies charged with ensuring the safety and soundness of these institutions.

35. Non-depository institutions, called mortgage companies or mortgage banks, also originate mortgages. Mortgage companies borrow money from banks (or by issuing bonds) and lend that money to consumers in the form of mortgage loans. They typically then sell those loans to other financial institutions and use that money to originate additional mortgages.

36. Mortgage lenders are sometimes owned by holding companies or other financial institutions. Some mortgage companies are owned by depository institutions, and are therefore

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<sup>6</sup> *In Re Agard*, 444 BR 231, 247 (E.D.N.Y. 2011).

subsidiaries of a depository. Others are owned by holding companies that also own a depository institution and are therefore an affiliate of a depository. Mortgage companies that are not a subsidiary or an affiliate of a depository institution are called independent mortgage companies.

37. Federal Housing Administration (“FHA”) loans are made by private lenders and insured by the FHA. They are usually made to low-income or moderate-income borrowers, often with weaker credit histories, and require smaller down payments. Historically, the size limits on these loans were low.

38. Veterans’ Administration (“VA”) loans are offered to military personnel and are guaranteed by the Department of Veteran Affairs. These too require little or no down payment.

39. One common type of mortgage is a 30-year fixed rate mortgage (“FRM”), in which the interest rate is fixed for the entire term of the loan and the borrower is required to make a series of equal monthly payments until the loan is paid off. The fixed payment amount that results in the loan being fully paid off at the end of the term is called the fully amortizing payment amount. By contrast, an adjustable rate mortgage (“ARM”) has an interest rate that is specified in terms of a margin above some interest rate index. For example, “Prime + 3%” means that the borrower is charged interest based on an interest rate equal to the prime rate plus 3 percentage points. The interest rate on an ARM adjusts at regular intervals. Other mortgages are hybrids of FRMs and ARMs in which the interest rate is fixed for some introductory period and then adjusts at regular periods according to some interest rate index. Other types of mortgages involve the borrower paying less than the fully amortizing amount each month.

40. For example, a balloon mortgage is one in which the borrower pays less than the fully amortizing payment amount but must then pay some relatively large fixed sum at the end of the term – “balloon payment” – to pay off the mortgage. Interest-only mortgages allow the borrower to pay only the interest accrued each month and make no payments toward principal

for some period. Option ARMs, also called negative amortization ARMs, allow the borrower to pay less than the interest charged for some period so that the balance on the loan grows over time before the required payment amount resets to the fully amortizing rate. Interest-only mortgages grew from only 2 percent in 2004 to 20 percent by 2007. Option ARMs and balloon mortgages also grew in this period.

**B. The Commoditization of Mortgages**

41. In the decades leading up to the early 1970s, the housing finance system was relatively simple: banks and savings and loan associations made mortgage loans to households and held them until they were repaid. Deposits provided the major source of funding for these lenders, as most were depository institutions.

42. In the 1970s, the housing finance system began to shift from depository-based funding to capital markets-based funding. By 1998, 64 percent of originated mortgage loans were sold by originators to large financial institutions that package bundles of mortgages and sell the right to receive borrowers' payments of principal and interest directly to investors. Key to this shift to capital markets-based funding of mortgage lending were Fannie Mae and Freddie Mac, the government-sponsored enterprises ("*GSEs*"), created by the federal government to develop a secondary mortgage market. The GSEs did this in two ways:

- a. by issuing debt to raise capital and using those funds to purchase mortgages to hold in their portfolios; and
- b. by securitizing mortgages, that is, by selling to investors the rights to the principal and interest payments made by borrowers on pools of mortgages through what is referred to as mortgage-backed securities ("*MBSs*").

43. MBSs are securities that give the holders the right to receive the principal and interest payments from borrowers on a particular pool of mortgage loans. The GSEs purchase mortgages to hold in portfolios and to securitize into MBSs that the GSEs guarantee against

default. MBSs issued by the GSEs or Ginnie Mae are referred to as agency MBSs.

44. Fannie Mae and Freddie Mac provide a guarantee that investors in their MBSs will receive timely payments of principal and interest. If the borrower for one of the underlying mortgages fails to make his payments, the GSE that issued the MBSs will pay to the trust the scheduled principal and interest payments. In return for providing this guarantee, Fannie Mae and Freddie Mac deduct an ongoing guarantee fee, which is charged by setting the pass-through annual interest rate (*i.e.*, the interest rate received by holders of the MBSs) about 20-25 basis points (*i.e.*, 0.20 - 0.25 percentage points) below the weighted average interest rate of the mortgages in the pool. MBSs issued by GSEs were generally thought by investors to be implicitly backed by the federal government, thereby removing their credit risk.

45. Other financial institutions also create MBSs, referred to as non-agency MBSs, which have a structure similar to agency MBSs but typically have no guarantee against default risk. In a non-agency securitization, the sponsor of the securitization, which could be an investment bank, commercial bank, thrift, or mortgage bank, first acquires a set of mortgages, either by originating them or by buying them from an originator. The sponsor then creates a new entity, a “special purpose vehicle” (“*SPV*”), and transfers the mortgages to the SPV.

46. The principal and interest payments on the pool of mortgages provide the underlying set of cash flows for the SPV. The SPV may then enter into contracts in order to manage the risk it faces. For example, to reduce interest rate-related risks, the SPV may enter into interest rate swap agreements that provided floating interest rate-based payments to the SPV in exchange for a fixed set of payments from the SPV. The SPV will then issue various classes of mortgage-backed securities that give investors who are holders of the securities rights to the cash flows available to the SPV.

47. Two features of MBSs, in particular, boost their value relative to other investment

options: bankruptcy-remoteness and favorable tax treatment as a real estate mortgage investment conduit (“REMIC”) under the Internal Revenue Code. Bankruptcy remoteness means both that the trust that issues the mortgage-backed securities cannot file for bankruptcy and that the trust’s assets cannot be brought into the bankruptcy estate of other entities in the mortgage loans’ chain of title. These features have the effect of isolating the cash flows on the mortgages from claimants other than the MBSs’ investors and the trustee, which thereby reduces the risks investors assume on the securities. REMIC status ensures that only the investors, who hold certificates issued by the trusts entitling them to payment, and not the trusts, are taxed.

48. Generally, investors in a Subchapter C corporation (under the Internal Revenue Code) are subject to double taxation because the corporation is taxed directly on its earnings, and then the investors are taxed on any distributions from the corporation. If the trust qualifies as a REMIC, however, it is treated as a “pass-through” entity for federal tax purposes, so there is only a single layer of taxation.

49. In order for trusts to enjoy the benefits of bankruptcy remoteness and pass-through tax status, they must be formed in a particular way, and their assets must be transferred to them in a particular manner. There are two documents in particular that need to be properly transferred to the trust – the promissory note and the mortgage or deed of trust. Possession of a note without a mortgage amounts to possession of unsecured debt and will ordinarily disqualify the issuer from enjoying REMIC status. The term “mortgage loan” generally refers to the mortgage and note together, although colloquially the term “mortgage” is also often used to refer to both the mortgage and the note.

50. The mortgage securitization process is often structured in a complex and detailed way to ensure that bankruptcy-remoteness and REMIC tax status are achieved. One form for the structure might be as follows. First, securitization of mortgage loans begins with origination of a



loan by one of the types of lenders discussed above. Second, a sponsor or seller assembles a pool of mortgage loans that it originated and/or purchased from unaffiliated third-party originating lenders. Third, the pool of loans is sold by the sponsor to an SPV subsidiary—the “depositor”—that has no other assets or liabilities. This step is executed to segregate the mortgage loans from the sponsor’s assets and liabilities. Fourth, the depositor sells the loans to the trust SPV which issues pass-through securities certificates to investors entitling them to payment from performance of the underlying mortgage loans.

51. These trusts are usually formed pursuant to, and governed by, contracts called Pooling and Servicing Agreements (“*PSAs*”), which are crafted to ensure that the benefits of mortgage securitization flow to the trusts. In order for a trust to be bankruptcy-remote, there must be a “true sale” of the mortgage loans, which means that all rights to the mortgage loan are transferred to the trust so that no other entity in the chain of title could claim control of the assets in the event of bankruptcy. True sale status also leads to MBS trusts attaining higher ratings from rating agencies than they otherwise would, which, in turn, means that the trust can charge a higher issuing price for the securities relative to the interest rate paid on the securities. The heightened value of the trust enables the Trustee to charge premium prices to investors.

52. Each class of securities in an MBS offering is referred to as a tranche. Unlike agency MBSs, non-agency MBSs are not typically guaranteed against credit loss. A crucial goal of the capital structure of the SPV was to create some tranches that were deemed low risk and could receive investment-grade ratings, such as AAA, from the rating agencies. Credit enhancements were used to achieve this goal.

53. One key credit-enhancement tool was subordination. The classes of securities issued by the SPV were ordered according to their priority in receiving distributions from the SPV. The structure was set up to operate like a waterfall, with the holders of the more senior

tranches being paid prior to the more junior (or subordinate) tranches. The most senior set of tranches—referred to simply as senior securities—represented the lowest risk and consequently paid the lowest interest rate. They were set up to be paid prior to any of the classes below and were typically rated AAA. The next most senior tranches were the mezzanine tranches. These carried higher risk and paid a correspondingly higher interest rate. The most junior tranche in the structure was called the equity or residual tranche and was set up to receive whatever cash flow was left over after all other tranches had been paid. These tranches, which were typically not rated, suffered the first losses on any defaults of mortgages in the pool.

54. The payments of principal and interest by borrowers flow first to make the promised payments to the AAA senior bondholders, then down to pay the AA bonds, and so forth. If there is any money left over after all bondholders have been paid, it flows to the residual tranche of securities.

55. An example of a typical subprime MBS in which cumulative losses on mortgages in the SPV were expected to amount to 4 percent of the total principal amount is as follows. Assume that AAA senior bonds make up 92 percent of the principal amount of debt issued by the SPV, AA bonds account for 3 percent, mezzanine BBB bonds make up 4 percent, and the residual tranche amounts to 1 percent. If the MBS does indeed experience such a 4 percent loss on its mortgage assets, then 4 percent of the total principal amount on its bonds would default. Because of the SPV's subordination structure, these losses would first be applied to the residual tranche. The residual tranche, which accounts for 1 percent of the principal amount of the SPV's bonds, would fully default, paying nothing. That would leave 3 percent more of the total principal amount in losses to apply to the next most junior tranche, the mezzanine BBB tranche. Since the mezzanine BBB tranche totals 4 percent of the deal, the 3 percent left in losses would reduce its actual payments to 1 percent, meaning that 75 percent of the BBB bonds' principal

value would be lost. The AA and AAA bonds, however, would pay their holders in full. In this simple example, the junior tranches below the AA and AAA bonds would be large enough to fully absorb the expected loss on the SPV's mortgages.

56. Another credit enhancement technique was overcollateralization. The principal balance of the underlying mortgages often exceeded the principal balance of the debt securities issued by the SPV. Thus, some underlying mortgages could default without any of the MBS bonds defaulting on their promised payments to investors.

57. Similarly, the weighted average coupon interest rate on the underlying mortgage pool would typically exceed the weighted average coupon interest rate paid on the SPV's debt securities by an amount sufficient to provide a further buffer before the debt tranches incur losses. In essence, the SPV received a higher interest rate from mortgage borrowers than it paid to investors in its bonds. The resulting excess spread gave the SPV extra cash flow to pay its bond holders, further insulating the MBSs from credit risk in the underlying mortgages.

58. With both over-collateralization and excess spread, the total amount of cash that had been promised to be paid to the SPV by mortgage borrowers was greater than the total amount of cash that the SPV had promised to pay out to investors. This gave the SPV a cushion in case some of the mortgage borrowers defaulted on their promised payments.

59. The prospectus for an MBS would include a description of the mortgages held by the SPV, such as information about the distribution of borrowers' credit scores and loan-to-value ratios, and the geographic distribution of the homes that serve as collateral for the mortgages. The underwriting practices used by the originators usually would also be described. For example, Goldman Sachs disclosed the following about the underwriting standards used by the originator - New Century Mortgage - of the mortgages it packaged in a 2006 MBS offering:

The mortgage loans will have been originated in accordance with the underwriting guidelines established by New Century. On a case-by-case basis, exceptions to the New Century Underwriting Guidelines are made where compensating factors exist. It is expected that a substantial portion of the mortgage loans will represent these exceptions. All of the mortgage loans were also underwritten with a view toward the resale of the mortgage loans in the secondary mortgage market. As a result of New Century's underwriting criteria, changes in the values of [homes securing the mortgage loans] may have a greater effect on the delinquency, foreclosure and loss experience on the mortgage loans than these changes would be expected to have on mortgage loans that are originated in a more traditional manner.

60. The originators of the mortgages also generally made representations and warranties to the SPV, described in the prospectus, regarding the nature of the mortgages in the pool. For example, they typically represented that the mortgages had never been delinquent and that they complied with all national and state laws in their origination practices. Moreover, in the event that any of the representations and warranties were breached, or if any of the mortgages defaulted early (within some fixed period after being transferred to the SPV), the originator typically agreed to repurchase the mortgage from the SPV.

61. The SPV would contract with a firm to service the mortgages in the pool, i.e., to collect payments from borrowers. The mortgage servicer would also handle defaults in the mortgage pool, including negotiating modifications and settlements with the borrowers and initiating foreclosure proceedings. In exchange, the mortgage servicer would get an ongoing servicing fee from the flow of interest payments from borrowers of typically between 25 and 50 basis points, or 0.25 and 0.50 percentage points, at an annual rate.

62. Servicers also typically would retain late fees charged to delinquent borrowers and would be reimbursed for expenses related to foreclosing on a loan. The borrowers would be informed by the originator or the new servicer when servicing rights to their mortgages were transferred so that they knew how to make payments to the new servicer.

63. The sponsor of an MBS typically approached Fitch, Standard & Poor's, or Moody's to obtain credit ratings on the classes of debt securities issued in the deal. The credit rating agencies analyzed the probability distribution of cash flows associated with each tranche using proprietary models based on historical data and assigned a credit rating to each debt tranche. These ratings were intended to represent the riskiness of the securities and were used by investors to inform their decision whether to invest in the security. Sponsors of MBSs typically structured them to produce as many bonds with the highest credit rating (*e.g.* AAA) while offering attractive yields. AAA-rated bonds were in demand by investors who required low-risk assets in their portfolio. The internal credit enhancements used in non-agency securitizations, discussed above, enabled the transformation of mortgages, including relatively risky mortgages to borrowers with low credit scores or with little equity, into bonds that were considered to be low risk but relatively high yield.

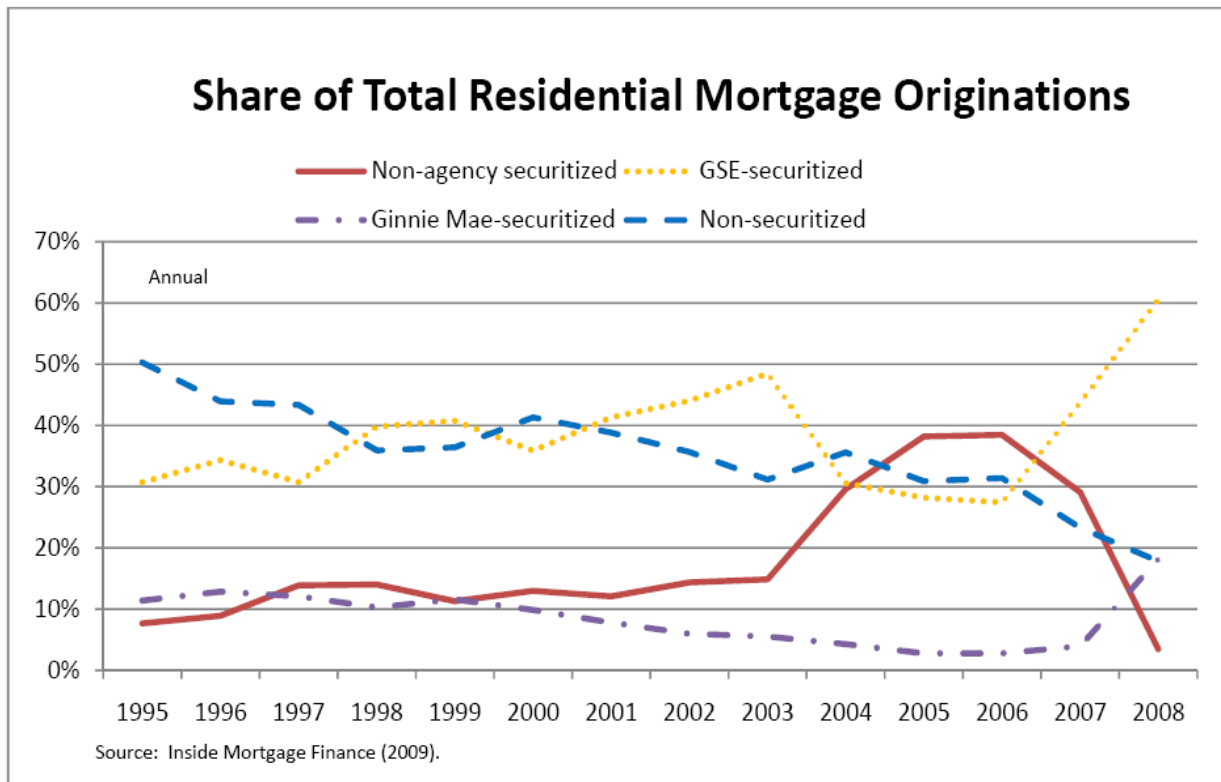
64. The junior tranches of an MBS typically received lower ratings because they were more likely to default than the senior tranches. This is because, as discussed above, senior securities would be paid before the junior securities would be paid, so that the more junior a tranche, the more likely it would be to bear losses if the underlying mortgages defaulted.

65. The same credit-enhancement techniques that produced highly rated tranches out of a pool of mortgages were used to create highly rated securities out of pools of junior tranches of MBSs. This was done using a product known as a collateralized debt obligation ("CDO").

66. The sponsor of such a CDO assembled a pool of junior tranches from many different MBSs, for example mezzanine tranches rated BBB, transferred them to an SPV, and using the same tools of subordination, over-collateralization, and excess spreads issued AAA-rated senior securities from that SPV, along with junior tranches and a first-loss residual tranche.

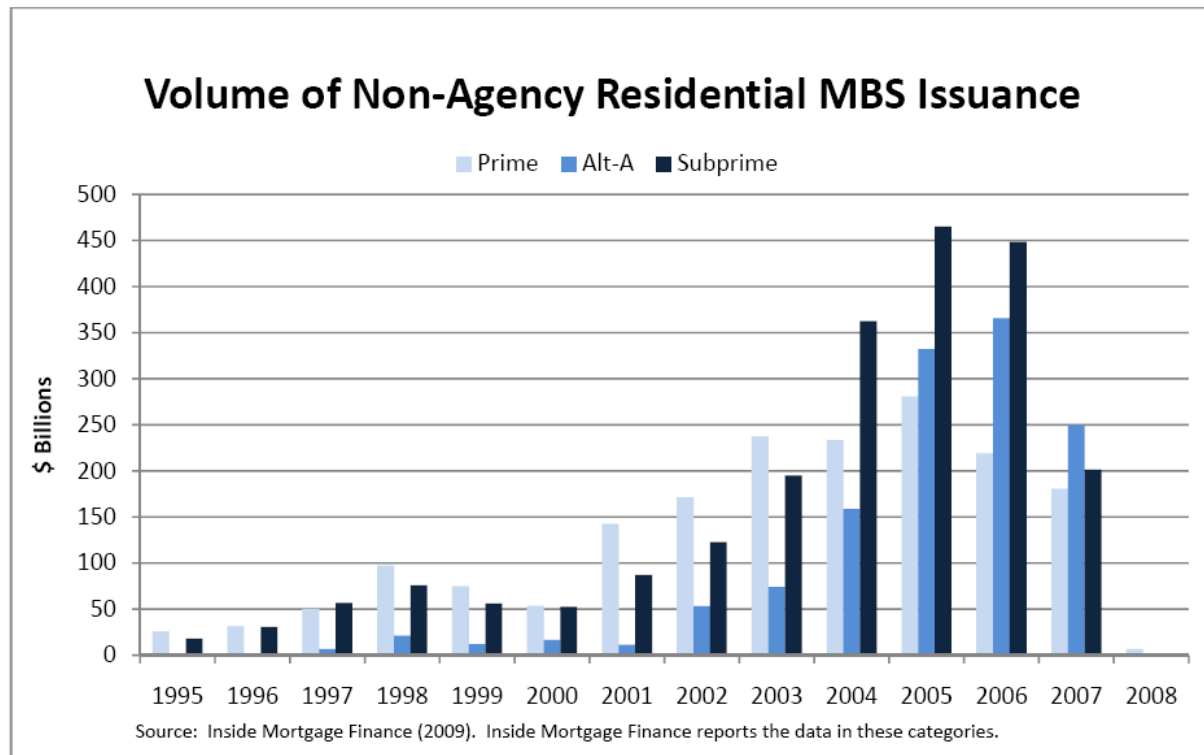
67. A credit default swap (“CDS”) was used to protect against the risk of an MBS defaulting. In a CDS, the buyer agreed to pay the seller a fixed stream of payments. In return, the seller agreed to pay the buyer a fixed amount if the “reference entity” of the CDS experienced a “credit event,” which was typically some sort of default. For MBS-based and CDO-based CDSs, the reference entity was the trust that issued the MBS or CDO security. CDSs were used by holders of MBSs and CDOs for the purpose of reducing their exposure to credit risk of MBSs and CDOs.

68. The following chart demonstrates that the 2000s saw a large increase in the market share of non-agency securitization. It shows the fraction of total residential mortgage originations in each year that were securitized into non-agency MBSs, GSE MBSs, and Ginnie Mae MBSs, as well as the fraction nonsecuritized (*i.e.*, held as whole loans by banks, thrifts, the GSEs, and other institutions).



69. Four trends are notable. Non-securitized mortgage originations declined steadily from half the market in 1995 to under 20 percent in 2008. Non-agency MBSs hovered between 8 and 12 percent until 2003; non-agency MBSs then more than trebled in market share to a peak of 38 percent in 2006. During the growth years for non-agency MBSs, Ginnie Mae's market share dropped considerably. Finally, both GSEs and Ginnie Mae rapidly escalated their market share as nonagency securitization dropped in 2008.

70. The following chart plots the volume of prime, subprime,<sup>7</sup> and alt-A<sup>8</sup> (self-identified as such by the sponsors) non-agency MBSs issued from 1995-2008.



<sup>7</sup> The term “subprime” refers to mortgage loans made to borrowers without credit histories or with relatively poor credit histories. These loans are therefore riskier than prime loans, which are made to borrowers with stronger credit. The marketing, underwriting, and servicing of subprime loans is different than that of prime loans.

<sup>8</sup> The term “alt-A” generally refers to loans made to borrowers with strong credit scores but which have other characteristics that make the loans riskier than prime loans. For example, the loan may have no or limited documentation of the borrower’s income, a high loan-to-value ratio (“LTV”), or may be for an investor-owned property.

71. This chart reveals that early in the period covered, the prime nonagency MBSs, which contained largely jumbo mortgages, were the biggest of the three types of non-agency MBSs. But by 2006 the subprime and alt-A non-agency MBSs had each surpassed prime non-agency MBSs in volume. In particular, subprime non-agency MBSs showed a dramatic increase from 2003 to 2005. Alt-A non-agency MBSs saw their largest jump in volume in 2005. Notably, the non-agency MBSs market was nearly nonexistent in 2008.

**C. The Collapse**

72. By 2004, commercial banks, thrifts, and investment banks caught up with Fannie Mae and Freddie Mac in securitizing home loans. By 2005, they had taken the lead. The two government-sponsored enterprises maintained their monopoly on securitizing prime mortgages below their loan limits, but the wave of home refinancing by prime borrowers spurred by very low, steady interest rates petered out. Meanwhile, Wall Street focused on the higher-yield loans that the GSEs could not purchase and securitize—loans too large, called jumbo loans, and nonprime loans that did not meet the GSEs’ standards. The nonprime loans soon became the biggest part of the market—“subprime” loans for borrowers with weak credit and “Alt-A” loans, with characteristics riskier than prime loans, to borrowers with strong credit.

73. By 2005 and 2006, Wall Street was securitizing one-third more loans than Fannie and Freddie. In just two years, private-label mortgage-backed securities had grown more than 30 percent, reaching 1.15 trillion in 2006; 71 percent were subprime or Alt-A.

74. To feed the MBS demand, Wall Street’s system made virtually unlimited funds available to unqualified buyers. More buyers in the market caused housing prices to rise thereby creating a housing bubble. Pretty soon, there were not enough buyers, qualified or not, to sustain the model, and the entire system collapsed. “Securitization could be seen as a factory line,” former Citigroup CEO Charles Prince told the FCIC. “As more and more and more of these



subprime mortgages were created as raw material for the securitization process, not surprisingly in hind-sight, more and more of it was of lower and lower quality. And at the end of that process, the raw material going into it was actually bad quality, it was toxic quality, and that is what ended up coming out the other end of the pipeline. Wall Street obviously participated in that flow of activity.” One theory for the demand Wall Street was so intent on satisfying pointed to foreign money.

75. Developing countries were booming and, due to past financial vulnerabilities, strongly encouraged saving. Investors in these countries placed their savings in apparently safe and high-yield securities in the United States. Federal Reserve Board Chairman Ben Bernanke called it a “global savings glut.” As the United States ran a large current account deficit, flows into the country were unprecedented. Over six years from 2000 to 2006, U.S. Treasury debt held by foreign official public entities rose from \$600 billion to \$1.43 trillion; as a percentage of U.S. debt held by the public, these holdings increased from 18.2 to 28.8 percent.

76. According to Frederic Mishkin, former member (governor) of the Board of Governors of the Federal Reserve System:

You had a huge inflow of liquidity. A very unique kind of situation where poor countries like China were shipping money to advanced countries because their financial systems were so weak that they [were] better off shipping [money] to countries like the United States rather than keeping it in their own countries.

The demand for what was perceived to be the safety of MBSs created a surplus in liquidity, thereby helping to lower long-term interest rates and providing easy money to mortgage originators. According to Paul Krugman, an economist at Princeton University:

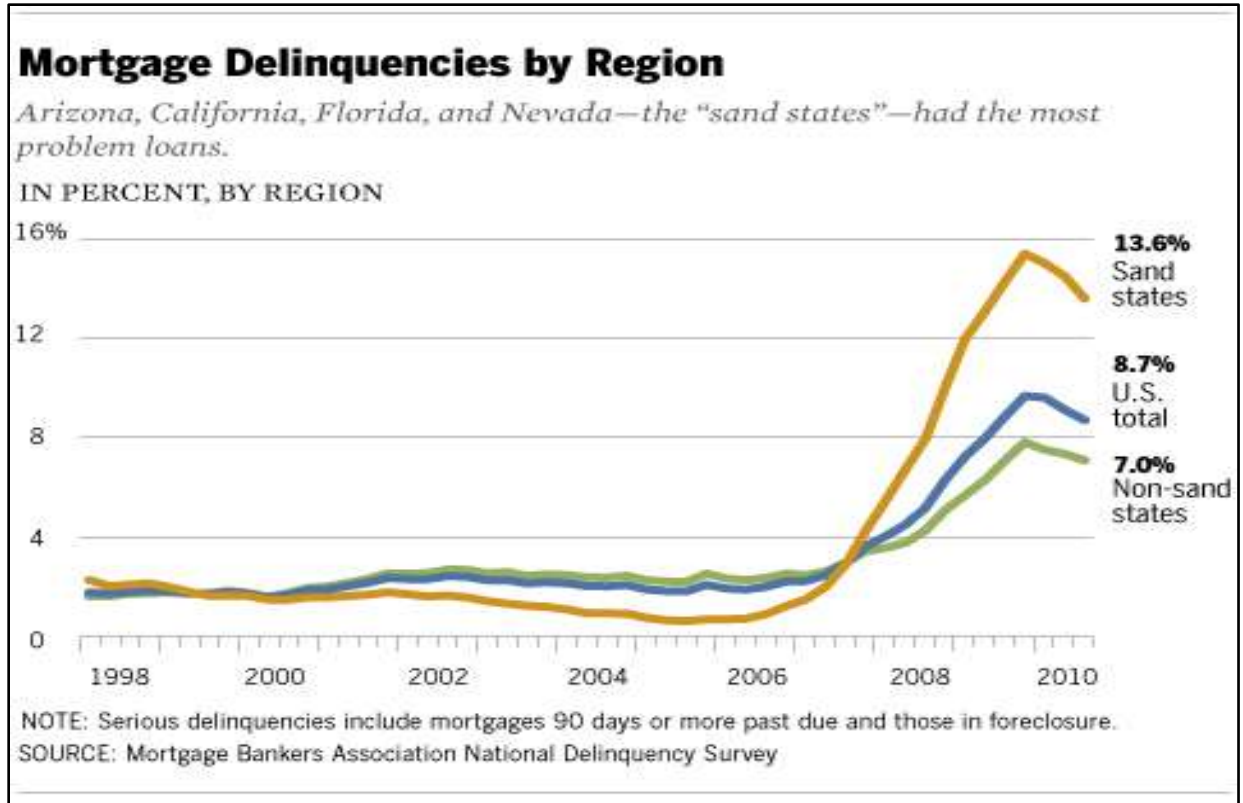
It’s hard to envisage us having had this crisis without considering international monetary capital movements. The U.S. housing bubble was financed by large capital inflows. So were Spanish and Irish and Baltic bubbles. It’s a combination of, in the narrow sense,

of a less regulated financial system and a world that was increasingly wide open for big international capital movements.

77. As more and more foreign capital became available, underwriting standards were lowered to extend credit to borrowers who represented a new risk paradigm. Predictably, borrowers who had been extended credit without having been adequately qualified began to default on their loans in escalating numbers beginning in late 2006. As 2007 went on, increasing mortgage delinquencies and defaults compelled the ratings agencies to downgrade first mortgage-backed securities, then CDOs.

78. As a result of the instability in the MBS market which began in late 2006, the summer of 2007 saw a near halt in many securitization markets, including the market for non-agency mortgage securitizations. For example, a total of \$75 billion in subprime securitizations were issued in the second quarter of 2007 (already down from prior quarters). That figure dropped precipitously to \$27 billion in the third quarter and to only \$12 billion in the fourth quarter of 2007. Alt-A issuance topped \$100 billion in the second quarter but fell to \$13 billion in the fourth quarter of 2007. Once-booming markets were now gone—only \$14 billion in subprime or Alt-A mortgage-backed securities were issued in the first half of 2008, and almost none after that.

79. Alarmed investors sent prices plummeting. Hedge funds faced with margin calls from their repo lenders were forced to sell at distressed prices; many would shut down. Banks wrote down the value of their holdings by tens of billions of dollars. As demonstrated by the following chart, defaults peaked in 2010.



80. The ease with which non-agency MBSs were created, and mortgages transferred into them, would not have been possible without the MERS System—a shadow recording system created by Wall Street to facilitate the commoditization the American mortgage and issuance of MBSs.

**D. Wall Street Ignores 300 Years of History and Creates the “MERS System”**

81. To facilitate the commoditization of mortgages and increase the velocity with which mortgages could be bought and sold and non-agency MBSs issued, Wall Street needed to create a mechanism that would enable it to buy and sell mortgages and mortgage servicing rights multiple times, packaged with tens of thousands of other mortgages, without the “inconvenience,” expense, or time associated with recording each transfer. In order to issue an MBS, however, the issuer was and is required by law and industry standards to record (and pay recording fees on) every assignment of a mortgage loan from origination through deposit in a

securitization trust. Faced with this dilemma, Wall Street, including Defendants BOA and Stewart, simply wrote its own rules and created MERSCORP and MERS, ignoring property laws throughout the United States, including Texas.

82. In order for a trust to have REMIC status, substantially all of its assets must be qualified mortgages. 26 U.S.C. § 860D(a)(4). A qualified mortgage is defined as “any obligation (including any participation or certificate of beneficial ownership therein) which is principally secured by an interest in real property.” 26 U.S.C. § 860G(a)(3). REMIC status is lost when too many non-qualified mortgages are in the trust. Retention of REMIC pass-through tax status is imperative because its loss would add significant costs to securitization, driving investors to other investments.

83. The PSAs contain express language to ensure that all rights to the mortgage loans have been transferred to the trust, so that the transaction is considered a true sale and, accordingly, bankruptcy-remoteness is achieved and the trust maximizes its ratings. The express language also ensures that the mortgage loan is secured by a security interest so that REMIC tax status is achieved.

84. The security interests transferred to the REMIC must be perfected security interests. Accordingly, a REMIC would ordinarily record assignments in states where assignments must by law be recorded or where a ratings agency required recording for the REMIC to obtain initial ratings. As to mortgages or deeds of trust where MERS is identified as the “mortgagee” or “beneficiary,” however, the assignments are not ordinarily recorded. The prospectus for a REMIC might explain this election not to record by stating:

The mortgages or assignments of mortgage for some of the Mortgage Loans may have been recorded in the name of Mortgage Electronic Registration Systems, Inc., or MERS, solely as nominee for the related Originator and its successors and assigns, including the Issuing Entity. Subsequent assignments of those mortgages are

registered electronically through the MERS system.

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Assignments of the Mortgage Loans to the Trustee (or its nominee) will not be recorded except in states where recordation is required by the rating agencies to obtain the initial ratings of the Certificates set forth in the table on page S-6 in this prospectus supplement. In addition to the foregoing, assignments of the Mortgage Loans will not be recorded (i) in states where, in the opinion of counsel acceptable to the Trustee, such recording is not required to protect the Trustee's interests in the Mortgage Loan against the claim of any subsequent transferee or any successor to or creditor of the Depositor, the Sponsor or the originator of such Mortgage Loan, or (ii) with respect to any Mortgage which has been recorded in the name of Mortgage Electronic Registration Systems, Inc. ("MERS") or its designee. With respect to any Mortgage that has been recorded in the name of MERS or its designee, no mortgage assignment in favor of the Trustee will be required to be prepared or delivered. Instead, each Servicer will be required to take all actions as are necessary to cause the Issuing Entity to be shown as the owner of the related Mortgage Loan on the records of MERS for purposes of the system of recording transfers of beneficial ownership of mortgages maintained by MERS. The Trustee, or a custodian on behalf of the Trustee, will promptly review each Mortgage File after the Closing Date (or promptly after the receipt by the Trustee, or a custodian on behalf of the Trustee, of any document permitted to be delivered after the Closing Date) to determine if any of the foregoing documents is missing. If any portion of the Mortgage File is not delivered to the Trustee, or a custodian on behalf of the Trustee, and the Depositor does not cure such omission or defect within 90 days, the Depositor will be required to repurchase the related Mortgage Loan (or any property acquired in respect thereof) at the Purchase Price described below to the extent such omission or defect materially and adversely affects the value of such Mortgage Loan.

**1. How MERS Works**

85. MERS is a subsidiary of MERSCORP. MERSCORP is owned by various mortgage banks, title companies, and title insurance companies, including Defendants BOA and Stewart. When a lender which is a "member" of MERS makes a mortgage loan, the lender instructs the title company to show not only the lender but also MERS, as "mortgagee" under a

mortgage and “beneficiary” under a deed of trust. MERS then shows up in the deed records as a “grantee.”

86. When the lender sells the note, or transfers the servicing rights, MERS remains as a “mortgagee” under a mortgage or “beneficiary” under a deed of trust and a “Grantee” in the deed records. The purchaser of the note, or successor servicer, agrees at the time of acquisition of its rights to notify MERS when the note is paid so that MERS can “release” its lien and the lien of the original lender. MERS has described its role as follows:

[MERS] and MERSCORP, Inc. were developed by the real estate industry to serve as the mortgagee of record and operate an electronic registration system for tracking interests in mortgage loans. . . Specifically, the MERS® System tracks the transfers of mortgage servicing rights and beneficial ownership interests in mortgage loans on behalf of MERS Members.

The promissory note is a negotiable instrument under Article 3 of the Uniform Commercial Code, and originating lenders routinely sell these notes on the secondary markets to investors. “The ability of lender to replenish their capital by selling loans in the secondary market is what makes money accessible for home ownership.”

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At the origination of the loan by a lender who is a MERS Member, the lender takes possession of the note (and becomes the holder of the note), and the borrower and lender designate MERS (as the lender’s nominee) to serve as the mortgagee or beneficiary of record. The lender’s secured interest is thus held by MERS. . . Rules, which are incorporated into all MERS’ agreements with its members, provide that members “shall cause Mortgage Electronic Registration System, Inc. to appear in the appropriate public records as the mortgagee of record with respect to each mortgage loan that the Member registers on the MERS® System.”

Accordingly, when a MERS Member originates a loan, the original lender and the borrower contractually agree in the mortgage that MERS will be the mortgagee and will serve as nominee for the lender and its successors and assigns. In the event of a default on the loan, MERS as the beneficiary or mortgagee, is authorized to foreclose on the home. After the borrower signs the mortgage agreement, it is recorded in the public, local land records with MERS as the named beneficiary or mortgagee.

The MERS Member then registers the mortgage loan information from the security instrument on the MERS® System. When the beneficial interest in a loan is sold, the promissory note is still transferred by an endorsement and delivery from the buyer to the seller, but MERS Members are obligated to update the MERS® System to reflect the change in ownership of the promissory note.

So long as the sale of the note involves a MERS Member, MERS remains the named mortgagee of record, and continues to act as the mortgagee, as the nominee for the new beneficial owner of the note (and MERS' Member). The seller of the note does not and need not assign the mortgage because under the terms of that security instrument, MERS remains the holder of title to the mortgage, that is, the mortgagee, as the nominee for the purchaser of the note, who is then the lender's successor and/or assign. Accordingly, there is no splitting of the note and mortgage for loans in the MERS® System. If, however, a MERS' Member is no longer involved with the note after it is sold, an assignment from MERS to the party who is not a MERS Member is executed by MERS, that assignment is recorded in the County Clerk's office where the real estate is located, and the mortgage is "deactivated" from the MERS® System.<sup>9</sup>

87. MERS's assertion that the subsequent assignment of notes secured by a deed of trust does not trigger a duty to file a notice of the assignment is false. Texas law requires that in order to release, transfer, assign or take any other action "relating to an instrument that is filed, registered, or recorded in the office of the county clerk," a person must "file, register, or record another instrument relating to the action in the same manner as the original instrument was required to be filed, registered, or recorded." MERS violated this duty millions of times in Texas alone.

**2. The MERS Lie – [W]hat is a lie? 'Tis but the truth in masquerade.**<sup>10</sup>

88. According to MERS, it is the "mortgagee" or "beneficiary," of record in more than 65 million mortgages filed in the deed records of counties throughout the United States.

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<sup>9</sup> *Mortgage Electronic Registration Systems, Inc. v. Nebraska Dept. of Bnknng and Fin.*, 704 N.W.2d 784 (Neb. 2005), Brief of Appellant at 11-12 (citations omitted).

<sup>10</sup> George Gordon Noel Byron, Lord Byron (1788–1824), *Don Juan*. Canto xi. Stanza 37.

MERS, however, does not actually have a security interest the real property that is the subject of such mortgages or deeds of trust. In MERS's own words:

MERS has no interest at all in the promissory note evidencing the mortgage loan. MERS has no financial or other interest in whether or not a mortgage loan is repaid. . .

MERS is not the owner of the promissory note secured by the mortgage and has no rights to the payments made by the debtor on such promissory note. . . . MERS is not the owner of the servicing rights relating to the mortgage loan and MERS does not service loans. **The beneficial interest in the mortgage (or the person or entity whose interest is secured by the mortgage) runs to the owner and holder of the promissory note.** In essence, MERS immobilizes the mortgage lien while transfers of the promissory notes and servicing rights continue to occur. (citation omitted).<sup>11</sup>

89. MERS has also admitted that under its agreement with its mortgagee-lender members, MERS **“cannot exercise, and is contractually prohibited from exercising, any of the rights or interests in the mortgages or other security documents”** and has **“no rights whatsoever to any payments made on account of such mortgage loans, to any servicing rights related to such mortgage loans, or to any mortgaged properties securing such mortgage loans.”**<sup>12</sup>

90. At this point one might ask how MERS can be the “mortgagee” in a mortgage or “beneficiary” of a deed of trust as to which the beneficial interest “runs to the owner and holder of the promissory note.”<sup>13</sup> Plainly, it cannot. As one court has observed:

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<sup>11</sup> *Mortgage Electronic Registration Systems, Inc. Nebraska Dept. of Bknng and Fin.*, 704 N.W.2d 784 (Neb. 2005), Brief of Appellant at 11-12 (emphasis added). MERS does not explain how it can be a “mortgage lien” holder or how it can “inoculate” loans “against future assignments” while simultaneously insisting that “MERS is not the owner of the promissory note secured by the mortgage and has no rights to the payments made by the debtor on such promissory note” and “is not the owner of the servicing rights relating to the mortgage loan.”

Also in question in cases pending in other jurisdictions is MERS's assertion that it has the authority to assign the note and mortgage to subsequent purchasers and the authority to appoint substitute trustees under the deeds of trust in which MERS appears as the “beneficiary” or “mortgagee.”

<sup>12</sup> *Id.* at 10 (emphasis added).

<sup>13</sup> *Id.* at 11-12.



MERS and its partners made the decision to create and operate under a business model that was designed in large part to avoid the requirements of the traditional mortgage recording process. This Court does not accept the argument that because MERS may be involved with 50% of all residential mortgages in the country, that is reason enough for this Court to turn a blind eye to the fact that this process does not comply with the law.

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Aside from the inappropriate reliance upon the statutory definition of “mortgagee,” MERS’s position that it can be both the mortgagee and an agent of the mortgagee is absurd, at best.

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This Court finds that MERS’s theory that it can act as a “common agent” for undisclosed principals is not supported by the law. The relationship between MERS and its lenders and its distortion of its alleged “nominee” status was appropriately described by the Supreme Court of Kansas as follows: “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.” *Landmark Nat’l Bank v. Kesler*, 216 P.3d 158, 166-67 (Kan. 2010).<sup>14</sup>

91. With regards to the legal accuracy of MERS’s recitation that it is the “mortgagee” or “beneficiary,” one scholar has stated:

MERS and its member use false documents to avoid paying recording fees to county governments. At the most simple level, mortgages and deeds of trust recorded at origination represent that MERS is the mortgagee or deed of trust beneficiary. Taking the appellate decisions in Arkansas, Kansas, Maine, and Missouri at face value, MERS recorded mortgages contain a false statement. While it is true that MERS recorded mortgages and deeds of trust also have qualifying language suggesting that MERS is also a “nominee,” the representation that MERS is the owner of the lien is not some innocuous legalism. It causes county recorders that maintain grantor-grantee indexes to list MERS in the chain of title for the land. The false designation of MERS as a mortgagee or beneficiary creates a false lead in the true chain of title defeating an essential purpose of recording mortgages and deeds of trust.

But perhaps even more troubling are the documents recorded in the name of MERS later in the life of mortgage loans. Recall that

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<sup>14</sup> *In Re Agard*, 444 BR 231 (E.D.N.Y. 2011).

MERS' business model does not include actually recording documents relating to its purported ownership itself. Instead, it allows employees of mortgage servicing companies and law firms to do so on its behalf. MERS has an internet web page where mortgage servicers and law firms can enter names of their own employees to automatically produce a boilerplate "corporate resolution" that purports to designate the servicers' and law firms' employees as certifying officers of MERS with the job title of assistant secretary and/or vice president. These servicer and law firm employees then sign and record documents such as mortgage assignments, substitution of deed of trust trustees, and substitutions of deed of trust beneficiaries—all including the representation that they are a MERS vice president or assistant secretary. Some states require that the individual signing a document conveying an interest in land have the job title of vice president or higher. Surely this policy is to prevent mistakes, confusion, and disputes over land ownership. But many servicer and law firm employees use the "vice president" title even when it is not required—perhaps because it just sounds better.

Only, it is not true. The representation that employees of mortgage servicing companies and foreclosure law firms are "vice presidents" of MERS is false. In the English language the words vice president primarily mean: "an officer next in rank to a president and usually empowered to serve as president in that officer's absence or disability." Sometimes, vice president can mean "any of several officers serving as a president's deputies in charge of particular locations or functions." The reality of what MERS "vice presidents" actually do, from whom they receive their paychecks, and their actual job titles are fundamentally inconsistent with a corporate officer than serves as president when the president is disabled, or acts as the president's deputy. A deposition transcript taken from a foreclosure case brought by a Florida debt collection law firm is illustrative. The deponent was a non-attorney employee of the firm that was claiming MERS certifying officer status. The employee was responsible for signing 20-40 mortgage assignments that would be recorded with county officials per day. The firm's rationale for allowing this was one of the boilerplate "corporate resolutions" taken off of MERS' website that stated: "The attached list of candidates are employees of Florida Default Law Group and are hereby appointed as assistant secretaries and vice-presidents of MERS." When this "Vice President" of MERS was asked about her relationship with MERS she responded:

**Q.** Did you have to have any sort of training to become a Certified Officer?

A. No.

Q. Do you know where MERS is located?

A. No.

Q. Have you ever been there?

A. No.

Q. Have you ever spoken with anyone at MERS?

A. No.

Q. Have you ever had e-mail transmissions back and forth with anyone from MERS?

A. No.

Q. Do you file any reports with MERS relating to assignments?

A. No.

Q. Do you know who the president of MERS is?

A. No.

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Q. And I guess at some point, somebody explained to you that you were a Certified Officer is that correct? . . .

A. Yes.

Q. And what do you remember as to their explanation as to what that meant?

A. Why I was being chosen as a Certified Officer?

Q. Yes.

A. That it was actually a group of us, we had one meeting and they explained that people that had an understanding of what an assignment was were going to go ahead and become certified officers because we then had authorization to execute on behalf of MERS.

It is inconsistent with even the most expansive definition of the term vice president, that an individual who is not an employee of the company, has never been to the company's location, does not even know where the company is located, has never met the

company's president, does not know who the president is, and has never personally communicated with the company in any way can be considered a vice-president of that company. It does not follow that because a belief is convenient, it is also true.

Perhaps the designation of servicer and law firm employees as "assistant secretaries" of MERS is less absurd, but it is also still false. While many of these servicer and law firm employees are secretarial workers in the businesses that they actually work for, they are not assistant secretaries of MERS in any meaningful economic sense. They have no more contact with MERS than vice presidents do. Indeed the fact that MERS' boilerplate resolutions allow the employees to just pick which title they want to use is compelling evidence that the whole concept is twaddle. MERS Assistant secretaries are not paid by MERS. They receive no health benefits from MERS. In yet one more example of Orwellian doublespeak, it is the financial institutions and law firms that pay MERS to allow them to pretend that they have MERS employees. Who pays to be an assistant secretary? While mortgage brokers and financiers may be keen on entrusting the nation's real property records to a company with these standard business practices, one can imagine that this might make the democratically elected county recorders that have dedicated their professional careers to preservation of land ownership rights somewhat uncomfortable.

County recorders deserve a fair hearing if they were to request payment of recording fees for assignments avoided through use of documents containing these false statements. Recording of these legally and factually false statements caused a reduction in the revenue that county governments would have collected from mortgage financiers. MERS itself used projections of this reduction in revenue in its sales pitches and marketing material. Indeed the studies done by accountants that justified the creation of MERS show how use of the MERS system—which entailed recording false documents—would cause a reduction in fees paid to counties.

But perhaps most compelling, pooling and servicing agreements packaging mortgage loans into securities legally require finance companies to record (and pay recording fees on) every assignment of a mortgage loan from origination through deposit in a securitization trust. A 2005 Pooling and Servicing Agreement between J.P. Chase Morgan's subprime subsidiary as a depositor, J.P. Chase Morgan's actual bank as servicer, and Wachovia Bank as trustee Chase's subprime subsidiary provides a typical example. The pool included both non-MERS and MERS loans, but had different assignment recording warranties for each. In the

agreement Chase's subprime subsidiary promised to turn over to the securitization trustee "Originals of all recorded intervening Assignments of Mortgage, or copies thereof, certified by the public recording office in which such Assignments or Mortgage have been recorded showing a complete chain of title from the originator to the Depositor, with evidence of recording. . . ." Conversely, in the case of MERS-recorded loans, the same agreement does not require recording of intermediate assignments. Instead it only requires the depositor to take "such actions as are necessary to cause the Trustee to be clearly identified as the owner of each such Mortgage Loan on the records of MERS. . ." In this typical securitization deal, Chase used the MERS system to duck a contractual obligation to produce recorded assignments for every non-MERS loan included in the pool—even though counties depend on the revenue produced by those assignments.<sup>15</sup>

92. Each of the Defendants filed or caused to be filed deeds of trust containing these legally and factually false statements in violation of Texas law. Defendants MERS, MERSCORP, BOA, and Aspire also released, transferred, assigned or took other action relating to such deeds of trust without ensuring that such action or actions were filed, registered, or recorded using another instrument relating to the action in the same manner as the original instrument was required to be filed, registered, or recorded."<sup>16</sup> Such conduct caused a reduction in the revenue that Plaintiff and the Class Members would have collected had Defendants complied with Texas law and recorded all subsequent transfers, assignments, transfers, and other activities related to the original deed of trust identifying MERS as the "beneficiary" of the deed of trust.

93. In its sales pitches, MERS used projections of the filing fees that its members would not pay to counties such as Plaintiff and Class Members. Indeed, the studies done by accountants that justified the creation of MERS show how use of the MERS System—which

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<sup>15</sup> Christopher L. Peterson, *Two Faces: Demystifying the Mortgage Electronic Registration System's Land Title Theory*, 53 WILLIAM & MARY L. REV. (forthcoming in 2011) (citations omitted) (available at: [www.papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1684729](http://www.papers.ssrn.com/sol3/papers.cfm?abstract_id=1684729)).

<sup>16</sup> TEX. LOC. GOV'T CODE § 192.007.

entailed recording false documents—would cause a reduction in fees paid to counties. And it has. By some estimates, the MERS System has cost counties nationwide in excess of \$10 billion.

94. In a nutshell, when Wall Street financiers talk to investors, they claim to own mortgages in order to convey the sense that they own what they are selling. But when financiers talk to the government they claim not to own what they are selling so as to not be obliged to pay fees associated with owning it. MERS and its members prevent recording fees from being paid on assignments—that was the whole point of MERS—but then attempt to avail themselves of the protection that having taken such an action would have afforded.”<sup>17</sup>

95. The havoc wrought by MERS was summarized aptly in an April 6, 2011 letter from the Guilford County, North Carolina Register of Deeds and Southern Essex District of Massachusetts Register of Deeds to Iowa Attorney General Tom Miller, leader of the Mortgage Foreclosure Multistate Group, comprised of state attorneys general in all 50 states. The letter outlines the concerns shared by county clerks and recorders nationwide and states, in part:

As County Land Record Recorders in Massachusetts and North Carolina, we have been gravely concerned about the role of the Mortgage Electronic Registration Systems (MERS) in not only foreclosure proceedings, but as it undermines the legislative intent of our offices as stewards of land records. MERS tracks more than 60 million mortgages across the United States and we believe it has assumed a role that has put constructive notice and the property rights system at risk. We believe MERS undermines the historic purpose of land record recording offices and the “chain of title” that assures ownership rights in land records.

As a result, we are asking as part of your probe, that this task force and the National Association of Attorney Generals require that all past and present MERS assignments of deeds of trust/mortgages be filed in local recording offices throughout the United States immediately. Assignments are required by statute to be filed in Massachusetts, however they are not currently required to be recorded in North Carolina. We feel, that it is important that the Registers of Deeds should have representatives at the table before

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<sup>17</sup> *Id.*

any settlement is discussed or agreed to as it relates to MERS failure to record assignments and pay the proper fees.

This action would serve three specific purposes. First, the filing of all assignments would help recover the chain of title that determines property ownership rights that has been lost and clouded over during the past 13 years because of the scheme that MERS has set in place. Second, transparency and confidence in ownership rights would be restored and this would prevent the infringement upon those rights by others. Third, this action would support a return to sound fundamentals in our economy between the financial services industry and public recording offices.

MERS has defended their practices by saying that they were helping the registries of deeds by reducing the amount of paperwork that needed to be recorded. This claim is outrageous. This is help we did not ask for, nor was it help that we needed. It is very clear that the only ones that they were helping were themselves. Over the past 10-12 years, recording offices across the United States have upgraded their internal and external technology to meet the demands of lenders, title underwriters, title searchers and citizens. In fact, in 1998 the Southern Essex District Registry of Deeds in Massachusetts became the first registry of deeds to provide both document images and indices available to the public, 24 hours a day, free of charge on the world-wide-web. In doing so, the Registry received a Computerworld Smithsonian Award which recognized the innovative use of technology to benefit society. In 2009, the Guilford County Register of Deeds was given a local Government Federal Credit Union Productivity Award by the North Carolina Association of County Commissioners for their technological innovations. Nationally, over 93% of the public land records are up to date and current, according to Ernest Publishing.

As of today, there are over 600 recording jurisdictions, covering 43% of the US population that have incorporated an eRecording model into their document recording operations. We believe these jurisdictions cover nearly 80% of the volume of assignments that should be recorded. The remaining areas could be covered quickly, with legislation requiring such action by state legislatures.

Quite frankly, we believe this can and should be done. It's the right thing to do.

In the coming weeks, we will be working with our national organizations, the National Association of County Recorders, Election Officials and Clerks (NACRC) and the International Association of Clerks, Recorders, Election Officials, and

Treasurers (IACREOT) to take the same position. We are also sending a copy of this Letter to the National Conference on State Legislatures (NCSL) and the National Association of Counties (NACO).<sup>18</sup>

96. The MERS System has created massive confusion as to the true owners of beneficial interests in mortgage loans and mortgages throughout the United States, and the loss of revenues has harmed U.S. counties, including Plaintiff and other members of the class. In short, the MERS System has collapsed the public recording system in the United States and the State of Texas.

**E. Texas County Deed Records**

97. Section 11.004 of the Texas Property Code requires that county clerks in the State of Texas: (1) correctly record, as required by law, within a reasonable time after delivery, any instrument authorized or required to be recorded in that clerk's office that is proved, acknowledged, or sworn to according to law; (2) give a receipt, as required by law, for an instrument delivered for recording; (3) record instruments relating to the same property in the order the instruments are filed; and (4) provide and keep in the clerk's office the indexes required by law.

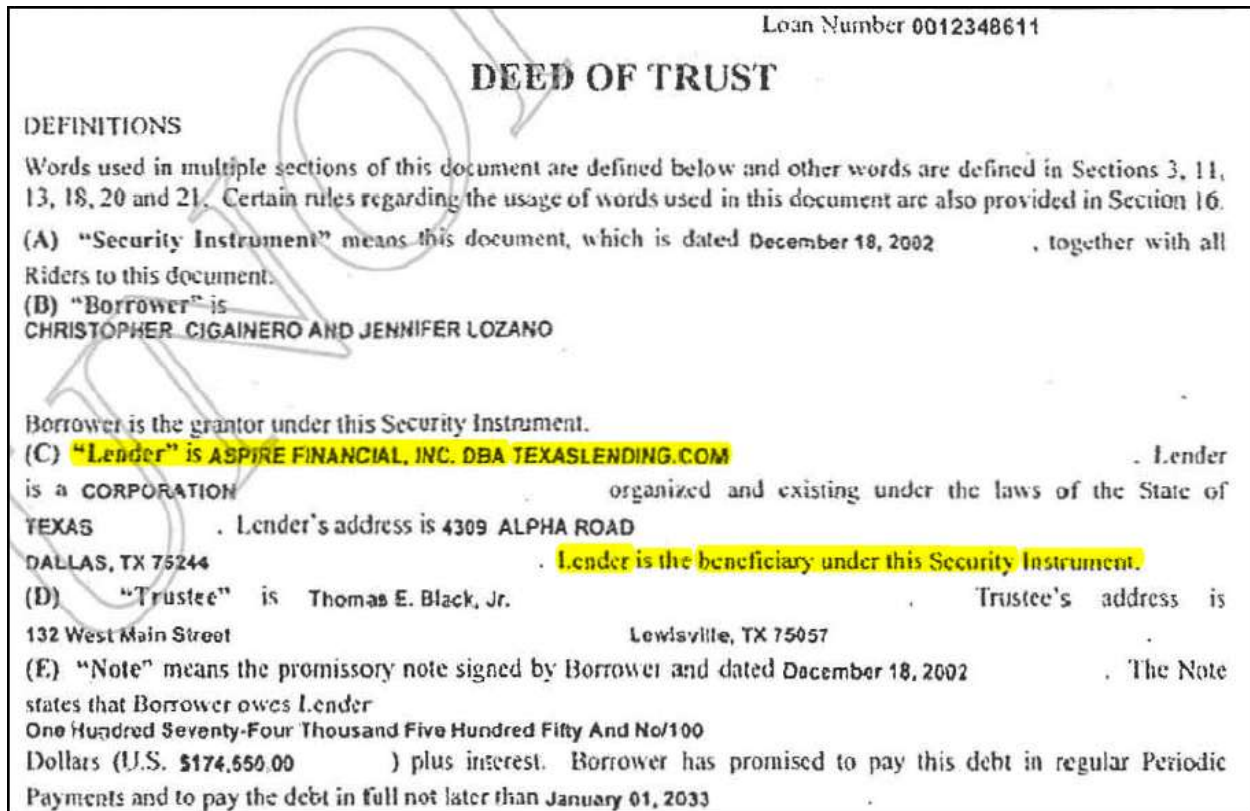
98. Section 193.003 of the Texas Local Government Code requires that a county clerk maintain "a well-bound alphabetical index to all recorded deeds, powers of attorney, mortgages, and other instruments relating to real property" with "a cross-index that contains the names of the grantors and grantees in alphabetical order." Under policies in effect for many years, employees of the Dallas County Clerk's Office, and upon information and belief employees in the offices of the other Class Members, record as a "Grantee" any person identified as a "lender," "beneficiary," or "grantee" in a deed of trust.

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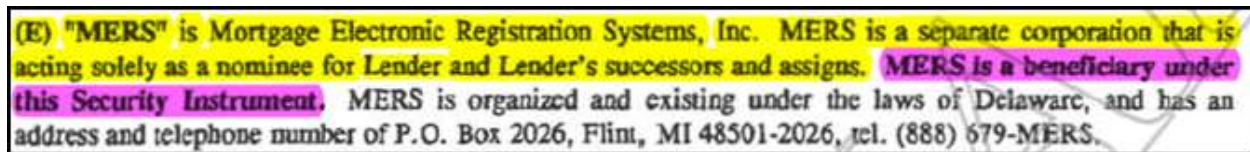
<sup>18</sup> [http://www.co.guilford.nc.us/departments/rod/ROD\\_Letter\\_To\\_AG\\_Miller.pdf](http://www.co.guilford.nc.us/departments/rod/ROD_Letter_To_AG_Miller.pdf).



99. Prior to the advent of the MERS System, the lender would normally be identified in the deed of trust as the “beneficiary” of the deed of trust. For example, in a deed of trust dated December 18, 2002, and filed in the Dallas County deed records, the relevant recitals identified Defendant Aspire as the “lender” and the “beneficiary:”



100. Following Defendant Aspire becoming a member of MERS, however, this changed. In an October 6, 2011, deed of trust filed in the Dallas County deed records, where Defendant Aspire is the lender, MERS is identified as “a beneficiary under this Security Instrument.”



101. Other deeds of trust filed in the Dallas County deed records often use the same or essentially the same language:

The beneficiary of this Security Instrument is MERS (solely as nominee for Lender and Lender's successors and assigns) and the successors and assigns of MERS. This Security Instrument secures to Lender: (i) the repayment of the Loan, and all renewals, extensions and modifications of the Note; and (ii) the performance of Borrower's covenants and agreements under this Security Instrument and the Note.

In yet another section of these deeds of trust, MERS is identified as follows:<sup>19</sup>

“MERS” is Mortgage Electronic Registration Systems, Inc. MERS is a separate corporation that is acting solely as a nominee for Lender and Lender's successors and assigns. **MERS is the beneficiary under this Security Instrument.** MERS is organized and existing under the laws of Delaware, and has an address and telephone number of P.O. Box 2026, Flint, MI 48501-2026, tel. (888) 679-MERS.

Despite its denomination as such, MERS is not the beneficiary of such deeds of trust, as the word “beneficiary” has been used in deeds of trust in Texas for over 100 years.

102. The explanation for why MERS is not identified only as the “nominee” or “agent” of the lender is simple — in order for the MERS System to work, MERS had to misrepresent its interests in the deeds of trust of which it purports to be a beneficiary.

103. For over 100 years, Texas law has provided that the grantee or beneficiary of a deed of trust is the lender on the note secured by the deed of trust.<sup>20</sup> So long as a debt exists, the “security will follow the debt,” and the assignment of the debt carries with it the rights created by the deed of trust securing the note.<sup>21</sup>

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<sup>19</sup> If this description of MERS's status under deeds of trust in which it appears as the “beneficiary” seems somewhat imprecise, that is because it is. MERS cannot be the “beneficiary” of a deed of trust which secures to **another**, *i.e.*, the Lender, (i) the repayment of the Loan, and all renewals, extensions and modifications of the Note and (ii) the performance of the Borrower's covenants and agreements under the Security Instrument and the Note.

<sup>20</sup> See *Lawson v. Gibbs*, 591 S.W.2d 292, 294 (Tex. Civ. App.-Houston [1st. Dist.] 1979, writ ref'd n.r.e.).

<sup>21</sup> A deed of trust in Texas creates a lien in favor of the lender; it does not operate as a transfer of title. This has been the law in Texas for more than a century. See *McLane v. Paschal*, 47 Tex. 365, 369 (1877); see also *Johnson v. Snell*, 504 S.W.2d 397, 399 (Tex. 1973).

104. Deed records in Texas were created to provide public notice of the identity of the person whose interest is protected by a deed of trust. Once properly filed, a deed of trust is “notice to all persons of the existence of the instrument,” protects the lender’s security interest against creditors of the grantor, and places subsequent purchasers on notice that the property is encumbered by a security interest.

105. In order to be shown in deed records in Texas as a “grantee,” and therefore a party whose interest is protected by recording, one must ordinarily be identified in a deed of trust as a “lender,” “mortgagee,” “grantee,” or “beneficiary” of the deed of trust. As noted above, however, MERS has admitted that it is none of these. According to MERS:

MERS has no interest at all in the promissory note evidencing the mortgage loan. MERS has no financial or other interest in whether or not a mortgage loan is repaid. . .

MERS is not the owner of the promissory note secured by the mortgage and has no rights to the payments made by the debtor on such promissory note. . . MERS is not the owner of the servicing rights relating to the mortgage loan and MERS does not service loans. **The beneficial interest in the mortgage (or the person or entity whose interest is secured by the mortgage) runs to the owner and holder of the promissory note.** In essence, MERS immobilizes the mortgage lien while transfers of the promissory notes and servicing rights continue to occur. (citation omitted).<sup>22</sup>

106. Here is MERS’ conundrum: if MERS is acting only as a “nominee” or “agent” of the lender, MERS itself has no security interest in the real property that is the subject of the deed of trust and therefore MERS has no rights which qualify it to assert that it is a beneficiary of the deed of trust. But unless MERS identifies itself as a “beneficiary,” MERS will not be denominated as a “grantee” in the deed records. And unless MERS is identified as a “grantee” in the deeds records, the MERS System does not work because the protections of the recording

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<sup>22</sup> *Mortgage Electronic Registration Systems, Inc. Nebraska Dept. of Bknng and Fin.*, 704 N.W.2d 784 (Neb. 2005), Brief of Appellant at 11-12 (emphasis added).

statutes are not extended to MERS. For MERS the solution was simple — ignore the law and identify itself as a “beneficiary” of an instrument in which it holds no beneficial interest. In that way, county clerks, including the Dallas County Clerk and other Class Members, would identify MERS as a “grantee” in their deed records, and MERS and its associates could take advantage of the recording system.

107. MERS also appears falsely as “Lender” and/or “Grantor” in hundreds of thousands of releases or assignments filed in the deed records of counties throughout the State of Texas.

108. As demonstrated by the criminal and civil penalties for filing false or deceptive real estate liens, Texas public policy favors a reliable functioning public recordation system to avoid destructive breaks in title, confusion as to the true identity of the holder of a note, fraudulent foreclosures, and uncertainty as to title when a home is sold. The MERS System has all but collapsed this system throughout the United States, including Texas.<sup>23</sup>

109. Upon information and belief MERS appears illegally as the “beneficiary” and/or

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<sup>23</sup> To understand the scale and seriousness of the institutional failures of MERS and MERSCORP and the role of these entities in creating a morass of the U.S. recordation systems, one need look no further than the disaster MERS has made of the foreclosure process. On April 12, 2011, MERSCORP and MERS entered into a *Consent Order* with several federal agencies. According to the findings contained in the *Consent Order*, MERS and MERSCORP “(a) have failed to exercise appropriate oversight, management supervision and corporate governance, and have failed to devote adequate financial, staffing, training, and legal resources to ensure proper administration and delivery of services to Examined Members; (b) have failed to establish and maintain adequate internal controls, policies, and procedures, compliance risk management, and internal audit and reporting requirements with respect to the administration and delivery of services to Examined Members” and, that “MERS and MERSCORP engaged in unsafe or unsound practices that expose[d] them and Examined Members to unacceptable operational, compliance, legal, and reputational risks.” *Consent Order*, April 12, 2011, OCC No. AA-EC-11-20; Board of Governors Docket Nos. 11-051-B-SC-1 and 11-051-B-SC-2; FDIC-11-194b; OTS No. 11-040; FHFA No. EAP-11-01 at 4-5.

In response to the hundreds of cases filed nationwide against MERSCORP and MERS for wrongful foreclosure, MERSCORP and MERS recently promulgated new policies that include the mandate that “[n]o foreclosure proceeding may be initiated, and no Proof of Claim or Motion for Relief from Stay (Legal Proceedings) in a bankruptcy may be filed, in the name of Mortgage Electronic Registration Systems, Inc. (MERS).”

“Grantee” in millions of deeds of trust filed in the deed records of counties throughout the State of Texas and as “Lender” and/or “Grantor” in millions more releases of lien or assignments filed in such deed records.

**F. Other Conduct of Defendants**

**1. MERSCORP AND MERS**

110. MERSCORP is the operating company that owns and operates the MERS System, charges and receives all fees for use of the MERS System, establishes and promulgates Rules of Membership in MERSCORP for those lenders and loan servicers desiring to become members for purposes of utilizing the MERS System, determines the *bona fides* of membership applications in MERSCORP, and is responsible for the day-to-day operation of the MERS System. Accordingly, the acts of misconduct alleged herein against MERS are alleged as well against MERSCORP as the owner and operator of MERS.

111. Pleading further, Plaintiff and Class Members would show that at all times material hereto, MERS has been a wholly-owned subsidiary of MERSCORP. MERS has been utilized by MERSCORP to shift liability away from MERSCORP and its shareholders for the violations of Texas statutes and law as set forth herein; to perpetrate a fraud in the form of wrongfully identifying MERS as the “beneficiary,” “mortgagee,” “grantee,” “lender,” or grantor in deeds of trust and other documents filed in the deed records of Plaintiff and Class Members; to evade the ongoing obligation to maintain the accuracy of deeds of trust and other documents filed in the deed records of Plaintiff and Class Members; and to justify the wrongs set forth herein. Accordingly, MERSCORP is liable for all of the acts of misconduct alleged against MERS herein.

112. MERSCORP established MERS without sufficient capitalization in view of the business in which MERS engaged. Moreover, MERSCORP failed to retain an appropriate

number of employees opting instead to direct MERS's member to have the members' employees appointed as "Vice-Presidents" or "Secretaries" of MERS for purposes of having the members, including BOA, purport to take actions as "MERS" through members' employees falsely or improperly denominated as offices of MERS.

113. MERS is effectively a "front" organization for its members, including Defendant BOA and, upon information and belief, Defendants Aspire and Stewart, which has created a systemically important mortgage registry but fails to properly oversee that registry or enforce its own rules on the members that participate in the registry. For example, rather than maintaining an adequate staff to provide MERS' services, MERS operates through a network of over 20,000 non-employee "corporate officers," including employees of BOA, who cause MERS to act without any meaningful oversight from anyone who works at MERS. Instead of meaningful internal controls, MERS relies on an "honor system" that fails to ensure the integrity of its registry. The lack of internal controls has resulted in MERS recording so-called "robosigned" documents in the deed records of Plaintiff and Class Members and has also resulted in MERS' failure to follow its own rules regarding proper institution of foreclosure proceedings.

114. The 20,000 individuals who identify themselves as MERS' corporate officers, are actually employees of MERS' members, including BOA, rather than MERS. These so-called "corporate officers" act on behalf of MERS in foreclosing mortgages and deeds of trust in which MERS is identified as a "mortgagee" or "beneficiary." In this manner, MERS operates like a puppet whose strings are pulled by its members' employees, including BOA. Members' employees cause MERS to take various legally operative actions, such as assigning mortgages, signing checks, and foreclosing on homeowners. Members purchase corporate seals for their signing officers from MERS at a cost of \$25 each. While MERS purports to act as agent for the holder or owner of a note, each act MERS performs on such entity's behalf is actually done by

that entity's own employee, acting as a MERS signing officer. Moreover, MERS encourages the widespread use of its corporate authority and performs no meaningful oversight over the acts of these signing officers. This use of member employees obfuscates the real entity dealing with consumers.

115. MERS' signing officers are not paid any compensation by MERS. Nor does MERS supervise or direct, nor have the right to supervise or direct, any of the work performed by its "signing officers." MERS "signing officers" do not seek, nor do they receive, any instruction, permission or approval from MERS to act on MERS' behalf.

116. The structure of MERSCORP and MERS and the fact that they undertake virtually no action except through the members of MERS, including BOA, justify the Court's ignoring the corporate fiction and imposing liability for the conduct of MERSCORP and MERS on the shareholders of MERSCORP, including BOA and Stewart.

## **2. BOA**

117. In addition to the actionable conduct of BOA alleged elsewhere herein, Defendant BOA's actionable conduct related to MERS and the other activities made the basis of this action included, but was and is not limited to, originating loans secured by deeds of trust recorded in the deed records of Plaintiff and other Class Members listing MERS as "mortgagee" or "beneficiary," which BOA filed or caused to be filed in the deed records of Plaintiff and other Class Members, and which BOA knew or should have known would result in the Plaintiff and other Class Members' county clerks improperly listing MERS as "grantee" in their deed records indexes. The denomination of MERS as "mortgagee" or beneficiary" or "grantee" is false and BOA knew or should have known that such denomination of MERS was false at the time BOA filed or caused to be filed the deeds of trust described above.

118. Upon information and belief, BOA has released, transferred, assigned, or taken other action relating to the instruments identified herein that BOA has filed or caused to be filed, but in violation of Texas law, BOA failed to file, register, or record another instrument relating to such actions in the same manner as the original instrument was required to be filed, registered, or recorded.

119. In addition to BOA's direct liability for its conduct alleged herein, Plaintiff seeks a determination of the Court that it is appropriate to pierce the MERSCORP and MERS corporate veils in this instance and hold BOA as a shareholder of MERSCORP liable for the conduct of MERSCORP and its subsidiary, MERS.

120. Recognizing the corporate existence of MERSCORP and MERS separate from their shareholders, including BOA, would bring about an inequitable result or injustice, or would be a cloak for fraud or illegality. MERSCORP and MERS were undercapitalized in light of the nature and risk of their business. The corporate fiction is being used to justify wrongs, as a means of perpetrating fraud, as a mere tool or business conduit for others, as a means of evading existing legal obligations, to perpetrate monopoly and unlawfully gain monopolistic control over the real property recording system in the State of Texas, and to circumvent statutory obligations.

121. **ASPIRE:** In addition to any actionable conduct of Aspire alleged elsewhere herein, Defendant Aspire's actionable conduct related to MERS and the other activities made the basis of this action included, but was and is not limited to, originating loans secured by deeds of trust recorded in the deed records of Plaintiff and other Class Members listing MERS as "mortgagee" or "beneficiary," which Aspire filed or caused to be filed in the deed records of Plaintiff and other Class Members, and which Aspire knew or should have known would result in the Plaintiff and other Class Members' county clerks improperly listing MERS as "grantee" in their deed records indexes. The denomination of MERS as "mortgagee" or beneficiary" or



“grantee” is false and Aspire knew or should have known that such denomination of MERS was false at the time Aspire filed or caused to be filed the deeds of trust described above.

122. Upon information and belief, Aspire has released, transferred, assigned, or taken other action relating to the instruments identified herein that Aspire has filed or caused to be filed, but in violation of Texas law, Aspire failed to file, register, or record another instrument relating to such actions in the same manner as the original instrument was required to be filed, registered, or recorded.

123. **STEWART TITLE:** In addition to any actionable conduct of Stewart Title alleged elsewhere herein, Defendant Stewart Title’s actionable conduct related to MERS and the other activities made the basis of this action included, but was and is not limited to, directing the preparation and filing of thousands of deeds of trust in the deed records of Plaintiff and other Class Members listing MERS as “mortgagee” or “beneficiary” and which Stewart Title knew or should have known would result in the Plaintiff and other Class Members’ county clerk’s office improperly listing MERS as “grantee” in the deed records indexes. The denomination of MERS as “mortgagee” or beneficiary” or “grantee” is false. Upon information and belief, many of the deeds of trust filed or caused to be filed by Defendant Stewart Title were subsequently released, transferred, assigned, or subject to other actions relating to such deeds of trust but such action were not recorded, in violation of Texas law. Stewart Title knew when it filed or caused to be filed the deeds of trust described herein that it was the intention of the lender and MERS that such deeds of trust would be released, transferred, assigned, or subject to other actions relating to such deeds of trust but that such action would not be recorded, in violation of Texas law.

124. Stewart Title also marketed MERS through Stewart Title’s established sales and marketing forces, thereby encouraging others to utilize the defective MERS System.

125. **STEWART:** In addition to any actionable conduct of Stewart alleged elsewhere

herein, Stewart is a Texas-based title insurance underwriter. It is relatively unique within the industry in that it only insures title risks and does not generally conduct title examinations or perform closing-related services. Instead, Stewart contracts with independent and affiliated agents for these functions, including Stewart Title.<sup>24</sup>

126. Plaintiff seeks a determination of the Court that it is appropriate to pierce the MERSCORP and MERS corporate veils in this instance and hold Stewart as a shareholder of MERSCORP liable for the conduct of MERSCORP and its subsidiary, MERS.

127. Recognizing the corporate existence of MERSCORP and MERS separate from their shareholders, including Stewart, would bring about an inequitable result or injustice, or would be a cloak for fraud or illegality. MERSCORP and MERS were undercapitalized in light of the nature and risk of their business. The corporate fiction is being used to justify wrongs, as a means of perpetrating fraud, as a mere tool or business conduit for others; as a means of evading existing legal obligations, to perpetrate monopoly and unlawfully gain monopolistic control over the real property recording system in the State of Texas, and to circumvent statutory obligations.

## VII. CAUSES OF ACTION

### A. Violation of § 12.002 of the Texas Civil Practice & Remedies Code – All Defendants

128. Section 12.002 of the Texas Civil Practice & Remedies Code (“*CPRC*”) provides:

- (a) A person may not make, present, or use a document or other record with:
  - (1) knowledge that the document or other record is a fraudulent court record or a fraudulent lien or claim against real or personal property or an interest in real or personal property;
  - (2) intent that the document or other record be given

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<sup>24</sup> Stewart is the successor-in-interest of Stewart Title North Texas, Inc., which merged into Stewart on or about October 1, 2008.

the same legal effect as a court record or document of a court created by or established under the constitution or laws of this state or the United States or another entity listed in Section 37.01, Penal Code, evidencing a valid lien or claim against real or personal property or an interest in real or personal property; and

(3) intent to cause another person to suffer:

(B) financial injury . . .

(b) A person who violates Subsection (a) or (a-1) is liable to each injured person for:

(1) the greater of:

(A) \$10,000; or

(B) the actual damages caused by the violation;

(2) court costs;

(3) reasonable attorney's fees; and

(4) exemplary damages in an amount determined by the court.

129. The deed records as described herein filed or caused to be filed by Defendants in the deed records of Plaintiff and Class Members, falsely represent MERS's interest in the real property that is the subject of such instruments; Defendants knew at the time of filing that such instruments falsely represented MERS's interest in the real property that is the subject of such instruments; Defendants filed or caused to be filed the instruments with the intent that they be given the same legal effect as a court record or document of a court created by or established under the constitution or laws of this state or the United States or another entity listed in Section 37.01, Texas Penal Code, evidencing a valid lien or claim against real or personal property or an interest in real or personal property; and intended by such conduct to financially injure Plaintiff and other Class Members by avoiding the costs and filing fees associated with filing, registering,

or recording subsequent releases, transfers, assignments, or other action relating to such instrument as required by Texas law.

130. Defendants conduct described herein violated section 12.002 of the CPRC for which Plaintiff and other Class Members seek judgment against Defendants, jointly and severally, in the amount of \$10,000 per violation, together with attorney's fees, court costs, and exemplary damages in an amount determined by the Court.

**B. Violation of Texas Local Government Code § 192.007**

131. For almost 300 years, common law and statute have required or permitted the recording of instruments affecting title to real property for the primary purpose of giving notice of their contents to the public. One of the primary purposes of recording documents affecting the title to real property is to make information pertaining to that property available to the general public and thus to protect persons from fraud. And because real estate is so tightly woven into the fabric of the U.S. financial system, stability and certainty regarding titles to real property is essential to the efficient functioning of the markets.

132. In order to perfect a security interest in real property in Texas, the instrument creating the security interest must be filed of record. But filing, generally, is not mandatory. Once a record of a security interest is filed of record, however, it must by statute be kept current in order to ensure continued accuracy of the real property records.

133. Section 192.007 of the Texas Local Government Code provides:

**TEX. LOC. GOV'T, SEC. 192.007**  
**Records of Releases and Other Actions**

- (a) To release, transfer, assign, or take another action relating to an instrument that is filed, registered, or recorded in the office of the county clerk, a person must file, register, or record another instrument relating to the action in the same manner as the original instrument was required to be filed, registered, or recorded.

- (b) An entry, including a marginal entry, may not be made on a previously made record or index to indicate the new action.

134. Defendants violated section 192.007 of Texas Local Government Code by failing to record all releases, transfers, assignments, and other actions relating to the deeds of trust in which they, separately or jointly, identified MERS as the “beneficiary.”

135. Damages to Plaintiff and other Class Members have been proximately caused by the conduct of Defendants as described herein, for which Plaintiff and other Class Members seek judgment of the Court, measured by the filing fees that would have been received by Plaintiff and other Class Members had all of the releases, transfers, assignments and other actions relating to the deeds of trust and other instruments described herein been filed, registered, or recorded in the office of the Plaintiff and other Class Members county clerks in the same manner as the original instrument was required to be filed, registered, or recorded.

**C. Unjust Enrichment – MERSCORP, MERS, BOA, and STEWART**

136. MERSCORP and MERS have been unjustly enriched by their conduct described above by their receipt of fees charged to MERS’s members for MERS to track mortgage loan and mortgage transfers which would otherwise have been recorded in the deed records of Plaintiff and other Class Members. BOA and Stewart are liable to Plaintiff and other Class Members for these damages alleged herein as shareholders in MERSCORP and/or MERS under a theory of alter-ego or otherwise piercing the corporate veil of MERSCORP and/or MERS.

137. Damages to Plaintiff and other Class Members have been proximately caused by Defendants’ conduct described herein, measured by the filing fees that would have been received by Plaintiff and other Class Members had all of the transfers described herein been recorded or, in the alternative as to MERS and MERSCORP, as measured by the fees received by MERSCORP and MERS for tracking the mortgage loans and mortgages tracked by MERS but

not recorded in the deed records of Plaintiff and other Class Members, for which damages they seek judgment of the Court.

**D. Unjust Enrichment – BOA and Aspire**

138. Defendants BOA and Aspire have been unjustly enriched by avoiding the filing fees associated with recordation of transfers that would otherwise have been recorded, but for their participation in the MERS System and violation of Texas law.

139. Damages to Plaintiff and other Class Members have been proximately caused by the conduct of BOA and Aspire described herein, measured by filing fees that would have been received by Plaintiff and other Class Members had all of the transfers described herein, and in which BOA or Aspire participated, been recorded rather than tracked exclusively on the MERS database, for which damages Plaintiff and other Class Members seek judgment of the Court.

**E. Negligent Misrepresentation – All Defendants**

140. Defendants negligently misrepresented the true beneficial owner of notes and related deeds of trust filed by them in the deed records of Plaintiff and other Class Members for the purpose of avoiding the recordation of subsequent transfers and payment of attendant filing fees.

141. Defendants negligently failed to properly record all releases, transfers, assignments, or other actions relating to instruments Defendants filed, registered, or recorded in the deed records of Plaintiff and other Class Members in the same manner as the original instrument was required to be filed, registered, or recorded.

142. The negligence of Defendants set forth herein was a proximate cause of damages to Plaintiff and other Class Members for which they seek judgment of the Court.

**F. Grossly Negligent Misrepresentation – All Defendants**

143. With gross negligence Defendants misrepresented the true beneficial owner of

notes and related deeds of trust filed by them in the deed records of Plaintiff and other Class Members for the purpose of avoiding the recordation of subsequent transfers and payment of attendant filing fees.

144. With gross negligence Defendants failed to properly record all releases, transfers, assignments, or other actions relating to instruments Defendants filed, registered, or recorded in the deed records of Plaintiff and other Class Members in the same manner as the original instrument was required to be filed, registered, or recorded.

145. The gross negligence of Defendants set forth herein was a proximate cause of damages to Plaintiff and other Class Members for which they seek judgment of the Court.

**G. Negligent Undertaking – All Defendants**

146. Defendants negligently undertook the misconduct alleged herein. Such negligence included, but was and is not limited to, filing false and deceptive records in the deed records of Plaintiff and other Class Members and failing to properly record all releases, transfers, assignments, or other actions relating to instruments Defendants filed or caused to be filed, registered, or recorded in the deed records of Plaintiff and other Class Members in the same manner as the original instrument was required to be filed, registered, or recorded.

147. The negligent undertaking of Defendants set forth herein was a proximate cause of damages to Plaintiff and other Class Members for which Plaintiff and other Class Members seek judgment of the Court.

**H. Grossly Negligent Undertaking – All Defendants**

148. Defendants were grossly negligent in the misconduct alleged herein. Such gross negligence included, but was and is not limited to, filing false and deceptive records in the deed records of Plaintiff and other Class Members and failing to properly record all releases, transfers, assignments, or other actions relating to instruments Defendants filed or caused to be filed,

registered, or recorded in the deed records of Plaintiff and other Class Members in the same manner as the original instrument was required to be filed, registered, or recorded.

149. The grossly negligent undertaking of Defendants was a proximate cause of damages to Plaintiff and other Class Members for which they seek judgment of the Court.

**I. Negligence Per Se**

150. Defendants were negligent per se in the misconduct alleged herein. Such negligence per se included, but was and is not limited to:

- a. violation of section 12.002 of the Texas Civil Practice & Remedies Code by filing false and deceptive records in the deed records of Dallas County, Texas; and
- b. violation of section 192.007 of the Texas Local Government Code by failing to properly record all releases, transfers, assignments, or other actions relating to instruments Defendants filed or caused to be filed, registered, or recorded in the deed records of Plaintiff and other Class Members in the same manner as the original instrument was required to be filed, registered, or recorded.

151. The negligence per se of Defendants set forth herein was a proximate cause of damages to Plaintiff and other Class Members for which Plaintiff and other Class Members seek judgment of the Court.

**J. Gross Negligence Per Se**

152. Defendants were grossly negligent per se in the misconduct alleged herein. Such gross negligence per se included, but was and is not limited to:

- a. violation of section 12.002 of the Texas Civil Practice & Remedies Code by filing false and deceptive records in the deed records of Dallas County, Texas; and
- b. violation of section 192.007 of the Texas Local Government Code by failing to properly record all releases, transfers, assignments, or other actions relating to instruments Defendants filed or caused to be filed, registered, or recorded in the deed records of Plaintiff and



other Class Members in the same manner as the original instrument was required to be filed, registered, or recorded.

153. The gross negligence per se of Defendants set forth herein was a proximate cause of damages to Plaintiff and other Class Members for which they seek judgment of the Court.

**K. Fraudulent Misrepresentation – All Defendants**

154. Defendants fraudulently misrepresented the true beneficial owner of notes and related mortgages filed by them in the deed records of Plaintiff and other Class Members for the purpose of avoiding the recordation of subsequent transfers and payment of attendant filing fees.

155. Defendants' fraudulent misrepresentations were a proximate cause of damages to Plaintiff and other Class Members for which they seek judgment of the Court.

**L. Declaratory Judgment**

156. Plaintiff and other Class Members hereby seek a judicial declaration that the filing of deeds of trust identifying MERS as a "mortgagee" or "beneficiary" under the deed of trust, when in fact MERS has no beneficial interest in the note secured by such deed of trust, constitutes a violation of section 51.901 of the Texas Government Code.

157. Plaintiff and other Class Members also seek a judicial declaration that the Defendants and each of them is liable for having failed to properly record all releases, transfers, assignments, or other actions relating to instruments Defendants filed or caused to be filed, registered, or recorded in the deed records of Plaintiff and other Class Members in the same manner as the original instrument was required to be filed, registered, or recorded.

**M. Request for Injunctive Relief**

158. Plaintiff and other Class Members seek an order of the Court permanently enjoining Defendants from filing any instruments in the deed records of Plaintiff or other Class Members identifying MERS or any other person or entity as a "mortgagee" or "beneficiary" of

any mortgage in which such person or entity does not have a beneficial interest or other legally sufficient interest.

159. Plaintiff and other Class Members further seek an order of this Court requiring Defendants, jointly and severally, to correct the false and deceptive filings described herein by causing the recordation of corrective instruments setting forth the entire chain of title for each instrument described herein.

**N. Exemplary Damages – All Defendants**

160. The conduct of each Defendant as set forth herein constituted fraud, malice, or gross negligence such that each Defendant is liable for exemplary damages for which they seek judgment of the Court.

**VIII.  
CONSPIRACY**

161. Defendants and each of them conspired together in the actionable conduct alleged herein so as to make each of MERSCORP, MERS, BOA, Stewart, Stewart Title, and Aspire liable for all damages suffered by Plaintiff and other Class Members. The conspiracy included these Defendants establishing an object to be accomplished; a meeting of minds on the object or course of action; one or more unlawful, overt acts; and damages to Plaintiff and other Class Members as the proximate result. As a result, Plaintiff and other Class Members seek damages against these Defendants jointly and severally.

**IX.  
JURY DEMAND**

162. Plaintiff requests trial by jury.

**X.  
PRAYER**

163. Wherefore, premises considered, Plaintiff on behalf of itself and all other Texas counties similarly situated, requests that Defendants be cited to appear and answer and, upon trial of this matter, Plaintiff and other Class Members be awarded damages as set forth above, costs of bringing this action, including all court costs, attorney's fees, and related expenses of bringing the action (including investigative expenses), pre- and post-judgment interest at the highest rate allowed by law, and for such other and further relief, in law and in equity, to which Plaintiff and other Class Members may show themselves justly entitled.

164. Plaintiff on behalf of itself and all other Texas counties similarly situated further requests that the Court order Defendants, jointly and severally, to file, register, or record another instrument relating to any release, transfer, assignment, or any other action relating to any instrument that was filed or caused to be filed by any Defendant in the deed records of Plaintiff and other Class Members and to do so in the same manner as the original instrument was required to be filed, registered, or recorded.

Respectfully submitted,

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**CERTIFICATE OF SERVICE**

The undersigned certifies that the foregoing document was filed electronically with the Clerk of Court using the CM/ECF system. As such, this document was served on all counsel who are deemed to have consented to electronic service. All other counsel of record not deemed to have consented to electronic service were served with a true and correct copy of the document on October 31, 2011.

*/s/ Stephen F. Malouf*  
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**Attorney for Plaintiff and the Class**