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VIA HAND DELIVERY

Sharon McGann Horstkamp, Esq.
Vice President and Corporate Counsel
MERSCORP, Inc.
1595 Spring Hill Road
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Vienna, VA 22182

Re: Validity of MERSCORP, Inc.'s eRegistry System

Dear Ms. Horstkamp:

You have asked us to evaluate MERSCORP, Inc.'s ("MERS") system of registering certain transferable records – namely, electronic mortgage notes ("eNotes") – with respect to the federal Electronic Signatures in Global and National Commerce ("E-SIGN") Act and the model Uniform Electronic Transactions Act ("UETA"). Specifically, you asked us to consider whether either E-SIGN or UETA restricts the types of entities that may operate an eNote registry ("eRegistry")[1], as well as whether the eRegistry as designed by MERS is consistent with the requirements of E-SIGN and UETA for the establishment of a system reliably evidencing the transfer of interests in a transferable record.

Based on our review of E-SIGN and UETA, and our understanding of the design of the MERS® eRegistry, it is our view that the MERS® eRegistry as designed satisfies the requirements of both E-SIGN and UETA for the establishment of a system reliably evidencing the transfer of interests in transferable records. Moreover, neither statute restricts the types of entities that may operate a system for transferable records; in particular, absent state law to the contrary, neither statute limits operation of such a system to a trust company or similar institution.

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[1] The MERS® eRegistry is a system of record that identifies the owner and custodian of registered eNotes.

In these circumstances, we conclude that MERS may permissibly operate the eRegistry as designed. Our detailed analysis is set forth below.

I. Background

A. E-SIGN and UETA

UETA represents the product of an effort by the National Conference of Commissioners on Uniform State Laws ("NCCUSL") in the late 1990s to rationalize widely-disparate state laws affording legal status to electronic records and signatures. Although a number of states adopted the UETA template for recognizing these records, the states often made significant changes to the model statute, thereby undermining NCCUSL's goal of uniformity in interstate commerce.

Congress intervened in 2000 by adopting E-SIGN[2] to overlay the inconsistent patchwork of state laws governing electronic records and signatures. Notably, Congress did not seek to preempt UETA.[3] Rather, it provided that any state law adopting UETA, in the form approved by NCCUSL, may "modify, limit, or supersede" E-SIGN.[4]

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[2] *See* Electronic Signatures in Global and National Commerce Act of 2000, Pub. L. No. 106-229, 114 Stat. 464 (codified at 15 U.S.C. §§ 7001 et seq.).

[3] "[S]tate law can be preempted in either of two general ways. If Congress evidences an intent to occupy a given field, any state law falling within the field is preempted. If Congress has not entirely displaced state regulation over the matter in question, state law is still pre-empted to the extent it actually conflicts with federal law . . . ." *Silkwood v. Kerr-McGee Corp.*, 464 U.S. 238, 248, 104 S. Ct. 615, 621 (1984) (internal citations omitted). Congress may express its intent to preempt state law explicitly (*i.e.*, in the language of the statute) or implicitly (*e.g.*, where compliance with federal and state law is impossible, where Congress has legislated comprehensively, or where there is implicit in federal law a barrier to state regulation). *See La. Pub. Serv. Comm'n*, 476 U.S. 355, 368, 106 S. Ct. 1890, 1898 (1986).

[4] 15 U.S.C. § 7002(a)(1).

In short, in adopting E-SIGN, Congress expressed no intent to "occupy the field" of regulation of electronic records. However, it nevertheless preempted state law to the extent such law either modifies UETA from the form in which UETA was adopted by NCCUSL in 1999, if such modification conflicts with E-SIGN, or otherwise is inconsistent with E-SIGN. *See id.*; *see also* 15 U.S.C. § 7001(a)(1) (providing that an electronic record or signature relating to virtually any transaction "may not be denied legal effect, validity, or enforceability solely because it is in electronic form," notwithstanding any other law or regulation). Although at least one court has, in *dicta*, questioned the authority of Congress to preempt state law "in respect to transactions not in interstate commerce," *People v. McFarlan*, 744 N.Y.S.2d 287, 293-94 (Sup. Ct. N.Y. Cty.
(continued…)

Both E-SIGN and UETA contain rules regarding so-called "transferable records." UETA defines a "transferable record" as an electronic record that would be deemed to be a note or document for purposes of the Uniform Commercial Code ("U.C.C.") if it were a physical "writing," provided that the issuer of the note or document has expressly agreed that it is a transferable record.[5] E-SIGN defines "transferable record" similarly, although it limits its application to loans secured by real property.[6] In light of these definitions, an electronic mortgage note may qualify as a "transferable record" under either statute and therefore is valid consistently nationwide.

While both E-SIGN and UETA pertain to records that would be governed by the U.C.C. if they were paper instruments, the statutes also expressly state that they do not apply to records that are, in fact, governed by the U.C.C.[7] In addition, the requirement that the issuer of the electronic record expressly agree that the record is a "transferable record" operates "to assure that transferable records can only be created at the time of issuance by the obligor."[8] Thus, a paper note cannot later be converted to a "transferable record" for purposes of the statutes.[9] For

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2002), no court in the four years since E-SIGN's enactment has upheld a constitutional challenge to E-SIGN. It is our sense that a constitutional challenge to E-SIGN's preemptive authority would face an uphill challenge; E-SIGN's design indicates that Congress carefully balanced state and federal authority in devising the legislation, and struck a compromise that, we believe, is likely to seem to most courts to be within Congress' Constitutional authority.

5 Uniform Electronic Transactions Act (UETA) § 16(a).

6 15 U.S.C. § 7021(a)(1).

7 Specifically, the statutes state that they do not apply to a transaction or record to the extent it is governed by "The Uniform Commercial Code other than Sections 1-107 and 1-206, Article 2, and Article 2A." UETA § 3(b)(2); *accord* 15 U.S.C. § 7003(a)(3).

Notably, the statutes exclude negotiable instruments, which are governed by Article 3 of the U.C.C. Under the U.C.C., a "negotiable instrument" is a "written" instruction or undertaking to pay money to another under certain conditions. *See* U.C.C. §§ 3-102(a), 3-103(a)(6), 3-103(a)(9), 3-104(a). Concerned about impacting the broad systems relating to payment mechanisms for such instruments (specifically, checks), the drafters of UETA limited the statute to apply only to *electronic equivalents* of paper notes and documents. *See* UETA § 16 cmt. 2 (emphasis added).

8 UETA § 16 cmt. 2.

9 *Id.* (stating that "the issuer would not be the issuer, in such a case, of an electronic record"). Rather, the issuer must set forth its agreement to designate the electronic record as a "transferable record" in the electronic record itself or, arguably, in a contemporaneously issued record. *Id.*

the most part, however, the substantive provisions of E-SIGN and UETA incorporate the U.C.C. provisions that would apply if the transferable record were a paper instrument.[10]

B. MERS® eRegistry

MERS has created and operates a national eRegistry that establishes the functional equivalent of an official promissory note holder for the real estate finance industry.

Specifically, as we understand it, eNotes are registered with MERS and uniquely identified in the eRegistry for tracking and verification. The eRegistry does not store the actual eNote. Rather, the eNote is stored by a legal fiduciary ("eCustodian") in a secure electronic repository ("eVault"). However, the eRegistry stores information regarding the owner (or "controller") and the location (or "custodian") of the eNote. In turn, the eNote contains specific language referring to the eRegistry to identify its controller. In this manner, the eRegistry enables the rightful eNote owner to demonstrate conclusive legal control of the transferable record.

Further, it is our understanding that, in performing initial registration of eNotes, the eRegistry:

- confirms the validity of the issuer;
- confirms that the registration dataset is complete;
- confirms that the eNote is not already registered by assigning a unique Mortgage Identification Number (MIN) and hash value to each eNote;
- creates a unique registration record; and
- sends a confirmation to the issuer.

Likewise, in recording a transfer of eNotes, the eRegistry:

- validates both the transferor and transferee;
- compares the hash value stored in the eRegistry with the value submitted by the transferor; and

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[10] In brief, the person who controls a transferable record has the same rights as a holder of an equivalent paper instrument under the U.C.C., including, where applicable, rights as a holder in due course. *See* UETA § 16(d); 15 U.S.C. § 7021(d). Likewise, the obligor is entitled to the defenses that it would have under the U.C.C. *See* UETA § 16(e); 15 U.S.C. § 7021(e).

- requires confirmation by the transferee within a specified time period after the transfer request.

Finally, we understand that the eRegistry performs additional functions, including (i) storing information about the location of an eNote; (ii) regulating access to the eRegistry by a controller or its delegatee; and (iii) providing functionality for handling the modification or liquidation of an eNote.

As discussed below, the foregoing elements of the MERS® eRegistry are consistent with the criteria of UETA and E-SIGN for establishing a system that reliably evidences the transfer of interests in a transferable record.

II. ANALYSIS

A. The eRegistry As Designed Satisfies the UETA/E-SIGN "Safe Harbor"

E-SIGN and UETA supplemented the traditional concept of "possession" of a paper instrument by a holder with an analogous concept of "control" over an electronic record.[11] "Control" in these circumstances serves as "the substitute for delivery, indorsement and possession" of a paper instrument.[12] In order for such control of an electronic record to be given meaning and effect, it is necessary pursuant to UETA and E-SIGN to establish a single, unique version of the electronic record with respect to which the rightful holder may assert "control."

Specifically, under E-SIGN and UETA, "[a] person has control of a transferable record if a system employed for evidencing the transfer of interests in the transferable record reliably establishes that person as the person to which the transferable record was issued or transferred."[13] The statutes also contain a "safe harbor" provision, enumerating criteria according to which a system may be deemed as a matter of law to establish reliably the identity of the controller, provided that the criteria are satisfied. These criteria are:

- a single authoritative copy of the transferable record exists that is unique, identifiable, and unalterable (except as provided below);

- the authoritative copy identifies the person asserting control as the person to whom the record was issued or (if the authoritative copy indicates that a transfer has occurred) the person to whom the transferable record was most recently transferred;

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11 *See* UETA § 16 cmt. 3.

12 *Id.*

13 UETA § 16(b); 15 U.S.C. § 7021(b).

- the authoritative copy is communicated to and maintained by the person asserting control or its designated custodian;

- copies or revisions that add or change an identified assignee of the authoritative copy can be made only with the consent of the controller;

- any copy that is not the authoritative copy is readily identifiable as such; and

- any revision of the authoritative copy is readily identifiable as authorized or unauthorized.[14]

Given the novelty of these issues, we think it likely that courts will seek to measure any eRegistry system against these criteria. Moreover, we expect that most courts will be reluctant to conclude that a system falling outside the safe harbor nonetheless reliably establishes "control" for purposes of the statutes. In this regard, we believe that the design of the eRegistry system created by MERS, in which MERS operates a single, authoritative registry of controllers nationwide, satisfies the foregoing safe harbor criteria.

Specifically, the eRegistry system, as we understand it:

(i) identifies a single authoritative copy of the transferable record that is unique, identifiable, and unalterable – which the system accomplishes by storing information regarding the controller and the custodian of the authoritative copy of the eNote;

(ii) verifies that the person asserting control is the person to whom the record was issued or to whom the transferable record was most recently transferred – which the system accomplishes by confirming the validity of the issuer upon initial registration, and validating both the transferor and transferee in the event of any transfer;

(iii) ensures that the authoritative copy is communicated to and maintained by the person asserting control or its designated custodian – which the system accomplishes by storing information regarding the controller and the custodian of the eNote, and requiring validation and confirmation for any transfer request;

(iv) ensures that copies or revisions that add or change an identified assignee of the authoritative copy can be made only with the consent of the controller – which the system accomplishes by requiring validation by the controller for any transfer request, as well as confirmation by the transferee within a designated time period;

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[14] UETA § 16(c); 15 U.S.C. § 7021(c).

(v) ensures that any copy that is not the authoritative copy is readily identifiable as such – which the system accomplishes by storing information regarding the location of the eNote, regulating access to the eRegistry, and requiring confirmation from the controller for any requested transfer; and

(vi) ensures that any revision of the authoritative copy is readily identifiable as authorized or unauthorized – which the system accomplishes by assigning hash values, MINs, and registration records to each eNote, which are verified upon any transfer request.

Notably, although the safe harbor provisions require that the system "identif[y] the person asserting control,"[15] the transferable record itself need not identify the individual by name. Rather, "[t]he control requirements may be satisfied through the use of a trusted third party registry system."[16] As we understand it, in the MERS® System the authoritative copy of the eNote identifies the rightful controller by reference to the eRegistry. Based on our review of the legislative history and commentary to UETA and E-SIGN, it is our view that this design is consistent with the statutory criteria that the system "idenift[y] the person asserting control;" indeed, the comments to UETA state that "[a] system relying on a third party registry is likely the *most effective* way to satisfy the requirements of [the safe harbor provision] that the transferable record remain unique, identifiable and unalterable, while also providing the means to assure that the transferee is clearly noted and identified."[17]

Accordingly, it is our view that MERS's eRegistry system establishes a reliable method for identifying the controller of a transferable record through the use of a trusted third party registry system, and that its design is consistent with the requirements of E-SIGN and UETA.[18]

B. Entities Permitted to Operate eRegistry

Separately, neither UETA nor E-SIGN imposes any conditions upon the types of entities that may establish or operate a system evidencing control over transferable records. Likewise, nothing in the background or implementation of E-SIGN or UETA suggests any such conditions. Indeed, E-SIGN and UETA were drafted in reaction to early state electronic signature laws, which generally required electronic signatures to be certified by a certificate

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15 UETA § 16(c)(2); 15 U.S.C. § 7021(c)(2).

16 UETA § 16 cmt. 3.

17 *Id.* (emphasis added).

18 *Id.* ("The control requirements may be satisfied through the use of a trusted third party registry system.")

authority licensed by the state. The statutes were designed to remove such government control in order to minimize restrictions on the use of electronic records and signatures.

We note that a state potentially could adopt legislation restricting operation of mortgage note registries to trust companies or similar entities;[19] however, such a law would only be valid if it applied equally to electronic and paper mortgage notes.[20] We are unaware of any state having imposed such a requirement, nor are we aware of any particular public interest or constituency that supports imposing such a requirement.

In these circumstances, we conclude that MERS may permissibly establish and operate the MERS® eRegistry for recording interests in electronic mortgage notes.

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We trust that the foregoing is responsive to your inquiry. Should you have any further questions, please do not hesitate to call me.

Very truly yours,

Mark E. Plotkin

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[19] *See* UETA § 3(d) ("A transaction subject to this [Act] is also subject to other applicable substantive law."); *see also* 15 U.S.C. § 7001(b)(1) (providing that E-SIGN does not "limit, alter, or otherwise affect" any rights or obligations under any other law or regulation).

[20] *See* UETA § 7(a); 15 U.S.C. § 7001(a) (providing that a record or signature may not be denied legal effect or enforceability solely because it is in electronic form).