A NEWSLETTER FOR LENDERS, TITLE INSURERS, INVESTORS, AND REAL ESTATE PROFESSIONALS DECEMBER 2011

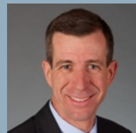
GARAN LUCOW MILLER P.C.

Michigan Real Estate Update

Editors

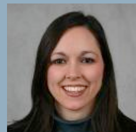
Tom Christy
Peter Worden

GLM Real Estate and Title Insurance Group



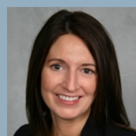
TRAVERSE CITY
231.941.1611
Peter Worden

TROY (DETROIT AREA)
248.641.7600
Tom Christy



Rachel Bissett

Mark Nawrocki



Emily Ross

MARQUETTE
906.226.2524
Sean Fosmire

GRAND BLANC
810.695.3700
Robert Goldstein

GRAND RAPIDS
616.742.5500
Tara Velting

© 2011 Garan Lucow Miller, P.C.

In this issue

- Mortgage priority: Michigan Court of Appeals allows equitable subrogation when a lender re-finances its own mortgage
- Michigan Supreme Court reverses *Saurman* (the MERS foreclosure case)
- Michigan Legislature increases criminal penalties for real estate fraud

Editors' note: Welcome to the first edition of Garan Lucow Miller's real estate newsletter. We hope that, in the tradition of our firm's other publications, our clients will find this newsletter a valuable resource to keep up-to-date on developments in Michigan real estate law.

Mortgage Priority: A New Lease on Life for Equitable Subrogation in Michigan

By Peter Worden

Executive summary: Although equitable subrogation remains unavailable to bolster mortgage priority in most cases, the Michigan Court of Appeals affirmed an exception for lenders re-financing their own loans, who can invoke equitable subrogation to maintain the priority of their earlier mortgage despite intervening liens.

A first-priority mortgage holder which refinances its own loan and accepts a new mortgage after discharging the first loan has priority over an intervening lien thanks to equitable subrogation, the Michigan Court of Appeals has held in a published decision.

The court's December 15, 2011 decision in *CitiMortgage, Inc. v. Mortgage Electronic Registration Systems, Inc.*, clarifies uncertainty which had existed ever since a 2005 Court of Appeals decision, *Washington Mutual v Shorebank,* eliminated equitable subrogation in Michigan in most circumstances.

Previous cases

Washington Mutual determined that a lender cannot be equitably subrogated to the priority of a senior lender merely because it provided funds used to pay off and discharge the senior lien, because a lender doing so is a mere "volunteer" and volunteers are not entitled to equitable subrogation. This holding was later confirmed by a conflict panel in *Ameriquest v Alton* (2007).

However, *Washington Mutual* left open two possible situations where equitable subrogation may still apply. One situation is where lenders refinance their own loans and discharge their own senior mortgages. The *Washington Mutual* Court noted that in *Schanhite v Plymouth United Savings Bank* (1936), the Michigan Supreme Court had held that a mortgagee that refinances its own loan and accepts a new mortgage and discharges the original senior mortgage retains priority over intervening lien holders. *Washington Mutual* distinguished the *Schanhite* decision by stating it was based on the equitable doctrine of mistake rather than subrogation, but nonetheless allowed that "such bolstering or priority may be applicable when the new mortgagee is the holder of the mortgage being paid off."

Since *Washington Mutual,* there has been much debate over whether *Wash-*

ington Mutual actually carved out an exception to the abrogation of equitable subrogation in Michigan. Lenders who had refinanced their own loans and inadvertently found themselves in a junior position argued that equitable subrogation still applied in such situations. Intervening lien holders argued that *Washington Mutual*'s discussion of this possible exception was merely non-binding dicta. Cases which followed, such as the federal district court case *VanDyk Mortgage v Buffum*, offered little clarity.

The exception to the rule

The *CitiMortgage* decision does much to remove that lack of clarity. It expressly holds that if a senior mortgage is released of record and, as part of the same transaction, is replaced with a new mortgage by the same lender, the new mortgage retains the same priority as its predecessor. The panel also expressly states that a lender which refinances its own loan is not a "mere volunteer" and is entitled to equitable relief.

There are some aspects of the *CitiMortgage* decision which likely will be debated in future cases. In *CitiMortgage,* the senior lender lacked actual knowledge of the intervening lien (though, as the intervening lien had been recorded, it certainly had constructive notice). While the lack of actual notice clearly played no part in the court's determination that equitable subrogation applied, expect that intervening lien holders will argue that the decision does not apply when the senior lender has actual knowledge of the intervening lien.

Also, *CitiMortgage* points out that equitable subrogation applies only where the senior lender is refinancing its own loan (third party lenders are out of luck), and only where the trial court has carefully balanced the equities to ensure that the junior lien holder has not been prejudiced. Expect intervening lien holders to raise any number of issues, such as loan renewal, in an effort to show that subrogation would result in "prejudice."

But, overall, the *CitiMortgage* decision goes a long way towards resolving the remaining uncertainly concerning equitable subrogation in Michigan.

Peter Worden practices law in Garan Lucow Miller's Traverse City, Michigan office. He can be reached at 231-941-1611, *or pworden@garanlucow.com.*

Supreme Court Allows MERS Foreclosures, Reverses Saurman

By Mark Nawrocki and Rachel Bissett

Executive summary: The Michigan Supreme Court overturned an earlier Court of Appeals decision and ruled that mortgages can be foreclosed in the name of MERS without first assigning the mortgage to the actual owner of the indebtedness.

Most readers are probably familiar with Mortgage Electronic Registration Systems, Inc. (MERS), which holds mortgages as "nominee" for the actual lender and tracks sales of mortgage debt on its systems. If foreclosure becomes necessary, either MERS assigns the mortgage to the debt holder to foreclose, or foreclosure occurs in MERS' own name. The latter procedure has been attacked in Michigan.

The problem

Most mortgages are foreclosed by advertisement in Michigan, which is a simpler and faster process than judicial foreclosure. In order to foreclose by advertisement, Michigan law requires that the foreclosing party must either (1) own the indebtedness secured by the mortgage; or, (2) own an interest in the indebtedness; or (3) be the servicing agent of the mortgage.

On April 21, 2011, the Michigan Court of Appeals, in a 4-3 split decision by a 7-judge special panel, threw a wrench into the MERS foreclosure gears when it decided *Residential Funding Co, LLC v Saurman.* In *Saurman,* the court held that MERS did not own indebtedness, own an interest in indebtedness, or service mortgages. Therefore, the court held that MERS lacked standing to foreclose by advertisement, and that any foreclosure by MERS as nominee was void *ab initio.*

Going forward, the Court of Appeals *Saurman* decision was avoidable if MERS assigned the mortgage to the lender before foreclosure. However, because the applicable statute requires the *indebtedness* to be assigned, not merely the mortgage, promissory notes also needed to be located and endorsed, as decided in *Bakri v. MERS,* an unpublished Court of Appeals case. Furthermore, thousands of mortgages had already been foreclosed in MERS' name.

Armed with the *Saurman* decision, homeowners flooded the courts with filings and argued that their foreclosures by advertisement in MERS' name must be set aside. Trial courts responded in different ways. Some followed *Saurman* and held foreclosures void *ab initio.* Some tried to draw distinctions to avoid the effect of *Saurman.* Some adjourned cases for several months, waiting further guidance from the Michigan Supreme Court. Meanwhile, some county sheriff departments entered moratoriums on foreclosures involving MERS.

Several attorneys went one step further and attacked the MERS system itself, arguing that if MERS was named anywhere in the title history, not only was the foreclosure invalid, but that the mortgage itself was invalid. The result could have been thousands of

indebted homeowners owing their home, mortgage free. However, trial courts were generally not receptive to this argument, nor was the Michigan Court of Appeals in *Bakri.*

The resolution

The *Saurman* case was appealed to the Michigan Supreme Court. On November 16, 2011, the court, understanding the urgency of the issues, peremptorily reversed the Court of Appeals judgment. Four justices joined in the order. The other three would have granted leave for a full appeal.

The court ruled that MERS does own an interest in the indebtedness. Specifically, the court agreed with the dissenting Court of Appeals opinion that MERS is "the owner…of an interest in the indebtedness secured by the mortgage" because "[MERS'] contractual obligations as the mortgagee were dependent upon whether the mortgagor met the obligation to pay the indebtedness which the mortgage secured."

The court reasoned: "MERS' status as an 'owner of an interest in the indebtedness' does not equate to an ownership interest in the note. Rather, as a record-holder of the mortgage, MERS owned a security lien on the property, the continued existence of which was contingent upon the satisfaction of the indebtedness. This interest in the indebtedness… authorized MERS to foreclosure by advertisement under MCL 600.3204 (1)(d)."

The issue of whether MERS can foreclose by advertisement is resolved. Furthermore, the legitimacy of the MERS system now seems established in Michigan. The Supreme Court's decision should allow disposal of hundreds of wrongful foreclosure suits currently pending.

Mark Nawrocki and Rachel Bissett practice law in Garan Lucow Miller's Troy, Michigan office. They can be reached at 248-641-7600, mnawrocki@ garanlucow.com, or rbissett@ garanlucow.com.

Michigan Increases Criminal Penalties for Real Estate Fraud

By Tom Christy

Executive summary: Michigan has amended various statutes to increase criminal penalties related to real estate fraud. The impact is likely negligible.

Michigan has enacted new statutes that increase penalties for various crimes related to real estate fraud. The new penalties take effective on January 1, 2012.

First, the maximum imprisonment for using false pretenses to defraud in combination with various types of transactions, including those related to real estate, will be increased from 10 years to 20 years for transactions over $100,000.

Second, whereas fraudulent notarization used to be only a misdemeanor, it will now be a felony when "relating to an interest in real property or a mortgage transaction." The maximum penalty is 4 years in prison and a $5,000 fine.

Proponents of the new law have trumpeted the new penalties in the press as significant victories. However, we are skeptical that the penalties will deter much fraud. In our experience, few notaries are foolish enough to notarize fraudulent deals in their own name. Rather, most fraudulent transactions involve notarizations by persons who are not notaries at all. These persons are never found, or turn out to be the alter ego of the main perpetrator of the fraud, who was already subject to felony prosecution.

Furthermore, most fraudsters are unlikely to find the difference between a 10 year and 20 year maximum sentence to be significant. They usually do the crime because they think that they are not going to get caught at all.

While the new penalties may make a difference in a few criminal cases, they will not reduce fraud by any significant amount. Don't believe the hype.

Tom Christy practices law in Garan Lucow Miller's Troy, Michigan office. He can be reached at 248-641-7600, or tchristy@garanlucow.com.