

## U.S. District Court Finds Transfers of Secured Debt by MERS Subject to Pennsylvania Recording Requirements

By Brian J. Levin

In the recent case of *Montgomery County, Pennsylvania, Recorder of Deeds v. MERSCORP, Inc. and Mortgage Electronic Registration Systems, Inc.* (2014 WL 2957494, June 30, 2014), the U.S. District Court for the Eastern District of Pennsylvania held, among other things, that the defendants, MERSCORP, Inc. and Mortgage Electronic Registration Systems, Inc. (together, MERS) were in violation of 21 P.S. §351 by failing to publicly record conveyances of an interest in real property when MERS did not record transfers of promissory notes between its own fee-paying members. In so holding, the court found that the transfer of a promissory note, separate and apart from an assignment of a mortgage, creates in the transferee an equitable interest in the mortgage, and that such a transfer of the note by operation of law also transfers the mortgage. Such a transfer is subject to the recording requirements of the Commonwealth of Pennsylvania.

### Background

The defendants serve as the mortgagee of record in the public land records as the “nominee” for a lender who holds the mortgage note, and such lender’s successors and assigns. The language contained in a typical MERS mortgage states that, “the Borrower does hereby mortgage, grant and convey to MERS (solely as the nominee for Lender and Lender’s successors and assigns) the following described property...” Thus, it is MERS, not the lender, that is identified as the mortgagee on the mortgage in the public records.

The various lenders who engage MERS to serve as the mortgagee are members

of a private, members-only electronic registration system, which is a database that tracks the beneficial interests in, and servicing rights to, the loans registered on and by the members of the MERS system. When a MERS member transfers or sells the debt or promissory note (but does not assign the mortgage), there is no assignment of mortgage, MERS remains as the mortgagee of record and there is no assignment or other document to be recorded in the public record. However, the MERS member is responsible for reporting the transfer by entering the data reflecting the transfer into the MERS database. When a mortgage is actually assigned, it is MERS that is the assignor and a MERS officer signs the assignment of mortgage. In those instances, an assignment of mortgage is recorded in the public land records. Thus, with respect to when a public recording is required, MERS has made the clear distinction between an assignment of mortgage, which is recorded in the public land records, and a transfer or sale of the promissory note, which is not recorded.

### Case

In the case at hand, Nancy Becker, the Recorder of Deeds for Montgomery County, Pa., filed suit on behalf of herself and all other Pennsylvania Recorders of Deeds claiming that MERS violated 21 P.S. §351 by failing to record conveyances of interests in real property by virtue of MERS’ practice of not recording a transfer of a promissory note in the public record, but, instead, by having created and maintained a private, members-only registry for recording and tracking such transfers. Section 351 requires the recording of “all deeds, conveyances, contracts and other instruments of writing by which the parties ... intend to grant, bargain, sell and convey any lands, tenements or hereditaments in the Commonwealth.”

The court first examined whether, in the absence of a written mortgage

assignment, Section 351 requires the transfer of secured debt to be documented in a form suitable for recording, and then recorded in the public land records. The court undertook a thorough review of the history of the Pennsylvania recording statutes, focusing largely on the Pennsylvania Supreme Court cases in which the court held that a mortgage assignment, a mortgage satisfaction and a mortgage release are all conveyances, and thereby subject to the recording act. The court went on to explain that, based upon “well-settled, long-held American law,” the note and mortgage are legally interwoven and inseparable. That premise, the court stated, is well-supported by the Restatement (Third) of Property [§5.4 (1997)] and by the language contained in the current Pennsylvania Mortgage forms (specifically the Single Family-Fannie Mae/Freddie Mac Uniform Instrument and Uniform Instrument with MERS), which are commonly used by MERS. Based upon such review, the court determined that the transfer of the note is, by operation of law, an assignment and conveyance of an interest in, and/or title to, the property that it secures, and that the Pennsylvania Recording Act requires that the transfer of secured debt first be documented in a form suitable for recording and then recorded in the land records because it creates in the transferee an equitable interest in the mortgage. As a result of this holding, MERS is obligated to create and record written documents memorializing the transfers of debt/promissory notes secured by real estate mortgages in the Commonwealth of Pennsylvania for all debt transfers in the past, present and future.

The court further concluded that MERS was, in fact, liable for, and subject to, the Pennsylvania Recording Statutes, notwithstanding the defendants’ argument that they serve only as the agent for its member-lenders. The

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primary support for this holding is that MERS does not disclose who the actual lender is, and under Pennsylvania law, an authorized agent who enters into a contract on behalf of a principal without disclosing that the agent is acting for the principal (and the identity of that principal), is personally liable on the contract. MERS' failure to disclose the identity of actual lenders left MERS principally liable for the failure to publicly record the note transfers.

Based upon its rulings, the court ordered that Declaratory Judgment be entered in

favor of the plaintiff and against MERS, and declared that the assignment/transfer of a promissory note secured by a mortgage on real estate in Pennsylvania is equivalent to a mortgage assignment. As such, MERS is obligated to record written documents memorializing the transfers of promissory notes secured by real estate in Pennsylvania. The extent of damages as a result of MERS' failure to comply with the Pennsylvania recording statutes will be determined at trial.

Pending the determination of damages, and given the potentially major impact

this case may have on how MERS operates in Pennsylvania (and perhaps other jurisdictions), MERS is almost certain to appeal this case.

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## PA Supreme Court Grants Petitions for Allowance of Appeal in Connection With Planned Residential Developments (PRDs)

By Stephen H. Kalis

In *Newtown Square East, L.P. v. Township of Newtown*, 2014 WL 4745695, the Pennsylvania Supreme Court granted petitions for allowance of appeal to determine the specificity with which a developer must identify a proposed use of a structure within a tentative plan for a Planned Residential Development (PRD). In the case, the court discusses whether the Township of Newtown's PRD ordinance meets the criteria of Pennsylvania's Municipalities Planning Code (MPC), and whether the tentative plan at issue met the requirements of the ordinance. Justice McCaffery authored the majority opinion and was joined by Chief Justice Castille, Justice Baer and Justice Stevens.

By way of background, a PRD is a flexible zoning arrangement where a single area of land can be developed for multiple uses (often a combination of residential and nonresidential) that do not correspond to the zoning restrictions and regulations established in any one zoning district. In Pennsylvania, Article VII of the MPC provides the parameters within which a municipality sets forth the standards, conditions and regulations for a PRD. A developer must submit an application for tentative approval of a PRD, which must provide the information "reasonably necessary to disclose to the governing body or planning agency . . . the density of land use to be allocated to parts of the site to be developed . . . [and] the use and approximate height,

bulk and location of buildings and other structures." 53. P.S. § 10707 (2014). A public hearing on the tentative plan must occur within 60 days of the application's submission. If an application for final approval complies with the tentative plan previously approved, a new public hearing is not required; however, if there are variations between the plan submitted for final approval and the plan granted tentative approval, the governing body may refuse to grant final approval on those grounds.

### Facts and Procedural History

In July 2009, the Newtown Township Board of Supervisors (Township Board) enacted a PRD ordinance pursuant to Article VII of the MPC. BPG Real Estate Investors submitted a tentative plan proposing a multi-use development of a 218-acre tract of land. The plan identified the proposed buildings and specified the maximum square footage that would be devoted to residential units, office space, hotel space and "commercial/retail/restaurant" space. The Township Board approved the tentative plan. Newtown Square East, L.P. (NSE), the owner of property adjacent to the tract, filed a challenge to the validity of the PRD ordinance with the Newtown Township Zoning Hearing Board (Zoning Board), arguing that the tentative plan failed to sufficiently identify the specific uses of buildings and structures included within the plan. The Zoning Board upheld

the validity of the PRD ordinance, and NSE appealed the decision to the Court of Common Pleas. NSE also filed an appeal of the Township Board's approval of BPG's tentative plan with the Court of Common Pleas.

The Court of Common Pleas agreed with the Zoning Board, holding that the PRD ordinance had only "minor textual differences" from the requirements of Article VII and did not exceed the scope of authority granted by the MPC. In addition, the court affirmed the Township Board's approval of the tentative plan, holding that the plan was consistent with the requirements of the PRD ordinance. NSE appealed both decisions to the Pennsylvania Commonwealth Court (Commonwealth Court).

On appeal, NSE again argued that the PRD ordinance is inconsistent with the MPC because it does not require a developer to identify the specific use of the buildings and proposed structures in the plan. In rejecting NSE's claim, the court found that the stated purpose of Article VII of the MPC was to provide flexibility in the PRD approval process. By definition, a PRD permits broad categories of use for the purpose of determining whether a tentative plan satisfies desired ratios of residential to non-residential uses. Because the MPC requires no more than a categorical identification of proposed use, the court found NSE's argument unconvincing.

The Commonwealth Court also rejected NSE's assertion that the lack of a public hearing at the final approval stage denied NSE due process. The court stated that there was "no substantive difference" between the PRD ordinance and the process afforded by the MPC; both permit variations between the tentative plan and the final plan, and both permit local authorities to assess whether these variations justify denying a final plan. Finally, the Commonwealth Court held that BPG's tentative plan was properly approved under the PRD ordinance. The tentative plan appropriately identified the location and category of proposed use for each structure contained within the plan, and the use-designations were consistent with the requirements of the PRD ordinance and the MPC. Therefore, the Township Board properly approved the tentative plan. NSE appealed the decisions of the Commonwealth Court.

### Supreme Court of Pennsylvania Decision

The Pennsylvania Supreme Court agreed with the Commonwealth Court that the tentative plan's categorical use-designations were sufficient under the MPC and the PRD ordinance. The court held that, contrary to NSE's position, a developer is not required to designate a single category of permitted use for each building at the tentative plan stage. Indicating several possible uses for a proposed building is consistent with the PRD ordinance and the MPC.

The Supreme Court also rejected NSE's argument that the ability to modify proposed uses between tentative and final approval infringed on the due process

rights of neighboring landowners. NSE argued that the lack of public hearing with respect to the proposed variations undermined due process guarantees that are inherent in the MPC. The court rejected this argument and agreed with the Commonwealth Court. It found that in creating the PRD, the General Assembly intended to grant discretion to local authorities to determine which variations between a tentative and final plan were significant enough to warrant a refusal to grant approval of the final plan. Under NSE's interpretation, a new public hearing would be required each time a developer sought a change to its tentative plan, which is inconsistent with the letter and spirit of the MPC. The court held that the PRD ordinance is consistent with, and "reflects the flexibility inherent in," the MPC.

Accordingly, the Supreme Court of Pennsylvania affirmed the decision of the Commonwealth Court.

### Justice Eakin's Dissent

In a dissenting opinion joined by Justice Saylor and Justice Todd, Justice Eakin disagreed that the tentative plan submitted by BPG was sufficiently specific, and found that the plan contained improper use-designations that precluded informed public comment and governmental consideration. Justice Eakin agreed that the PRD ordinance was consistent with the MPC and conceded that the MPC encourages, and requires flexibility in, the approval process. But according to Justice Eakin, that flexibility does not excuse a developer from classifying a proposed use and its location within the plan.

Merely identifying a building or space as "commercial" or "non-residential" does not allow the governing body to understand what it is approving, or the public to ascertain whether it has any objections. Justice Eakin notes, "Flexibility does not equate to 'obfuscation by generality,'" and, in his view, the tentative plan contained insufficient information to allow an informed approval or sufficient public discourse.

Justice Eakin stressed that his interpretation is necessary based on how the relevant MPC provisions are constructed. If an application for final approval has been properly filed and meets the specifications of the written communication of tentative approval, the MPC indicates that the municipality *shall grant* the application. See §10711(b). It is only when there are variations between the tentative and final plan that the municipality *may refuse* to grant final approval. See §10711(c). To Justice Eakin, these provisions illustrate the problem with allowing multi-use designations at the tentative-plan stage. A developer could make unfettered changes to the tentative plan and remain within the parameters of the MPC so long as the tentative plan was sufficiently vague. Accordingly, Justice Eakin dissented.

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## New Jersey Appellate Division Victory for QuickChek

By Henry L. Kent-Smith

On November 7, 2014, the Appellate Division upheld an amended zoning ordinance adopted by Howell Township, N.J., to permit convenience stores with fuel service as a conditional use, and affirming the Howell Planning Board site-plan approval for the Route 33 and Colts Neck Road QuickChek location. The Appellate Division decided two consolidated cases: *QuickChek v. Howell*

*Township Zoning Board of Adjustment and New Horizon PropertyII; and New Horizon PropertyII v. Township Council of the Township of Howell*, docket number A- 3376 – 12T2. Henry Kent-Smith and Irina Elgart successfully defended QuickChek in this appeal, resulting in a hard-won vindication of QuickChek's proposal to develop a new store location.

In 2010, QuickChek filed an application for a use variance to permit its proposed convenience store with fuel service at the intersection of Route 33 and Colts Neck Road. The Howell Zoning Board denied the application for failure to secure five affirmative votes. QuickChek filed an appeal of this action, which was resolved with the adoption of Ordinance 11 – 47. Ordinance 11-47 permitted convenience

## In the Zone

stores with fuel service as a conditional use in all three of the Township's Highway Commercial districts.

The litigation arose when a competing gas station across Route 33 from the proposed QuickChek filed an appeal challenging the validity of Ordinance 11-47. The same competitor also appealed QuickChek's site-plan approval. The trial court upheld both Ordinance 11-47 and the site-plan approval.

The Appellate Division consolidated the appeals to both trial court decisions, and

upheld the trial court. The Appellate Division found that the trial court properly applied the appropriate standards of review in dismissing the challenge to the validity of Ordinance 11-47. The court found appropriate purposes of zoning were advanced by the Ordinance, and that the Ordinance was adopted in a proper procedural manner, as the enhanced notice requirements of N.J.S.A. 40:55D-62.1 were not required. Both the trial court and Appellate Division held the Ordinance's addition

of a single conditional use in all three Highway Commercial districts did not constitute, as a matter of law, a change in classification of the HC-3 zone. This action paves the way for construction of the long-delayed QuickChek.

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