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The Non-Uniform Commercial Code: The Creeping, Problematic Application of Article 9 to Determine Outcomes in Foreclosure Cases

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Abstract

[Excerpt] "This article will discuss the operation of two portions of the Uniform Commercial Code ("U.C.C.") on mortgage foreclosure law. Article 3 of the U.C.C. governs negotiable instruments, whereas Article 9 governs secured transactions. For decades, courts have utilized Article 3 to determine the rights of lenders and their assigns to enforce mortgage promissory notes and to foreclose mortgages thereon. However, certain jurisdictions do not utilize the U.C.C. in foreclosure cases, whereas other jurisdictions have recently begun to look to Article 9 instead. This article argues that the Uniform Commercial Code should receive more uniform application, with Article 3 as the enforcement tool of the land.

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Parts I-III of this Article will discuss the negotiable nature of mortgage notes, and the significance of this character. Part I will briefly discuss the importance of a plaintiff's standing to initiate and pursue foreclosure. Part II will analyze the history of both the negotiability of notes and the foreclosure of mortgages. This historical analysis is meant to provide an explication of the divergent paths notes and mortgages have taken, in terms of the predictability of enforcement outcomes and the relative harshness each produces. Part III will discuss the negotiable character of mortgage promissory notes. If a note is a negotiable instrument, then transfer of the note may be analyzed under Article 3. However, even if a note is negotiable, that does not mean that it is not also potentially subject to enforcement under Article 9.

Part IV will provide an overview of enforcement mechanisms utilized in various jurisdictions. This Part will highlight the law in jurisdictions in which Article 3 is applied to determine the standing of foreclosure plaintiffs. Following that, Part IV will review application of common law and other enforcement mechanisms in jurisdictions that do not look to the U.C.C. in determining a plaintiff's standing to enforce a negotiable instrument and foreclosure the security interest secured thereby. Finally, this Part will explore recent cases in which Article 9 has been applied in the foreclosure context.

Part V will argue that uniform application of the U.C.C. will aid the recovering housing market and provide a predictable framework for foreclosure of mortgage, going forward. Specifically, Part V will argue that the U.C.C. should be applied to determine whether a plaintiff has standing to foreclose and will further argue that courts should utilize Article 3 of the Code in making such determinations."

Keywords

U.C.C., UCC, foreclosure, housing, mortgage, MERS

The Non-Uniform Commercial Code: The Creeping, Problematic Application of Article 9 to Determine Outcomes in Foreclosure Cases

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CONTENTS

INTRODUCTION

This article will discuss the operation of two portions of the Uniform Commercial Code ("U.C.C.") on mortgage foreclosure law.[1] Article 3 of the U.C.C. governs negotiable instruments, whereas Article 9 governs secured transactions. For decades, courts have utilized Article 3 to determine the rights of lenders and their assigns to enforce mortgage promissory notes and to foreclose mortgages thereon. However, certain jurisdictions do not utilize the U.C.C. in foreclosure cases, whereas other jurisdictions have recently

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[1] The interplay between state law and the U.C.C. is important in the context of mortgage foreclosures, because foreclosures are governed by local real property laws, but are variously contextualized by state versions of the Code. Am. Law Inst., Report of the Permanent Editorial Board for the Uniform Commercial Code: Application of the Uniform Commercial Code to Selected Issues Relating to Mortgage Notes 1 (2011).

begun to look to Article 9 instead.[2] This article argues that the Uniform Commercial Code should receive more uniform application, with Article 3 as the enforcement tool of the land.

It can hardly be overstated that the current backlog of foreclosure cases is and has been stalling the housing recovery, causing ripple effects throughout the economy.[3] In general, states operate within one or two superstructures, so far as the foreclosure process is concerned. Foreclosure of a mortgage can either be a judicial process or a non-judicial process, and roughly half of the states operate in each of these frameworks.[4] The process of judicial foreclosure is a costly and lengthy means to effectuate a foreclosure sale.[5] While there is little uniformity between states in terms of foreclosure laws, the law of negotiable instruments exists in forty-nine states, and presents potentially uniform rules aiding the prosecution of plaintiffs' attempts to enforce notes and foreclose mortgages.[6]

An extended and uncertain foreclosure system causes various problems. Lengthening the foreclosure process may cause opportunistic borrowers to become more likely to engage in strategic default, which creates a cycle of foreclosures by furthering the backlog of foreclosure cases, thus increasing the time to resolve any given foreclosure case, further emboldening would-be strategic defaulters.[7] Moreover, lengthy foreclosure processes increase the likelihood that a code violation will occur or that an absentee owner may take tenants' rent payments without dutifully meeting the burden of investing in

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[2] *See generally* Elizabeth Renuart, *Uneasy Intersections: The Right to Foreclose and the U.C.C.*, 48 WAKE FOREST L. REV. 1205, 1241–50 (2013).

[3] Helen Mason, *No One Saw It Coming – Again Systemic Risk and State Foreclosure Proceedings: Why a National Uniform Foreclosure Law is Necessary*, 67 U. MIAMI L. REV. 41, 47–49 (2012) (indicating that clearing foreclosure inefficiencies would aid the housing recovery). As of 2012, "[h]istorically high levels of mortgage defaults continue to overwhelm the foreclosure system." Alan M. White, *Losing the Paper – Mortgage Assignments, Note Transfers and Consumer Protection*, 24 LOY. CONSUMER L. REV. 468, 469 (2012). Although the number of properties with foreclosure filings fell to 1,117,426 in 2014, that amount is still approximately 156% of the number of filings during 2006. *See 1.1 Million U.S. Properties with Foreclosure Filings in 2014, Down 18 Percent from 2013 to Lowest Level Since 2006*, REALTYTRAC (Jan. 15, 2015), http://www.realtytrac.com/content/foreclosure-market-report/11-million-us-properties-with-foreclosure-filings-in-2014-down-18-percent-from-2013-to-lowest-level-since-2006-8205. Additionally, "a recent surge in foreclosure starts and scheduled foreclosure auctions in several states in the last few months of 2014 indicate that lenders are gearing up for a spring cleaning of deferred distress in the first half of 2015 in some local markets." *Id.* (internal quotations omitted).

[4] RESTATEMENT (THIRD) OF PROP.: MORTGS. § 3.4 (1997).

[5] Mason, *supra* note 3, at 47–49.

[6] *Id.* at 53.

[7] *Id.* at 69–70. This problem also carries with it the risk that lenders will be less willing to engage in workout options with individuals who are acting in good faith.

building upkeep.[8] These problems combine to slow or prevent a full recovery from occurring.

As will be discussed, *infra*, the concept of "negotiability," namely that parties should be able to affect the transfer of certain instruments by a transfer of possession, provides a predictable and largely complete framework for determining a party's right to enforce an instrument such as a promissory note.[9] Negotiable notes are involved in many judicial foreclosure proceedings, and the negotiability of such notes facilitates the determination of the parties' rights.

Some states and courts do not use the U.C.C. in determining who is entitled to enforce a mortgage note.[10] In other states, there have been recent attempts to forego determining who is entitled to enforce a note by way of its negotiability and to, instead, apply portions of the U.C.C. that deal with secured transactions.[11] These changes largely began after the National Conference of Commissioners on Uniform State Laws (the "National Conference") adopted amendments to Article 9 of the U.C.C., initially for the purpose of facilitating the securitization of mortgages.[12] Recently, in *HSBC Bank USA, N.A. v. Perez*,[13] a court determined the priority of two would-be possessors of fraudulent notes and mortgages for the same property by looking to the State's codification of Article 9.[14] It is against this backdrop that the history and future of mortgage note negotiability should be discussed.

Parts I-III of this Article will discuss the negotiable nature of mortgage notes, and the significance of this character. Part I will briefly discuss the importance of a plaintiff's standing to initiate and pursue foreclosure. Part II

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[8] Steven T. Hasty, *Protecting Tenants at Foreclosure by Funding Needed Repairs*, 20 J. L. & POL'Y 581, 594 (2012).

[9] Report of the Editorial Board, *supra* note 1, at 4. The "complete set of rules" provided in Article 3 is generally only contingent upon the instrument overcoming one entry barrier to enforcement: "If the mortgage note is a negotiable instrument" then Article 3 will be able to help parties and the courts determine who may enforce obligations and to whom obligations are owed. *Id.*

[10] *See* Renuart, *supra* note 2, at 1249–50.

[11] *See generally* Thomas Erskine Ice, *Negotiating the American Dream: A Critical Look at the Role of Negotiability in the Foreclosure Crisis*, 86 FLA. B.J. 8 (Dec. 2012); Matthew D. Weidner & Michael Fulchino, *Foreclosing in a Hurricane: Florida Courts Struggle to Deal with a Crisis of Epic Proportions*, 41 STETSON L. REV. 679 (2012); White, *supra* note 3, at 473.

[12] Renuart, *supra* note 2, at 1206 (stating that easing securitization protocols was a "driving force" in the subject amendments to the U.C.C. and noting that the amendments extend coverage to the sale of promissory notes, declare that the sale of a note constitutes a sale of the mortgage, and provide for automatic perfection of "interests in both the note and the accompanying mortgage without the need to file").

[13] 165 So. 3d 696 (Fla. Dis. Ct. App. 2015).

[14] As will be discussed, *infra*, the court in *Perez* relies upon a case, which utilized Article 3 to determine a similar situation, and does not explain its reason for deviating from reasoning under Article 3.

will analyze the history of both the negotiability of notes and the foreclosure of mortgages. This historical analysis is meant to provide an explication of the divergent paths notes and mortgages have taken, in terms of the predictability of enforcement outcomes and the relative harshness each produces. Part III will discuss the negotiable character of mortgage promissory notes. If a note is a negotiable instrument, then transfer of the note may be analyzed under Article 3. However, even if a note is negotiable, that does not mean that it is not also potentially subject to enforcement under Article 9.

Part IV will provide an overview of enforcement mechanisms utilized in various jurisdictions. This Part will highlight the law in jurisdictions in which Article 3 is applied to determine the standing of foreclosure plaintiffs. Following that, Part IV will review application of common law and other enforcement mechanisms in jurisdictions that do not look to the U.C.C. in determining a plaintiff's standing to enforce a negotiable instrument and foreclosure the security interest secured thereby. Finally, this Part will explore recent cases in which Article 9 has been applied in the foreclosure context.

Part V will argue that uniform application of the U.C.C. will aid the recovering housing market and provide a predictable framework for foreclosure of mortgage, going forward. Specifically, Part V will argue that the U.C.C. should be applied to determine whether a plaintiff has standing to foreclose and will further argue that courts should utilize Article 3 of the Code in making such determinations.

I. STANDING AS A MAJOR INGREDIENT IN A FORECLOSURE DISPUTE

At its simplest, "standing" in a lawsuit means that a party has a sufficient stake in a controversy to obtain judicial resolution of that controversy.[15] An action to foreclose a mortgage requires a plaintiff to either accelerate the balance due on a note or await the maturity date of a note on which the borrower has defaulted.[16] An action to foreclose a mortgage also requires the

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[15] John Dimanno, *Beyond Taxpayers' Suits: Public Interest Standing in the States*, 41 CONN. L. REV. 639, 642 (2008) (quoting Sierra Club v. Morton, 405 U.S. 727, 731 (1972)). This article will not discuss federal concepts, such as standing under Article 3 of the United States Constitution or the "prudential" limitations on standing applied to federal cases, because foreclosure is a state issue and standing in foreclosure cases is generally found in a state's application of its own version of the U.C.C. or in state common law. *See* Joseph William Singer, *Foreclosure and the Failures of Formality, or Subprime Mortgage Conundrums and How to Fix Them*, 46 CONN. L. REV. 497, 516 (2013) (arguing that one of the myriad problems with the system employed by banks using Mortgage Electronic Registration Systems, Inc., referred to as "MERS," was that they "operated in the context of a national or international securities market, and did not focus on the fact that property law is state law").

[16] *See generally* R. Wilson Freyermuth, *Enforcement of Acceleration Provisions and the Rhetoric of Good Faith*, 1998 BYU L. REV. 1035, 1041 (1998) (discussing the different means

plaintiff to foreclose the mortgage, which is given as security for the repayment of the loan obligation, itemized in the note.[17] A plaintiff in a foreclosure action has standing to maintain the suit if the plaintiff has the right to enforce the note and foreclose the mortgage.[18]

Leading up to the 1998 amendments of the U.C.C. and continuing thereafter, securitization of loans had become not only a standard practice in mortgage banking, but had also received mixed praise for its ability provide liquidity to banks while reducing funding needs.[19] Due to the tendency to transfer and/or securitize mortgage loans, a lender's standing to enforce a note and foreclose mortgage has become a critical issue in the litigation surrounding mortgage foreclosure.[20] Prior to the foreclosure crisis, the banking industry developed a system whereby it used the Mortgage Electronic Registration Systems, in its corporate form Mortgage Electronic Registration Systems, Inc., also referred to as "MERS," to stand in for lenders in mortgage transactions, acting in a nominal role.[21] This system allowed the mortgage to be placed in the name of MERS, for the benefit of the lender.[22] Lenders and mortgage servicers then transferred mortgages within the MERS system, without the necessity and cost of recording assignments of mortgage.[23] Amongst other documentation issues, the MERS system was highlighted for its deficiencies during the mortgage crisis.[24]

Although the standing of lenders and mortgage servicers has been uniformly questioned since the crisis, the law surrounding standing to foreclose a mortgage has not been uniformly harmonized. Different

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by which a mortgagee may find itself "insecure" in its security interest and thus accelerate the balance, be they "objective" violations, such as the failure to make payments, or "subjective" violations, wherein a mortgagee may "deem itself insecure," pursuant to RESTATEMENT (THIRD) OF PROP.: MORTGS § 8.1).

[17] RESTATEMENT (THIRD) OF PROP.: MORTGS § 5.4(c) (1997) ("A mortgage may be enforced only by, or in behalf of, a person who is entitled to enforce the obligation the mortgage secures.").

[18] *Id.*

[19] The European Central Bank deployed this analysis of securitization, concluding that "asset securitization increases banks' liquidity while reducing banks' funding needs in the event of monetary tightening." Yener Altunbas et al., *Securitisation and the Bank Lending Channel*, (European Central Bank, Working Paper No. 838, Dec. 2012). Also of note was that securitization "allows banks to swiftly transfer part of their credit risk to the markets," which feature enabled the global crisis that followed. *See id.*

[20] Christopher Cifrino, Comment, *Now UCC Me, Now You Don't: The Massachusetts Supreme Judicial Court Ignores the UCC in Requiring Unity of Note and Mortgage for Foreclosure in Eaton v. Fannie Mae*, 54 B.C. L. REV. E-SUPP. 99, 103–04 (2013) (discussing the difficulty in producing documentation that occurred in post-2007 mortgage foreclosure case throughout the United States).

[21] Singer, *supra* note 15, at 515.

[22] *See id*.

[23] *See id*. at 515–16.

[24] *Id.* at 517–18.

jurisdictions have developed different rules on the issue, and the law on this subject is still developing, years later.[25]

II. THE HISTORY OF NEGOTIABILITY AND THE FORECLOSURE PROCESS

In the context of the negotiability of mortgage notes, the historical framework of negotiability should be analyzed alongside the historical development of the law relating to foreclosure. The law of negotiability developed as a fine-tuning process to enable the smooth function of commerce,[26] while the law of foreclosure developed around a power struggle between borrowers and lenders. From a historical vantage point, it makes sense to apply the collaboratively developed, and ultimately codified, rules of negotiability to the haphazard laws of mortgage foreclosure, which were cobbled together in a piecemeal, adversarial process that had no overarching vision or goal.

Initially, during the sixteenth century, bills of exchange, which would become the principal means of negotiation, were little used.[27] At the same time during England's feudal period, real property transfers in England were occasioned by the conveyance of an absolute deed from a borrower to a lender, giving the lender the enormous power of being able to decline to convey the deed upon the borrower's failure to fulfill any term of the agreement between the parties.[28]

The concept of negotiability arose in Europe, largely during the seventeenth century, because merchants required a method to pay for goods.[29] The early process for negotiating an instrument was a cumbersome four-party exchange.[30] While the concept of negotiability was just developing, the

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[25] For example, and as further discussed *infra*, the principle point of this article turns on the lack of uniformity in the baseline decision of whether standing in a foreclosure action is grounded in the Uniform Commercial Code and, if so, in which section.

[26] American Securitization Forum, Transfer and Assignment of Residential Mortgage Loans in the Secondary Mortgage Market 3, 9–10 (2010), http://www.americansecuritization.com/uploadedFiles/ASF_White_Paper_11_16_10.pdf.

[27] Kurt Eggert, *Held Up in Due Course: Codification and the Victory of Form Over Intent in Negotiable Instrument Law*, 35 Creighton L. Rev. 363, 377 (2002). Even then, such bills could have been described as arcane.

[28] Basil H. Mattingly, *The Shift from Power to Process: A Functional Approach to Foreclosure Law*, 80 MARQ. L. REV. 77, 89 (1996). As can be imagined, this scheme left borrowers without much, if any, recourse.

[29] Ice, *supra* note 9; Eggert, *supra* note 27, at 377.

[30] Eggert, *supra* note 27, at 378. This four-party exchange would involve: (1) the maker of the bill; (2) the intended recipient of the funds; (3) a "drawer"; and (4) a "drawee." A drawer would draw a bill for the amount that the maker intended to pay to the intended recipient. The bill was, in effect, an instruction for the drawee to pay the recipient. The drawee would ultimately—and inefficiently—pay the sum. Eventually, and often through a course of dealings, the drawee and drawer would settle their debts.

use of bills of exchange remained fairly limited.[31] During this period, English real property common law developed the "equity of redemption," which swung power to borrowers by providing a right to redeem property by paying any outstanding indebtedness within a "reasonable period."[32] The equity of redemption caused manifest uncertainty in lenders, which led to attempts by lenders to force borrowers to limit or waive the equity.[33] Though courts initially struck down the lenders' attempts and claimed that lenders were clogging the court system, lenders eventually persuaded the courts that the "reasonable period" was too nebulous, and the courts began to require that the equity be exercised within a specific timeframe, resulting in a process of "strict foreclosure."[34] In cases of strict foreclosure, foreclosure of the property interest did not extinguish a borrower's underlying debt.[35]

Over time, the use of bills of exchange expanded, and so did the scope of their use.[36] Early limitations on negotiability were eliminated, and negotiable instruments became more widely used and understood.[37] Moreover, the process of negotiability became streamlined, as instruments could now be negotiated by a three-party or two-party exchange.[38] While the process surrounding negotiable instruments was being fine-tuned, early American jurisprudence regarding foreclosure was beginning to develop, finding its origins in the English common law.[39] Early American courts viewed the concept of strict foreclosure as unduly harsh and modified the foreclosure process to include a public sale so that all, or at least a portion, of the

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[31] *Id.* at 380. A limited scope of use for bills of exchange appears to have been the contemplated objective at the time, as they primarily concerned merchants dealing with foreign trade. Limiting who could use bills of exchange, and with whom they could be used, would have prevented common merchants from having to navigate a set of complex and unfamiliar rules.

[32] Mattingly, *supra* note 28, at 89. The "reasonable period" was itself undefined and largely open to varying interpretations.

[33] *Id.* at 90.

[34] *Id.* at 90–91.

[35] *Id.*

[36] Eggert, *supra* note 27, at 380–81. This expansion began due to a bleeding of the definition of who was a "merchant," within the meaning of trade practices. The courts began to hold that parties using bills intended to be treated as merchants, thus creating a tautology whereby only merchants may use bills of exchange, but the limitation on merchants is practically delimited to anybody who uses such a bill. However, over time, the merchant limitation was eliminated altogether.

[37] *Id.* at 381.

[38] *Id.* at 381–82. A three-party exchange could involve the maker drawing the bill on the maker, eliminating the need for a drawer. This exchange made it easier for makers and intended recipients of funds to interact; however, in the event that the maker does not have a course of dealings with the drawee, then it would have likely been more inconvenient for the drawee to settle a single debt with numerous makers than it would have been to settle numerous debts with a single drawer.

[39] Mattingly, *supra* note 28, at 91.

underlying indebtedness could be satisfied, and the borrower would not lose the property and remain liable for the total debt.[40]

The foreclosure process splintered between states around whether the foreclosure process should be a judicial action: some states now use a non-judicial process with limited rights for borrowers, while other states will only permit a foreclosure sale to occur after a lengthy lawsuit, in which borrowers are entitled to full due-process rights and safeguards.[41] The process of foreclosure in judicial states thus productively provides access to the courts and other dispute-resolution mechanisms for borrowers, but is comparatively cumbersome and onerous, and can take years.[42]

Eventually, negotiability was codified in the Uniform Commercial Code, specifically in Article 3. Codification provided three measurable benefits: it relieved courts, attorneys, bankers, and merchants from having to learn and apply multiple conflicting sets of law; it promoted the application of harmonized amendments to the rules governing negotiable instruments; and it further increased the negotiability of instruments, freeing them from local impediments hindering their negotiability.[43] The process of negotiability thus democratized and developed from an arcane set of principals used by few people in a limited set of circumstances as a substitute for money into a robust, uniform process for use in various settings and available to just about anybody. The concept of negotiability has already expanded from its initial limited application as a private currency for merchants, and its function within the mortgage foreclosure process brings predictability and uniformity to an otherwise chaotic and unwieldy process.[44]

III. NEGOTIABILITY OF MORTGAGE PROMISSORY NOTES

A. Mortgage Promissory Notes as Negotiable Instruments

Typically, mortgage promissory notes are negotiable instruments.[45] Under the Uniform Commercial Code, a negotiable instrument is defined as follows:

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[40] *Id.*
[41] *See id.* at 92.
[42] *Id.* at 93 (providing that "a nonjudicial foreclosure skirts the court system").
[43] Eggert, *supra* note 27, at 408–09 (stating that parties were also freed from "latent" impediments to negotiability, such as, perhaps, claims that mortgage notes in national circulation are not negotiable under a particular state's interpretation).
[44] *See* Renuart, *supra* note 2, at 1207 (stating that, in the context of non-uniform application of the U.C.C., "[t]he possibility of unnecessarily inconsistent outcomes is real and harmful to the homeowners, litigants, and the integrity of the legal system").
[45] The prevailing view with regard to the negotiability of mortgage notes is that "most mortgage notes are negotiable instrument governed by Article 3 of the Uniform Commercial Code." Singer, *supra* note 15, at 526.

> [A]n unconditional promise or order to pay a fixed amount of money, with or without interest or other charges described in the promise or order, if it:
> (1) is payable to bearer or to order at the time it is issued or first comes into possession of a holder;
> (2) is payable on demand or at a definite time; and
> (3) does not state any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money, but the promise or order may contain (i) an undertaking or power to give, maintain, or protect collateral to secure payment, (ii) an authorization or power to the holder to confess judgment or realize on or dispose of collateral, or (iii) a waiver of the benefit of any law intended for the advantage or protection of an obligor.[46]

To be negotiable, a promissory note should be free from contingencies and memoranda that would control it.[47] However, a promissory note may nevertheless reference an additional document, such as a mortgage that secures the debt.[48]

Most courts accept that mortgage notes are negotiable instruments, and apply their state's version of Article 3.[49] Questions may arise concerning the certainty and unconditionality of mortgage promissory notes.[50] However, promises in promissory notes are presumed to be unconditional.[51] Moreover, a promissory note is not made conditional simply by reference to a mortgage

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[46] U.C.C. § 3-104 (AM. LAW INST. & UNIF. LAW COMM'N 2002).

[47] Overton v. Tyler, 3 Pa. 346 (Pa. 1846) (holding that a note which is not free some such contingencies or which contains "a memorandum" which controls "it, though endorsed on it, would be incorporated with it and would destroy it" is not a "courier without luggage" and is thus non-negotiable). The mere recital of the existence of a separate agreement, such as a mortgage, does not eviscerate the negotiability of the reciting note. Robert T. Tobin, *Negotiable Instruments — Due Date of Notice — Effect of Acceleration Clause in Mortgage* — Poultrymen's Service Corp. v. Brown, 4 B.C. LAW REV. 772 (1963).

[48] U.C.C. § 3-106, cmt.1.

[49] White, *supra* note 3, at 473 (citing a case from Massachusetts and Dale Whitman, *How Negotiability Has Fouled up the Secondary Mortgage Market, and What to Do About It*, 37 PEPP. L. REV. 2 (2010), which surveyed "cases that either address negotiability or assume mortgage notes are negotiable"). White asserts "some provisions of U.C.C. Article 9 arguably permit proof of a mortgage note transfer without endorsement and delivery, by proving the existence of a separate written agreement to sell the note." *Id.* at 474. However, such a circumstance, arguable as it is, would nonetheless only apply in a vacuum created by a failure to negotiate the note, meaning that Article 3 could never have been the determinant, to begin with.

[50] *See* GMAC v. Honest Air Conditioning & Heating, Inc., 933 So. 2d 34, 37 (Fla. Dist. Ct. App. 2006) (expressing that a negotiable instrument should be "simple, certain, unconditional, and subject to no contingencies.").

[51] *See* U.C.C. § 3-106(a) (providing that "a promise or order is unconditional unless . . .").

or its terms.[52] Article 3 specifically contemplates that the express incorporation into a promissory note of an external set of promises does not affect the negotiability of the note; instead, a negotiable note which refers to a mortgage that contains non-negotiable terms, and which states that the note is made in consideration for the mortgage, is negotiable because any executory promise contained in the mortgage is merely a permissible, implied condition in the note.[53] Finally, Section 3-106 of the Uniform Commercial Code provides that mortgage promissory notes are negotiable, inasmuch as "[m]any notes issued in commercial transactions are secured by collateral, are subject to acceleration in the event of default, or are subject to prepayment. . . . In some cases it may be convenient not to include a statement concerning collateral, prepayment, or acceleration . . . , but rather to refer to an accompanying loan agreement, security agreement, or mortgage for that statement."[54] Consequently, mortgage promissory notes are nearly *per se* negotiable.

It bears noting that the U.C.C. contemplates that Article 3 may be applied to determine enforceability of an instrument that is not negotiable. The Official Comment 2 to Section 3-104 of the Uniform Commercial Code expresses that courts "could not arrive at a result similar to the result that would follow if the writing were a negotiable instrument," and that "it may be appropriate . . . for a court to apply one or more provisions of Article 3 to the writing by analogy."[55] Therefore, it is functionally irrelevant whether a particular mortgage promissory note is in fact negotiable, so long as the courts have expressed an interest in treating such notes as negotiable.

B. Lenders' Right to Claim Status as a "Holder"

Almost as a matter of course, plaintiff lenders in foreclosure actions encounter defenses regarding their standing to sue or their status as a real party in interest. There are many avenues to establish standing in a foreclosure action, and a plaintiff may be in a position to acquire standing through more than one means at a time.[56] Where the note at issue is a

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[52] *See* U.C.C. § 3-106(b) (providing that "[a] promise or order is not made conditional . . . by a reference to another record for a statement of rights with respect to collateral, prepayment or acceleration"); *see also* American Securitization Forum, *supra* note 26*,* at 10.

[53] *See* U.C.C. § 3-106, cmt.1.

[54] *Id.*

[55] U.C.C. § 3-104, cmt. 2; *see also* Fred H. Miller & Alvin C. Harrell, *The Law of Modern Payment Systems* § 1.03[1][b] (2003).

[56] *See* McLean v. JP Morgan Chase Bank N.A., 79 So. 3d 170, 172–73 (Fla. Dist. Ct. App. 2012) (holding that standing may be established by any of the following: (a) a mortgage assignment or equitable transfer prior to the filing of the complaint; (b) plaintiff's status as a holder; (c) a special endorsement in favor of plaintiff or a blank endorsement; (d) an assignment from the payee to the plaintiff or an affidavit of ownership to prove plaintiff's status as a holder of the note; (e) mere delivery of a note and mortgage, with intent to pass title; or (f) filing the original note with a special endorsement in favor of plaintiff). McLean

negotiable instrument, a lender may establish standing as either a "holder in due course" or merely as a "holder." The decision to establish standing as a holder is both beneficial and disadvantageous to a lender.

Negotiability presents the possibility of a transferee taking a position that is better than the transferor.[57] The Uniform Commercial Code defines a number of different possible parties to a negotiation. There are three general positions that a transferee can occupy in a transfer under a negotiable instrument: the transferee can occupy a better position, a same position, or a worse position, with each position being relative to the transferor.[58] Typically, lenders in foreclosure actions occupy the same or worse position, given their frequent status as a "holder,"[59] rather than the better position of a "holder in due course."[60]

Under Article 3, a "holder in due course" occupies a privileged position.[61] Specifically, a holder in due course is insulated from numerous defenses to the right to enforce an instrument. A holder in due course is susceptible only to the "real defenses" of a borrower or other interested party.[62] The real defenses include claims of infancy, essential fraud, insolvency, duress, incapacity, or illegality.[63] Though there is an assumption of good faith in Article 3 dealings,[64] a holder in due course is still protected from many defenses to the right to enforce.

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has been cited in sixty cases since 2012, including multiple federal cases, and state cases in Kansas, New Hampshire, Ohio, and South Dakota. The pertinent analysis has been distilled into a tighter framework, in which a plaintiff in a foreclosure case who is not the original lender "may establish standing . . . by submitting a note with a blank or special indorsement, an assignment of the note, or an affidavit otherwise proving his status as holder of the note." Pennington v. Ocwen Loan Servicing, L.L.C., 151 So. 3d 52, 53 (Fla. Dist. Ct. App. 2014).

57 Curtis Nyquist, *A Spectrum Theory of Negotiability*, 78 MARQ. L. REV. 897, 907–08 (1995) (calling negotiability "a fundamental and indispensable way of thinking about transfers of property").

58 *Id.* at 904.

59 *Id.* at 953 (explaining that a holder who fails to comply with the strictures of Article 3 takes a note in a worse position, whereas a holder who fully complies may take a same position).

60 A holder in due course is a holder, where there is an absence of apparent evidence of forgery, alteration, or irregularity at the time of issuance or negotiation, and where the instrument is take for value, in good faith, without notice of the instrument being overdue, dishonored, or in default, without notice of an unauthorized signature or alteration, without notice of a claim to the instrument, and without notice of a defense or claim in recoupment. U.C.C. § 3-302(a). Contrast this with that of a holder, who is merely "the person in possession of a negotiable instrument that is payable either to bearer or to an identified person that is the person in possession." U.C.C. § 1-201(b)(21)(A). The position of a holder in due course, while providing protection from certain defenses, is more difficult to claim and obtain, and thus less frequently used in a typical foreclosure dispute.

61 Nyquist, *supra* note 57, at 904 (arguing that holder in due course status represents the "archetypal 'better than' position").

62 *Id.* at 928–29.

63 *Id.*

64 *Id.* at 929.

Alternatively, a "holder" is merely "the person in possession of a negotiable instrument that is [made] payable to bearer or to an identified person that is the person in possession."[65] By claiming to simply be a holder, rather than a holder in due course, foreclosure plaintiffs are not subjected to certain questions about actual ownership of notes and mortgages.[66] However, status as a holder leaves lenders open to defenses from which holders in due course would be shielded, and, additionally, opens up the possibility for counterclaims, such as claims arising under the Federal Truth in Lending Act or other federal or state statutes.[67] Pleading as a holder, therefore, entitles a lender to certain evidentiary privileges—while balancing those privileges with added rights and defenses for borrowers and third parties.

C. The Thief's "Right" to Enforce a Note

In a technical sense, a note holder may be a "thief," inasmuch as the holder may be in wrongful possession of the note and may not actually own the note.[68] Section 3-301 of the Uniform Commercial Code provides that "[a] person may be a person entitled to enforce the instrument even though the person is not the owner of the instrument or is in wrongful possession of the instrument."[69] Therefore, a close reading of Section 3-301 may lead to the assumption that a thief will be duly authorized to enforce mortgage promissory notes in open court.[70] However, such a reading is at odds with the reality of mortgage promissory note enforcement. Two principles of negotiable instrument enforcement contribute to solve the anomaly of a thief's enforcement: the authorization principle and the negligence principle.[71] Additionally, the right to enforce lost or stolen instruments generally prevents thieves from enforcing mortgage promissory notes.[72]

The enforcement of instruments is governed in part by the authorization principle, which may be stated either by the maxim "authorization imposes

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[65] U.C.C. § 1-201(b)(21)(A); *see also* Weidner and Fulchino, *supra* note 11, at 683–84; Timothy R. Zinnecker, *Extending Enforcement Rights to Assignees of Lost, Destroyed, or Stolen Negotiable Instruments Under U.C.C. Article 3: A Proposal for Reform*, 50 U. KAN. L. REV. 111, 113 (2001); American Securitization Forum, *supra* note 26, at 12 (noting that, while the term "possession" is not defined in the U.C.C., it is generally permissible for a holder to constructively possess a note).

[66] Dustin A. Zacks, *Standing in Our Own Sunshine: Reconsidering Standing, Transparency, and Accuracy in Foreclosures*, 29 QUINNIPIAC L. REV. 551, 562 (2011).

[67] *Id.*

[68] Ice, *supra* note 11, at 11–12.

[69] U.C.C. § 3-301.

[70] *See id.*

[71] L. Ali Khan, *A Theoretical Analysis of Payment Systems*, 60 S.C. L. REV. 425, *passim* (2008).

[72] Zinnecker, *supra* note 65, 131–32.

liability" or, alternatively, by the aphorism "no authorization; no liability."[73] In essence, the person who authorizes a negotiation is liable for the negotiation. The authorization principle serves the function of equity,[74] purposefully overlooking forged or missing endorsements to achieve the end of inquiring whether the payment is made to the intended payee.[75] In practice, the authorization principle resolves whether a thief may enforce a mortgage promissory note: it is unlikely that a court will allow a thief to both steal an instrument and subsequently argue that said thief is entitled to enforce the instrument as that would force the obligor, as a matter of law, to pay the instrument.[76]

Moreover, in the unlikely event that the thief is entitled to enforce a mortgage promissory note, Article 3 provides for a just allocation of loss. The depository bank that the thief deals with will ultimately bear the loss, because the thief will be unlikely to reimburse the bank.[77] This theory of loss is acceptable under Article 3 because the one who deals with the wrongdoer must suffer the loss.[78] Effectively, the depository bank is charged with ensuring that it is not allowing a thief to profit.[79]

In addition to the authorization principle, the negligence principle provides for equitable allocation of loss in the unlikely event that a thief is able to effectively enforce a mortgage promissory note. A party whose negligence contributes substantially to the alteration or forgery of an instrument is held liable.[80] The negligence principle, which is robustly applied to negotiable instruments, simply requires persons to use care when issuing, transferring, debiting, and crediting payment orders.[81]

Finally, the right to enforce lost or stolen instruments prevents thieves from enforcing mortgage promissory notes. Under Section 3-301(iii), a former holder may enforce a lost, stolen, or destroyed instrument.[82] The purpose of this enforcement right as to stolen instruments is to take the "criminal mind" into account and to prevent the inequity of a thief being entitled to enforce a note.[83] Article 3 has multiple, redundant safeguards to prevent the enforcement of a mortgage promissory note by a thief, notwithstanding the fact that such enforcement is technically possible.

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[73] Khan, *supra* note 71, at 434.
[74] Equity is important in these disputes, because foreclosure is generally an equitable remedy, rather than a remedy at law. *See* Andrew J. Kazakes, *Developments in the Law: Protecting Absent Stakeholders in Foreclosure Litigation: The Foreclosure Crisis, Mortgage Modification, and State Court Responses*, 43 LOY. L. REV. 1383, 1393 (2010).
[75] Khan, *supra* note 71, at 444.
[76] *Id.* at 445–46.
[77] *See id.* at 447–48.
[78] *Id.*
[79] *Id.* (providing that the theory is consistent with international negotiable instrument law).
[80] *Id.* at 458.
[81] Khan, *supra* note 71, at 458–59
[82] U.C.C. § 3-301(iii) (2002).
[83] Zinnecker, *supra* note 65, at 131–32.

D. Plaintiff Holder's Right to Foreclose the Mortgage

As the holder of a mortgage promissory note, a lender plaintiff is entitled to enforce the mortgage securing the note. A genesis of cases following reasoning akin to that found in *Johns v. Gillian* holds that a note-holder is entitled to enforce a mortgage because the mortgage follows the note.[84] The holding that the mortgage follows the note facilitates the secondary mortgage market, and is so universal that every state except for Minnesota follows it.[85]

There has been recent pushback against the concept that the mortgage follows the note, in which borrowers have attempted to argue that *Johns* has been misapplied in case law for almost one hundred years, and therefore should entitle only the owner to enforce the mortgage, rather than the holder.[86] The attack generally centers on the factual circumstances in *Johns*, and applies those facts to all cases claiming that the mortgage follows the note.[87] However, it is generally understood that a note-holder may foreclose a mortgage, and a plaintiff need only establish entitlement to enforce the note in order to demonstrate its ability to foreclose the incidental mortgage; such a plaintiff need not demonstrate ownership of the note.[88]

IV. APPLICATION IN VARIOUS JURISDICTIONS: THE TREND TOWARD ENFORCEMENT UNDER ARTICLE 9

Prior to amendment, Article 9 of the U.C.C. governed only conventional security interests in personal property.[89] The reach of Article 9 was expanded by amendments in 1972 and, subsequently, in 1998.[90] Based on the 1998 amendments and state legislation adopted thereafter, there are recent attempts to forego determining who is entitled to enforce a note by way of its negotiability and instead to apply portions of the U.C.C. that deal with secured transactions as opposed to negotiable instruments.[91] These attempts may have begun with the Massachusetts case *U.S. Bank, N.A. v. Ibanez*, in which a promissory note was prosecuted as though it had been given in the

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[84] Johns v. Gillian, 184 So. 140 (Fla. 1938).
[85] Ann M. Burkhart, *Third Party Defenses to Mortgages*, 1998 BYU L. REV. 1003, 1012–13 (1998) (providing that "courts in all but one state hold that a negotiable instrument imparts its quality of negotiability to the mortgage").
[86] Ice, *supra* note 11, at ¶¶ 36–39; Weidner and Fulchino, *supra* note 11, at *passim*.
[87] Ice, *supra* note 11, at ¶¶ 36–39; Weidner and Fulchino, *supra* note 11, at *passim*.
[88] *See* Chris Markus, Ron Taylor & Blake Vogt, *From Main Street to Wall Street: Mortgage Loan Securitization and New Challenges Facing Foreclosure Plaintiffs in Kentucky*, 36 N. KY. L. REV. 395, 406–07 (2009).
[89] Renuart, *supra* note 2, at 1224 (discussing the original drafting of Article 9).
[90] *Id.*
[91] Ice, *supra* note 11, at ¶¶ 36–39; Weidner and Fulchino, *supra* note 11, at *passim*; White, *supra* note 32, at 473 (2012).

context of a sale according to non-U.C.C. state law.[92] Recently, in *HSBC Bank USA, N.A. v. Perez*, a Florida court applied Article 9 to determine who was entitled to enforce a mortgage in a dispute between two entities claiming to have received a first mortgage for the same property from the same borrower.[93]

The Permanent Editorial Board of the U.C.C. identified four rules with regard to enforcement of mortgage promissory notes and mortgages.[94] First, Article 3 determines who is entitled to enforce a negotiable note.[95] Second, Article 9 determines whether a property right attaches to a transferee of a note.[96] Third, Article 9 provides an attached property right in the mortgage to a transferee with an attached property right in a note.[97] Fourth, Article 9 enables an owner of a note and mortgage to record its interest for the purpose of seeking remedies in non-judicial states.[98] However, each of the aforementioned Article 9 rules appears to apply more easily in the context of non-judicial foreclosure states, because in a judicial state the rules would appear to conflict with Article 3 determinations of entitlement to enforce a negotiable note. Moreover, the U.C.C. is not adopted in the same manner in each state, and each state's case law applies different reasoning with regard to their individual statutory schemes.

This section will discuss this trend, with focus on development in eleven states, to wit: California, Tennessee, Arizona, South Carolina, Indiana, Michigan, Massachusetts, Illinois, Colorado, New York, and Florida.[99] In federal or state courts in certain jurisdictions, borrowers have attempted to argue that Article 9 governs any determinations that the court would make, and have been rebuffed. In at least one state, the courts have decided that the U.C.C. is *per se* inapplicable to mortgage foreclosures. In other jurisdictions, there is an apparent tilt toward the application of Article 9 to determine who is entitled to enforce the note and foreclose the mortgage. This section will focus first on jurisdictions that apply Article 3, then on jurisdictions that do not look to the U.C.C. to determine who may foreclose a mortgage, and finally to jurisdictions in which Article 9 is being utilized.

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[92] U.S. Bank, N.A. v. Ibanez, 941 N.E. 2d 40 (Mass. 2011).
[93] HSBC Bank USA, N.A. v. Perez, 165 So. 3d 696 (Fla. Dist. Ct. App. 2015).
[94] *See* Renuart, *supra* note 2, at 1241.
[95] Report of the Editorial Board, *supra* note 1.
[96] *Id.*
[97] *Id.*
[98] *Id.*
[99] A comprehensive list of where states stood on this issue, as of 2013, is detailed in the article *Uneasy Intersections: The Right to Foreclose and the U.C.C.* *See* Renuart, *supra* note 2, at 1243–50. However, the ground appears to have shifted since then, with either state or federal opinions in a number of jurisdictions clarifying the states' application of the U.C.C. or reversing course on this issue. Professor Renuart determined that there are three categories of states, subsequent to the Article 9 revisions: states which rely on the U.C.C. to provide the result, states which utilize other state law and the U.C.C. to provide the result, and state which rely on other state law, which law may conflict with the U.C.C. *Id.* at 1254.

A. Article 3 Jurisdictions

1. California: *In re Smith*

The U.C.C. is codified in California's Commercial Code.[100] In *In re Smith*,[101] the court reviewed whether, under the Commercial Code, a mortgage promissory note is a negotiable instrument, along with the question of whether enforcement of the note should be determined by Article 3 or Article 9.[102]

The argument in *In re Smith* turned on the securitization of the note—the borrower argued that the note was governed by Article 9 because the note had been transferred to a third-party pool of loans.[103] The court held that "securitization does not change the obligation of the borrower to pay the note or the note holder's right to foreclose."[104] The court reasoned that Article 3 of the U.C.C. "pertains to negotiable instruments," while "Article 9 governs the sale of most payment rights, including the sale of both negotiable and non-negotiable notes."[105] The court noted, however, that "the sale of a promissory note under Article 9 does not necessarily change the identity of the person entitled to enforce the note."[106] Ultimately, the court ruled that the note holder was entitled to enforce the note, regardless of the impact of any securitization of the loan.[107]

2. Tennessee: *Deutsche Bank Nat. Trust Co. v. Tibbs*

In *Deutsche Bank Nat'l Trust Co. v. Tibbs*,[108] plaintiff lender sought a declaration regarding priority and enforceability of a deed of trust lien.[109] The borrowers argued that plaintiff was required to prove ownership of the "mortgage loan, note and deed of trust" because the loan had been sold.[110] The borrowers further alleged that the plaintiff could not establish a right to enforce the note by being a holder under Article 3 of the U.C.C. because

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[100] CAL. COM. CODE, *passim* (West).
[101] *In re* Smith, 509 B.R. 260 (Bankr. N.D. Cal. 2014).
[102] *Id.* at 265.
[103] *Id.* The borrower, as plaintiff in an adversary proceeding in bankruptcy court, argued that the note could not be enforced, so long as it was held in a securitized trust. *Id.*
[104] *Id.* The latter half of this holding, that the holder's right to foreclose is unaffected by securitization, places this case in a seemingly-eroding framework, as discussed, *infra*.
[105] *Id.*
[106] *Id.*
[107] *In re* Smith, 509 B.R. at 268–69; s*ee also In re* Nordeen, 495 B.R. 468, 479–80 (B.A.P. 9th Cir. 2013).
[108] No. 3:11-0763, 2014 WL 280365, at *1 (M.D. Tenn. 2014).
[109] Plaintiff alternatively sought damages for the borrowers' purported involvement in a conspiracy to deprive the bank of its rights in the property. *Id.*
[110] *Id.* at *2.

Article 3 is inapplicable to the sale of mortgage notes.[111] Instead, the borrowers argued that Article 9 controlled the case because the transfer of the mortgage and/or promissory note is within the purview of Article 9.[112]

The court noted "similar arguments have been soundly rejected."[113] The court then reasoned that, although Article 9 applies to the sale of promissory notes, Article 3 provides the rules governing payments.[114] Additionally, the court held that a holder may enforce a note that has been sold, even if the holder is not the owner of the note.[115] *Tibbs*, therefore, seems to place Tennessee into states utilizing Article 3 for purposes of determining the right to enforce sold or securitized mortgage notes.[116]

3. Arizona: *In re Tarantola*

Arizona follows the rule that Article 3 of the U.C.C. governs the enforcement of mortgage notes. In *In re Tarantola*,[117] the sole question was whether a trustee of a securitized mortgage pool had standing to enforce a promissory note secured by a deed of trust.[118] The trustee filed a motion for relief from the stay imposed by the bankruptcy case.[119] The borrower responded by claiming that the trustee did not have standing to seek relief from the stay, which argument the court initially accepted, because the trustee did not demonstrate its entitlement to enforce the note due to a failure to "produce competent evidence of its standing because it did not provide critical securitization documents."[120] In the decision regarding the motion for relief from stay, the court found that "for Defendant to have a colorable claim sufficient to be granted relief from the automatic stay, Defendant had to either own the Note or be entitled to enforce it."[121]

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[111] *Id.*
[112] *Id.* It does not appear that the borrowers reconciled the fact that a negotiation is, itself, a transfer. *See* U.C.C. § 3-201(a); U.C.C. § 3-203(b).
[113] *Id.* (citing *In re* Connelly, 487 B.R. 230, 240 (Bankr. D. Ariz. 2013).
[114] *Tibbs*, No. 3:11-0763, 2014 WL 280365, at *3.
[115] *Id.* The court also ruled against the borrowers on procedural grounds, for failure to properly preserve the issue.
[116] *See id.* at *passim*.
[117] 491 B.R. 111 (Bankr. D. Ariz. 2013).
[118] *Id.* at 113. *In re* Tarantola arises out of an adversary proceeding in a Chapter 13 bankruptcy case.
[119] *Id.* at 114.
[120] *Id.* (indicating that the trustee also provided "conflicting versions of the Note in a series of submissions that was. . . frankly, inept and alarming.").
[121] *Id.* The court discussed that a showing of entitlement to enforce a note could be made by any of the following: (1) a demonstration that indorsements on the note were executed by parties with authority to act for the owners of the note at the time of each indorsement's execution; (2) a demonstration that the note was properly transferred to a pool pursuant to a governing pooling and servicing agreement; or (3) a demonstration that the note was transferred to a pool pursuant to a governing mortgage loan purchase agreement. The first of these methods goes against the Article 3 presumption of validity of endorsements, and

Following the motion for relief from stay, the case proceeded to trial, and the parties submitted post-trial memoranda.[122] The borrower reiterated the position that the note is not a negotiable instrument and that Article 9 of the U.C.C. provides the controlling law.[123] The court determined that, because the trustee was the holder of the note, the trustee was entitled to enforce the note and foreclose the mortgage pursuant to Article 3.[124] Further, the court specifically rejected the argument that Article 9 could provide the governing law for the case.[125]

4. South Carolina: *Swindler v. Swindler*

There are occasions where the application of Article 3 serves to prevent the foreclosure of a mortgage. *Swindler v. Swindler* presents such an occasion.[126] A family brought an action to foreclose a mortgage against their sister-in-law, who claimed that the debt had been renounced when the family's mother had given the defendant possession of the original note.[127]

If Article 3 of the U.C.C. did not govern the note in *Swindler* then the note would not have been subject to renunciation by transfer of possession to the debtor.[128] The parties did not dispute that the note was a negotiable instrument.[129] However, the lower court found that, although the note was a negotiable instrument within the meaning of Article 3, it was nonetheless subject to the provisions of Article 9.[130] The appellate court reversed, reasoning "nothing in Article 9 provides a limitation on the applicability to notes secured by mortgages on real estate."[131]

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constrains the free exchange of commercial paper. The latter two methods would require a plaintiff in a foreclosure dispute to offer proof of contracts or transactions to which the borrower would be neither a party nor a third party beneficiary.

[122] *Id.* at 116–18.

[123] *In re* Tarantola, 491 B.R. at 116–18.

[124] *Id.* at 118–19 (acknowledging that, even if the trustee were not a holder of the note, under exceptions found in Article 3, the trustee may still have had the right to foreclose as a nonholder in possession of the instrument).

[125] *Id.* at 120-21 (holding that "Plaintiff's argument that Article 9 provides the governing law of this case is not meritorious").

[126] Swindler v. Swindler, 584 S.E. 2d 438 (S.C. Ct. App. 2003) (reversing a judgment of foreclosure).

[127] *Id.*

[128] *See id.* at 441–42.

[129] *Id.* at 440.

[130] *Id.* South Carolina's adaptation of the U.C.C. contains a statute that provides that "[t]he provisions of this chapter are subject to the provisions of the chapter on . . . secured transactions." *Id.*

[131] *Swindler*, 584 S.E. 2d at 441. The court went on to reason that, under the facts in *Swindler*, there was no conflict between any provision of Article 3 and Article 9. *Id.* The analysis in *Swindler* arguably does not apply to a situation in which a note is sold, securitized, or otherwise transferred to a third party.

5. Indiana: *First Valley Bank v. First Sav. and Loan Ass'n of Central Indiana*

In *First Valley Bank*,[132] First Valley Bank was held liable in eighteen separate summary judgments as an endorser with recourse of mortgage notes.[133] First Valley Bank appealed, arguing in part that mortgage notes are not negotiable instruments and raising issues concerning Article 9 of the U.C.C.[134] First, the court explained that Article 3 of the U.C.C. applies to a promissory note secured by a mortgage.[135] Rejecting the bank's argument to the contrary, the court held that "mortgage notes are subject to the general law of negotiable instruments. . . without regard to the fact that they are affected with an interest in real property."[136]

Secondly, the court concluded that Article 9 did not operate as to trump enforcement under Article 3 with regard to mortgage promissory notes.[137] Indiana's adaptation of the U.C.C. has a common clause regarding Articles 3 and 9, stating that Article 3 is made subject to the provisions of Article 9.[138] However, because Article 9 does not apply "to the creation or transfer of an interest or lien on real estate," the court found that Article 9 "has no provisions relating to mortgage of real property."[139] The court cites to a comment to section 9-104(j), which cites two cases dealing with a security interest given by a mortgagee, and concluded that both cases hold that "a holder in due course of a negotiable instrument takes the mortgage freed of personal defenses."[140] Therefore, even in a situation in which the mortgagee gives an Article 9 security interest to a third party in Indiana, the holder analysis in Article 3 controls enforcement of the note and the attendant right to foreclose the mortgage.

B. Non-U.C.C. Jurisdictions

1. Michigan: *Al-Raeis v. Aurora Bank, FSB*

In *Al-Raeis v. Aurora Bank, FSB*,[141] the Michigan court affirmed a finding that summary disposition was appropriate in a non-judicial

[132] 412 N.E.2d 1237 (Ind. Ct. App. 1980).
[133] *Id.* at 1239.
[134] *Id.*
[135] *Id.* at 1241 (holding that "[s]o far as Article 3 of the Uniform Commercial Code is concerned, a promissory note secured by a mortgage is a negotiable instrument").
[136] *Id.*
[137] *See id.*
[138] *Id.*
[139] *First Valley Bank*, 412 N.E.2d at 1241. The court goes so far as to hold that "UCC's 9-104(j) silences Article 9 as to real estate mortgages."
[140] *Id.*
[141] No. 3136269, 2014 WL 6953557 (Mich. App. Dec. 9, 2014).

foreclosure.[142] The borrower brought an appeal, claiming that she had standing to challenge the sale.[143] Challenging a Michigan statute related to the specific process of foreclosure by advertisement,[144] the borrower alleged that certain assignments of mortgage were not accompanied by the promissory note.[145] The borrower's argument involved a claim under both Articles 3 and 9, averring that a party seeking to enforce or negotiate a promissory note must be in possession of the note.[146]

The court, reasoning under Michigan statutes unrelated to an adaptation of the U.C.C., held that the promissory note was functionally irrelevant to an ability to foreclose the mortgage,[147] and further found that, as a third party to the subject assignments of mortgage, the borrower did not have standing to challenge the assignments.[148] Specifically, the court in *Al-Raeis* rejected application of the U.C.C. to the foreclosure of mortgages by advertisement wholesale, and held that a "mortgage instrument" is not a "negotiable instrument."[149] The court does not discuss the impact of the note having the

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[142] *Id.* at *1. Michigan permits a foreclosure to occur by advertised sale, following which a party may move for summary disposition, provided that there is neither an allegation of fraud or irregularity in the sale process or a judicial determination regarding any claims prior to the expiration of the state's redemption period. *See id.*

[143] *Id.*

[144] MICH. COMP. LAWS ANN. § 600.3204(3) (West 2014) (providing that "[i]f the party foreclosing a mortgage by advertisement is not the original mortgagee, a record chain of title must exist before the date of sale . . . evidencing the assignment of the mortgage to the party foreclosing the mortgage").

[145] *Al-Raeis*, 2014 WL 6953557 at *3.

[146] *Id.* Were the party to establish the right to enforce a lost note, actual possession would not be required. However, the foreclosing party in the case did not allege that it was entitled to enforce a lost note. As a result, that question was not a part of the borrower's argument or the court's reasoning.

[147] *Id.* at *3–4.

[148] *Id.* The court's announcement that a third party may not challenge assignments of a mortgage is a frequent refrain in foreclosure disputes, and extends in certain jurisdictions to other documents related to transfers of security instruments, including pooling and servicing agreements. *See* Velasco v. Sec. Nat. Mortgage Co., 823 F. Supp. 2d 1061, 1067 (D. Haw. 2011) *aff'd*, 508 F. App'x 679 (9th Cir. 2013) (citations omitted); McGill v. Impac CMB Trust Series 2007-A, No. 6:12-cv-1142-Orl-28TBS, 2013 U.S. Dist. LEXIS 112575, at *5–6 (M.D. Fla. July 18, 2013) (citations omitted); Coursen v. JP Morgan Chase & Co., No. 8:12-cv-690-T-26EAJ, 2013 U.S. Dist. LEXIS 144295, *33–34, (M.D. Fla. June 27, 2013) (citations omitted); Castillo v. Deutsche Bank Nat. Trust Co., 89 So. 3d 1069, 1069 (Fla. Dist. Ct. App. 2012); Bank of Am. Nat. Ass'n v. Bassman FBT, L.L.C., 2012 981 N.E.2d 1, 7, ¶ 15 (Ill. App. Ct. 2012), *modified on denial of reh'g,* (Dec. 7, 2012) (citations omitted).

[149] *Al-Raeis*, 2014 WL 6953557, at *3–4. The language used by the court in *Al-Raeis* on this point is curious, because the reference to a "mortgage instrument" could seemingly be a reference to either the mortgage note or the mortgage, itself. The citation to *Mox v. Jordan* provides some clarity, because the court in *Mox* was clearly discussing a mortgage: "A mortgage merely secures payment of the negotiable instrument." 463 N.W.2d 114, 115 (1990). Although *Al-Raeis* appears limited to foreclosures by advertisement, "several courts in" the Eastern District of Michigan "have held that the U.C.C. does not apply to mortgage foreclosures." Berry v. Main St. Bank, 977 F. Supp. 2d 766, 773 (E.D. Mich. 2013).

property of a negotiable instrument, or whether a mortgage note is deemed to have such a quality under Michigan law.[150]

2. Massachusetts

a. *U.S. Bank Nat'l Ass'n v. Ibanez*

In *U.S. Bank Nat'l Ass'n v. Ibanez*, trustees had foreclosed on two properties and then purchased the properties back at the foreclosure sales.[151] The trustees filed complaints seeking a declaration that they held clear title to the properties.[152] The court held that the trustees did not demonstrate that they had standing to foreclose, and therefore held that the foreclosures sales were not valid to convey title to the properties.[153] The court invalidated the sales without relying on the U.C.C., and instead applied Massachusetts common law.[154]

b. *Eaton v. Fed. Nat'l Mortg. Ass'n*

In *Eaton v. Fed. Nat'l Mortg. Ass'n*,[155] the Massachusetts court analyzed a fact pattern in which the borrower executed a note in favor of BankUnited FSB and a mortgage in favor of MERS, Inc., acting as nominee for BankUnited FSB.[156] The mortgage was assigned to Green Tree Servicing, LLC, which attempted to foreclose the mortgage following a default for failure of the borrower to make payments.[157] Green Tree was the highest bidder at the sale and assigned its bid to Federal National Mortgage Association.[158]

Upon the borrower's refusal to vacate and surrender the property, eviction proceedings were commenced.[159] The borrower filed a counterclaim, alleging that foreclosure should not have occurred because the foreclosing party was only in possession of the mortgage, and was not in

[150] *See generally Al-Raeis*, 2014 WL 6953557.
[151] U.S. Bank Nat'l Ass'n v. Ibanez, 941 N.E.2d 40, 44 (Mass. 2011).
[152] *Id.*
[153] *Id.* at 53.
[154] *Id.* at 54.
[155] 969 N.E.2d 1118, 1127–28 (2012). Massachusetts is a non-judicial foreclosure state, which permits foreclosures to occur by a vehicle called a "power of sale." Following the sale of the property, a borrower may attempt to prevent eviction or reverse the foreclosure, by means of judicial process. MASS. GEN. LAWS ch. 183, § 21.
[156] *Eaton*, 969 N.E. 2d at 1121–22 (citations and footnotes omitted). Listing MERS as a nominee for the lender is a typical practice, which creates a nominal interest in MERS, mainly permitting mortgages to be transferred within the MERS system. *Id.* This has led to problems related to record-keeping, which are more fully elucidated elsewhere. *See Id.* at 1131–33.
[157] *Id.* at 1122.
[158] *Id.* at 1122–23.
[159] *Id.* at 1123.

possession of the note.[160] Federal National Mortgage Association was enjoined from interfering with the property, and an appeal commenced.[161] The borrower argued on appeal that Article 3 of the U.C.C. governed the question of whether Green Tree had been entitled to enforce the note.[162]

Rather than turn to Article 3 or Article 9 of the U.C.C., the court reasoned through Chapter 183 and Chapter 244 of the Massachusetts General Laws.[163] The court arrived at the conclusion that the entity foreclosing the mortgage must also have the ability to enforce the note.[164] Although the court arrived at a similar result to what would have likely occurred were it to have analyzed the case through the prism of Article 3, the case failed to create a precedential imperative to apply article 3 to mortgage foreclosures in Massachusetts.[165]

3. Illinois: *In re Haase*

In a heavily litigated bankruptcy action, the bailor of cattle, which were improperly sold by the debtor at a livestock auction sale, sought the proceeds of the sale and had priority over a bank's claim to the subject proceeds.[166] In *In re Haase*, as one of the bank's claims to priority, the bank attempted to argue entitlement to priority by virtue of being a holder in due course, pursuant to Article 3 of the U.C.C.[167] The court held that a stranger to an agreement which is otherwise governed by Article 3 does not have their rights determined by Article 3.[168]

The analysis begins by noting that Article 3 applies to negotiable instruments and governs the rights and obligations of those who are parties to or are in possession of negotiable instruments.[169] With regard to the underlying transaction, the following parties engaged in the transaction: the debtor who sold a non-party's cattle through an auction, the auction that issued the check for the sale, and the banks that drew and deposited the

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[160] *Id.*
[161] *Id.*
[162] Reply Brief for Appellant at 3, Eaton v. Fed. Nat'l Mortg. Ass'n, 969 N.E.2d 1118 (2012) (No. SJC-1104), 2011 WL 4826356, at *3.
[163] *Eaton*, 969 N.E. 2d at *passim*. The court additionally utilized reasoning from common law, which itself was not premised upon either of the subject articles of the U.C.C. *See id.*
[164] *Id.* at 1132–33.
[165] In fact, it has been noted that "the court's failure to address the UCC" goes so far as to obfuscate "the relationship between the UCC and foreclosures in Massachusetts." Cifrino, *supra* note 20, at 110. The opinion in *Eaton* represents a pattern in Massachusetts, because it was "not the first time the SJC has neglected the UCC in a mortgage context" and citing *Ibanez* as contradicting Article 9. *Id.* at 110–11.
[166] *In re* Haase, 224 B.R. 673, 678 (Bankr. C.D. Ill. 1998).
[167] *Id.*
[168] *Id.*
[169] *Id.* (citing W. Grp. Nurseries v. Pomeranz, 867 P.2d 12, 16 (Colo. App. 1993)).

check.[170] The court in *In re Haase* rejects the application of Article 3, for one sole reason: the case does not involve the four parties to the exchange, but instead involves the non-party—a bailor, whose bailed cattle was improperly sold.[171]

C. Potential Article 9 Jurisdictions

1. Colorado: *Western Group Nurseries, Inc. v. Pomeranz*

Western Grp. Nurseries, Inc. v. Pomeranz presents a dispute related to notes and security agreements that does not expressly deal with mortgage foreclosure, but does revolve in pertinent part around whether application of Article 3 or Article 9 of the U.C.C. is appropriate.[172] The case arose out of the sale of nursery stock and other assets, and the simultaneous sale of the subject assets by the purchaser to a third-party company, when the second sale involved a security agreement.[173] The notes in the transactions did not specifically bar a suit against the limited partners of the initial seller.[174]

The limited partners moved for summary judgment, claiming that application of Article 3 of the U.C.C. restricted their liability, due to the contents of the security agreements between the parties.[175] The first purchaser filed a cross-motion for summary judgment, seeking application of Article 9 of the U.C.C., which would not contain such a restriction.[176] The lower court entered summary judgment in favor of the first purchaser.[177]

Finding that the trial court did not err in its application of Article 9, the court reasoned that Article 9, in addition to applying to security interests in personal property and fixtures, also applied to security interests created by contract, including security interests arising by pledge or by assignment.[178] Noting that a security interest is an interest in property that secures payment

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[170] *In re* Haase, 224 B.R. at 678. The group dynamic in this transaction mirrors the traditional four-party exchange.
[171] *Id.*
[172] Western Group Nurseries, Inc. v. Pomeranz, 867 P.2d 12 (Colo. App. 1993). The court also analyzes the parties' argument regarding collateral estoppel and fraud, which are not directly relevant to the U.C.C. question. *Id.* at 15–16.
[173] *Id.* at 13. The sale took place in two steps, including the purchase of the nursery stock and assets by one company, for which a non-recourse note was given, and the sale of assets by the first purchaser to a second company, which occurred almost simultaneously. *Id.* This second transaction involved a wraparound note. *Id.*
[174] *Id.*
[175] *Pomeranz*, 867 P.2d at 14.
[176] *Id.*
[177] *Id.* at 15.
[178] *Id.* at 15. (citing to Colorado's version of article 9, COLO. REV. STAT. ANN. § 4-9-102(2) (1992 Repl. Vol. 2)).

or performance of an obligation, the court held that "the transfer of a note for security purposes is governed by Article 9."[179]

Due to the fact that the security agreement for the second sale created a security interest in the note given for that sale, and further due to the fact that a court in a related case in a different jurisdiction ordered that that note be sold at a foreclosure sale, the court held that the trial court's application of Article 9, rather than Article 3, was appropriate.[180] The court in *Pomeranz* did not expressly rule that the sale or assignment of a mortgage note creates a security interest, in which Article 9 would apply to determinations of the right to enforce the note. However, the reasoning in *Pomeranz* is similar to that employed in *Perez*, discussed more fully, *infra*.[181]

2. New York: *Provident Bank v. Community Home Mortgage Corp.*

In *Provident Bank v. Cmty Home Mortg. Corp.*,[182] the New York court determined priority between banks that each received duplicate original notes and assignments of mortgages. As discussed more fully, *infra*, applying both Articles 3 and 9, the court found in favor of the same party via negotiation and the law of secured transactions.[183] The lower court case was decided at summary judgment.[184] Therefore, the court endeavored merely to determine whether there was a genuine issue of material fact that precluded judgment prior to trial.[185]

Defendant mortgage banker had originated residential mortgage loans and obtained the money to fund the mortgages by entering into agreements with banks, which operated as warehouses until a permanent investor purchased the loans, to fund portions of the purchase prices of the loans.[186] The banks alleged that defendant engaged in a scheme whereby its borrowers would execute duplicate original promissory notes and mortgage assignments.[187] After the loans were sold to an investor, only one of the banks that operated as a warehouse lender would be fully compensated.[188] A

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[179] *Id.*
[180] *Id.*
[181] *See Pomeranz*, 867 P.2d at 13–16. In a separate, additional related case, the Eleventh Circuit applied New York law and made its ruling under the rules of contract interpretation, rather than seeking guidance from the U.C.C. *See* W. Grp. Nurseries, Inc. v. Ergas, 167 F.3d 1354, 1359 (11th Cir. 1999).
[182] 498 F. Supp. 2d 558 (E.D.N.Y. 2007).
[183] *Id.* at 575.
[184] *Id.* at 563–64.
[185] *Id.*
[186] *Id.* at 561–62 (footnote omitted).
[187] *Id.* at 562. The court in *Provident Bank* appears to refer to the original mortgage as a "mortgage assignment," because it is discussing the document signed by the borrowers, rather than a document transferring the mortgage between entities with a lien or property interest arising out of the mortgage. *Id.* (footnote omitted).
[188] *Provident Bank*, 498 F. Supp. 2d at 562 (citations omitted).

dispute arose in *Provident Bank* as to which entity had priority in terms of being paid for its purchase of the mortgage. One bank took possession of the original notes and received and recorded assignments of mortgages; another bank received the loans first in time, and the notes were specifically endorsed to the first in time bank by defendant.[189]

The court used Article 9 to reason through the priority dispute.[190] Initially, the court noted that it is clear that an assignment of mortgage creates a security interest in the note secured by the mortgage.[191] The court explained that the lack of clarity regarding "which statutes govern mortgages" in New York cause creditors to have difficulty in correctly perfecting their security interests in mortgages.[192] The court stated that the recordation of the assignment of mortgage served as notice under New York's race-notice statute.[193] New York follows the rule that "the mortgage follows the note."[194] In application of this rule, the court questioned whether Article 9 governs perfection of both the note and the mortgage.[195] The court explained that the unique characteristic of *Provident Bank* is that there is no case law addressing adjudication over duplicate original notes and mortgages.[196]

Predictably, the bank that recorded its assignments of mortgages first argued that the race-notice statute should govern priority.[197] The bank that took possession of the endorsed notes first argued that Article 9 should govern the court's analysis.[198] The court cited a number of cases wherein Article 9 was applied in bankruptcy and to non-judicial foreclosure sales.[199]

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[189] *Id.* at 563. There was one exception to the first-in-time receipt, amongst a total of eight notes. Seven of the notes were received by the bank that did not record assignments of the mortgages prior to receipt of the duplicate documents by the other bank. *Id.*

[190] *Id.* at 564–66.

[191] *Id.* at 564 (citation omitted).

[192] *Provident Bank*, 498 F. Supp. 2d at 564. Here, the court assumes that there is an Article 9 interest in the mortgage, which may be perfected, without providing authority demonstrating this interest. *Id.*

[193] *Id.* There are generally three types of statues which determine priority for interests in real property: race, notice, and race-notice. Argent Mortg. Co., LLC v. Wachovia Bank, N.A., 52 So.3d 796, 798–99 (Fla. Dist. Ct. App. 2010). States may freely adopt the notice of their choosing. Under a race statute, a subsequent mortgagee will prevail against a prior mortgagee if the subsequent mortgage is recorded first. Under a notice statute, a subsequent mortgagee who purchased for value and without notice of a prior mortgagee will prevail against the prior mortgagee. Under a race-notice recording statute, a subsequent mortgagee who purchased for value and without notice will prevail against the prior mortgagee, if and only if the subsequent mortgage is recorded before the prior mortgage. *Id*.

[194] *Provident Bank*, 498 F. Supp. 2d at 564–65 (citation omitted).

[195] *Id.*

[196] *Id.* at 565. The application of Article 9 in *Provident Bank* may be limited to cases in which there is a dispute over duplicate notes and/or mortgages, but the court does not expressly state whether there is such a limitation.

[197] *Id.*

[198] *Id.*

[199] *Id.* at 569–70 (footnotes omitted) (citations omitted).

The court then held that "pursuant to Article 9, possession of the note perfects the assignee's security interest, under the principle that the mortgage follows the note."[200]

Following its discussion of Article 9, the court also applied Article 3.[201] The court held that the notes were negotiated and sufficiently endorsed.[202] *Provident Bank* does not discuss whether application of Article 9 to the assignment of security interests conflicts with Article 3, thereby requiring an application of one or the other, but not both.[203] Further, *Provident Bank* does not turn on the application of either Article 3 or Article 9 to determine standing in an action to foreclose a non-duplicate mortgage.[204] Ultimately, *Provident Bank* underscores the difficulty in determining which portions of the U.C.C. apply in a particular set of facts.

3. Arizona/Illinois: *In re Veal*

In *In re Veal,* the Bankruptcy Appellate Panel for the 9th Circuit applied Illinois state law to questions regarding parties' standing, in regards to a choice of law provision in a relevant mortgage contract.[205] A bank, acting as trustee for a loan trust, obtained relief from the automatic stay under the bankruptcy code, relating to debtors' property.[206] Additionally, an objection to debtors' proof of claim was overruled, in favor of a mortgage loan servicer.[207] The debtors appealed the relief from the stay and the overruling of the objection in a consolidated appeal.[208] The issues before the court were whether the bank had standing to seek relief from the automatic stay and whether the servicer had standing to file the proof of claim.[209]

The note was specifically endorsed.[210] There was also an assignment of mortgage.[211] Further, there was an assignment of the note, which the court held to be superfluous in light of the specific endorsement.[212] The court reasoned that it was necessary to determine whether the bank or the servicer

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[200] *Provident Bank*, 498 F. Supp. 2d at 570. This statement is curious, because the court does not require the Article 9 methods of attachment and perfection, but instead uses Article 9 as a stand-in for the analysis under Article 3. *See id.* at 571 (citations omitted).
[201] *Id.* at 572. The reasoning applies to a party who claims the status of a holder in due course, which the subject bank claimed. *Id.*
[202] *Id.* at 573.
[203] *See generally Id.* (avoiding a discussion of whether application of Article 9 conflicts with Article 3).
[204] *Provident Bank*, 498 F. Supp. 2d at 574–75.
[205] *In re* Veal, 450 B.R. 897, 916 n.32 (B.A.P. 9th Cir. 2011).
[206] *Id.* at 902.
[207] *Id.*
[208] *Id.*
[209] *Id.*
[210] *Id.* at 903.
[211] *In re Veal*, 450 B.R. at 903.
[212] *Id.* at 904 n.6.

had standing, generally, and also whether they had prudential standing, to be able to access the federal courts.[213]

The court noted that the U.C.C. embraces instances in which the person who owns the note is not the person entitled to enforce the obligation to pay thereunder.[214] This fact lends credence to the notion that "the rules that determine who is entitled to enforce a note are concerned primarily with the maker of the note" and who they must pay to avoid default—as opposed to the rules concerning transfer of ownership and other interests in the note, which are concerned with who, "among competing claimants," is entitled to the value of the note.[215] This distinction is important for the court, because it allows the court to distinguish Article 9 ownership rights in the note from the Article 3 right to enforce the note, with the attendant right to foreclose the mortgage.[216] However, the court notes that, if a payee seeks to use the note as collateral or sell the note to a third party "in a manner not within Article 3," Article 9 would govern the transaction and determine whether a property interest in the note is obtained.[217] Ultimately, the court holds that the parties seeking the value of the note could prove entitlement to same by demonstrating that they were a person entitled to enforce the note under Article 3, but that one party could also alternatively demonstrate that it had some ownership or other property interest in the note.[218]

4. Florida

a. GE Credit Corp. v. Air Flow Indus.

GE Credit Corp. v. Air Flow Indus., Inc. involved the aftermath of a foreclosure action relating to a mortgage given for the construction of a pool.[219] The foreclosure was based on an ineffective mortgage, which described a parcel of land that did not exist.[220] Thereafter, plaintiff brought an action against the company that had assigned the mortgage to plaintiff, as well as the company's principals who had individually guaranteed the mortgage.[221]

The Florida court considered whether the U.C.C. governs "the legal consequences of the assignment of a real estate mortgage," and concluded

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[213] *Id.* at 906. Prudential standing is not a relevant fact in determining whether a party may enforce a note or foreclose a mortgage in a typical foreclosure matter. *Id.* at 907 (footnotes omitted) (citations omitted).
[214] *Id.* at 912 (footnote omitted).
[215] *Id.*
[216] *In re Veal*, 450 B.R. at 912.
[217] *Id.* at 913 (footnote omitted).
[218] *Id.* at 912 (footnotes omitted).
[219] GE Credit Corp. v. Air Flow Indus., Inc., 432 So. 2d 607 (Fla. Dist. Ct. App. 3d 1983).
[220] *Id.* at 608. The court calls the mortgage an "ineffective instrument," though it is likely that the note was the instrument, rather than the mortgage.
[221] *Id.*

that it did not.[222] The court found that Articles 2, 3, and 9 were each inapplicable to the assignment.[223] With regard to its analysis under Article 3, the court cites a single section of the Florida Statutes, which no longer exists.[224] However, the application of Article 3 to the legal consequences of an assignment of mortgage is irrelevant, because Article 3 nevertheless covers negotiable instruments, such as the note that provides the underlying debt that the assigned mortgage would secure.[225]

The court's holding regarding Article 9 is most significant. For support, the court cites to *Rucker v. State Exchange Bank*,[226] which held that "the assignment of a real estate mortgage securing a promissory note as collateral for a bank loan is not a secured transaction under Article 9 of the Uniform Commercial Code because it is specifically excluded by Section 679.104(10)."[227] However, as will be discussed, *infra*, the applicability of this holding in *Rucker* has been undercut by subsequent legislation, which is potentially only material to the question of whether recordation of an assignment of mortgage is necessary.[228]

b. HSBC Bank USA, N.A. v. Perez

In *HSBC Bank USA, N.A. v. Perez*, two banks took possession of similar mortgage promissory notes, which were both secured by the same mortgage, and each disputed that the other did not have the right to foreclose the single mortgage.[229] The Florida circuit court applied portions of Chapter 701, Florida Statutes, which governs the assignment and cancellation of mortgages.[230] The appellate court concluded that "the Uniform Commercial Code, and not the recording statute, controls this case."[231] However, the court did not look to Chapter 673 of the Florida Statutes, which governs negotiability. Instead, the court reasoned that "[u]nder the Code, the bank

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[222] *Id.* at n.5.
[223] *Id.*
[224] *See id.* (citing FLA. STAT. § 673.104 (1981)).
[225] *See* FLA. STAT. ANN. § 673.1041 (West 1994).
[226] 355 So. 2d 171 (Fla. Dist. Ct. App. 1978).
[227] *Id.* at 175. The court in *Perez*, *infra*, analyzes this language in *Rucker* and explains that Chapter 679 was reformed to clear up any misconceptions and provide that an assignment of a security interest is a secured transaction, for the purpose of not requiring the cost of recordation of assignments of mortgage. HSBC Bank USA, N.A. v. Perez, 165 So. 3d 696, 707 (Fla. Dist. Ct. App. 2015).
[228] *Perez*, 165 So. 3d at 707.
[229] *Id.* at 698.
[230] *Id.*; *see also* FLA. STAT. ANN. § 701.
[231] *Perez*, 165 So. 3d at 698. The recording statute referenced is FLA. STAT. ANN. § 701.02, which governs the recordation of assignments of mortgages. Florida has a separate recording statute, generally, at FLA. STAT. ANN. § 695.01.

that first perfected its interest in a note and related mortgage is entitled to the priority of its interest."[232]

Florida's enactment of Article 9 is contained in Chapter 679 of the Florida Statutes.[233] The court in *Perez* noted that "[g]enerally, Chapter 679 does not apply 'to the creation of' a real property mortgage.'"[234] However, this concession was meant to set up an exception that may apply to most, if not all, of foreclosure cases in the state. The court goes on to state "if . . . the note in a mortgage transaction is sold or assigned, Chapter 679 applies to the security interest created in favor of the purchaser or assignee of the note."[235] This exception is expansive because, as discussed, *supra*, most mortgage promissory notes are sold or assigned, at some point.

The court cites the following Official Comment in support of its reasoning:

> O borrows $10,000 from M and secures its repayment obligation, evidenced by a promissory note, by granting to M a mortgage on O's land. [Article 9] does not apply to the creation of the real-property mortgage. However, if M sells the promissory note to X or gives a security interest in the note to secure M's own obligation to X, [Article 9] applies to the security interest thereby created in favor of X. The security interest in the promissory note is covered by [Article 9] even though the note is secured by a real-property mortgage.[236]

[232] *Perez*, 165 So. 3d at 698.
[233] *Id.* at 699.
[234] *Id.* (quoting FLA. STAT. ANN. § 679.1091).
[235] *Id.* The opinion in *Perez*, to the extent that it appears to provide space for standing to be established under Article 9 precepts, appears to conflict with recently-enacted Florida law, which requires complaints to plead standing to foreclose pursuant to Article 3. Specifically, section 702.015, Florida Statutes and rule 1.115, Florida Rules of Civil Procedure, each require a plaintiff in a foreclosure action to track the language of Article 3.
[236] *Id.* (quoting FLA. STAT. ANN. § 679.1091, cmt. 7). The court here neglects to reference the following paragraph in the Comment, which states that "an attempt to obtain or perfect a security interest in a secured obligation by complying with non-article 9 law, as by an assignment of record of a real properly mortgage, would be ineffective," though this section is discussed elsewhere in the opinion to arrive at a determination that the mortgage assignment recording statute is irrelevant to a determination under Article 9. *See id.* at 707–08. That said, it is disputable whether the status of the parties needs to be determined by a resort to Article 9, in the first place, and the court does not address this question. *See id.*; *see also* Am. Bank S. v. Rothenberg, 598 So. 2d 289, 291 (Fla. Dist. Ct. App. 1992) (reasoning, before the 1998 amendments to Article 9, that "the promissory note meets the requirements of section 673.104, Florida Statutes (1991) and is thus a negotiable instrument" and determining priority based on Florida's statutory scheme adopting Article 3 of the Code). In fact, the court in *Rothenberg* held that "the rights of the parties must be determined by the character of the promissory note," and not by the potential attachment or perfection of any interests in same. *Rothenberg*, 598 So. 2d at 291; *see also* Midfirst Bank, SSB v. C.W. Haynes & Co., 893 F. Supp. 1304,

The mortgage in *Perez* was in favor of Federal Guaranty Mortgage Company.[237] HSBC obtained physical possession of one of the notes when it closed on a pooling and servicing agreement.[238] Subsequent to HSBC's purchase, the second bank entered into a separate pooling and servicing agreement and took possession of the second note.[239] The court held that, "[o]nce HSBC took possession of the note it had an Article 9 security interest in the note," which attached.[240] The perfecting of the security interest in the note resulted in a perfection of the security interest in the mortgage, as well.[241]

In an attempt to make the decision seem consistent with prior precedent on the subject, the court reasoned that the facts in the dispute are consistent with "the notion that the promissory note, not the mortgage, is the operative instrument in a mortgage loan transaction, since a mortgage is but an incident to the debt, the payment of which it secures, and its ownership follows the assignment of the debt."[242] However, immediately following this pronouncement of consistency, the court then discussed how a security interest attaches to collateral,[243] and restated a stricter requirement than that for Article 3 negotiation: attachment occurs "when (a) value has been given, (b) the assignor has rights in the collateral or the power to transfer rights in the collateral to a secured party, and (c) the assignor has authenticated a security agreement that provides a description of the collateral or the assignee has taken possession of the note under section 679.3131."[244]

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passim (D.S.C. 1994) (applying Article 3 to a dispute between two defrauded, innocent parties, and expressly rejecting application of Article 9).

[237] *Perez*, 165 So. 3d at 698.

[238] *Id.* A pooling and servicing agreement relates to the securitization of mortgage loans and is a typical document in transactions between lending institutions and mortgage servicers. These agreements tend to be rigid mechanisms to govern "the management of securitized mortgage loan pools." Anna Gelpern and Adam J. Levitin, *Rewriting Frankenstein Contracts: Workout Prohibitions in Residential Mortgage-Backed Securities*, 82 S. CAL. L. REV. 1075, 1077 (describing a pooling and servicing agreement as being designed to "preclude or severely constrain the modification of both the securitization arrangement and the underlying mortgages").

[239] *Perez*, 165 So. 3d at 698.

[240] *Id.* at 699.

[241] *Id.*

[242] *Id.* (internal citations omitted). The court cites WM Specialty Mortg., LLC v. Salomon, 874 So. 2d 680, 682 (Fla. Dist. Ct. App. 2004), which quotes Johns v. Gillian, 184 So. 140, 143 (Fla. 1938). Both *Salomon* and *Gillian* involve a set of facts in which a mortgage was assigned. However, as discussed, *supra*, such an assignment would be insufficient under Article 9.

[243] *Perez*, 165 So. 2d at 699–700. Pursuant to Article 9, a party may not foreclose unless the security interest has attached to the collateral. JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 23-1, at 1185 (6th ed. 2010).

[244] *Perez*, 165 So. 3d at 699–700 (internal. quotations omitted). *See also* FLA. STAT. ANN. § 679.2031; U.C.C. § 9-203. Note the difference between the requirement of value, the right to transfer, and either a formal agreement with specific information or physical possession and

The *Perez* court discusses the idea of perfection of a security interest in negotiable notes, as opposed to attachment of the security interest to the note, by stating that "[o]ne method of perfecting a security interest in a promissory note is by taking possession of the original promissory note."[245] It is argued that perfection functions as public notice, because the collateral is not left in the hands of the debtor.[246] However, perfection is not required for the prosecution of a foreclosure case.[247]

Following its discussion of the applicability of the doctrines of attachment and perfection, the court reasoned that HSBC, and not the subsequent possessor of the second note, had priority, as determined under Article 9 and Florida's legislation in furtherance thereof.[248] The priority determination is less pertinent to this discussion than is the fact that Article 9 was utilized to make the determination. The *Perez* court notes that, in a prior case,[249] the court concluded that the assignment of mortgage recording statute had no application to a determination of priority, much like the court's ruling in *Perez*.[250] Unlike in *Perez*, the court in the prior case "applied Chapter 673 of Florida's Uniform Commercial Code to hold American Bank's interest superior to Rothenberg's by virtue of its status as possessor of a valid assignment of mortgage and holder in due course of the original note."[251] The court further cited a case which "held that 'the assignment of a real estate mortgage securing a promissory note as collateral for a bank loan is not a secured transaction under Article 9' of the UCC."[252] Although the case had been supplanted by legislation meant to demonstrate that an assignment

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the requirement that a person be in possession of a negotiable instrument that is payable either to bearer or to an identified person that is the person in possession.

[245] *Perez*, 165 So. 3d at 700 (citing FLA. STAT. § 679.3131(1) (2008)). Perfection determines matters of priority and provides third parties with notice of the transaction. *See id.*

[246] *Id.*; *see also* David A. Ebroon, Note, *Perfection by Possession in Article 9: Challenging the Arcane but Honored Rule*, 69 IND. L.J. 1193, 1194 (1994).

[247] *See id.* The court in *Perez* cites to the Report of the Permanent Editorial Board for the Uniform Commercial Code, cited herein *supra* note 1. The Report distinguishes between an enforcement interest in an instrument and its security interest on the one hand and an entitlement to the economic value of the instrument or security interest, on the other hand. *See* Report of the Editorial Board, *supra* note 1, at 339. There being two separate possible interests: one of entitlement to enforce an instrument and another of entitlement to the economic value of the instrument, application of Article 9 to sold or transferred mortgage promissory notes is of no moment, because the rules therein apply only "among competing claimants," which is wholly within the world of the mortgagee. *See id.* In the world of the mortgagor, questions of who the mortgagor is required to pay and who may enforce the loan documents are resolved under Article 3. *See id.* at 345. However, this is not clarified in *Perez*, and appears not to be recognized by other jurisdictions, as discussed, herein.

[248] *Perez*, 165 So. 3d at 708.

[249] *Rothenberg*, 598 So. 2d 289 (Fla. Dist. Ct. App. 1992).

[250] *Perez*, 165 So. 3d at 702–04.

[251] *Id.* at 704 (internal quotations omitted).

[252] *Id.* at 707 (quoting Rucker v. State Exchange Bank, 355 So. 2d 171, 174 (Fla. Dist. Ct. App. 1978)).

of a security interest in a mortgage is a secured transaction,[253] the court does not respond to the established precedent that the character of the note is what matters, rather than the perfection of any interest in the note.[254] It may be that the *Perez* court intended for Article 9 to apply to disputes between lenders, while leaving Article 3 for resolution of disputes between a lender and borrowers, but this is not explicitly stated. It may also be that the court's reasoning means standing in a garden variety foreclosure case will be decided by use of Article 9, if there was ever a sale or transfer of the loan.

V. THE PREFERENCE OF UNIFORM COMMERCIAL CODE ARTICLE 3 ENFORCEMENT OF MORTGAGE PROMISSORY NOTES TO ENFORCEMENT UNDER ARTICLE 9

Under the Uniform Commercial Code, there are two avenues to establish a lender's standing to enforce a mortgage promissory note: a lender may either travel under Article 3 or may attempt to travel under Article 9.[255] Article 3 governs negotiable instruments, whereas Article 9 governs secured transactions.[256] Applied to the arena of foreclosures, Article 9 serves to replicate many of the fundamental errors that arose during the fashioning of foreclosure jurisprudence, including uncertainty in terminology, disharmony amongst jurisdictions, and a tendency toward the harsh end of strict foreclosure. Article 3, on the other hand, represents a solution to many of the problems made manifest under Article 9.

A. Article 9: Definitional Uncertainty, Non-Uniformity, and a Trend Toward Strict Foreclosure

Article 9 is divided into five main components: "scope, attachment, perfection, priorities, and enforcement."[257] Scope and attachment are the critical components for the purpose of this article; those components control whether Article 9 applies in the context of an action to foreclose a mortgage and whether Article 9 would be preferable to the traditional methodology under Article 3.

The scope of Article 9 reaches a security interest arising under other sections of the U.C.C.[258] However, the security interests covered under Article 9 on this point generally relate to interests arising under Articles 2, 4,

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[253] *Id.* (quoting FLA. S. JUSTICE APPROP. COMM., S.B. 370 (2005), Staff Analysis 7–8 (Apr. 4, 2005)).
[254] *Id.*
[255] *See* Report of the Editorial Board, *supra* note 1, at 333–34.
[256] *Id.* at 333.
[257] Keith G. Meyer, *A Potpourri of Article 9 Issues*, 8 DRAKE J. AGRIC. L. 323, 323 (Summer 2003) (citing U.C.C. §§ 9-108, 9-109, 9-203, 9-204, 9-315(a) (2000)).
[258] *Id.* at 324 n. 252 (citing U.C.C. § 9-109(a)(5)); *see also* U.C.C. § 9-109(a)(6).

and 5, and do not include reference to any Article 3 interests.[259] Article 9 also applies to promissory notes.[260] The section defining scope does not include mortgages.[261] Article 9 has been applied to mortgage foreclosure cases, where the property is used for the production of agricultural crops.[262] Notwithstanding this application, there are specific portions of the U.C.C. dedicated to security interests in crops,[263] and agricultural interests under Article 9 are governed specifically and directly.[264]

Sections 9-109(c) and (d) set for enumerated transactions that are exempt from application of Article 9. One exemption is for an assignment of "accounts, chattel paper, payment intangibles, or promissory notes which [are] for the purpose of collection only."[265] Additionally, with exceptions, the creation or transfer of an interest in or lien on real property is exempt.[266]

Article 9 does not apply to a pure real estate transaction.[267] However, when Article 9 was revised in 2002, the definition of "account" was broadened "to include the right to payment of a monetary obligation for property that has been . . . sold, leased, licensed, assigned, or otherwise disposed of."[268] Therefore, the obligation to make payments under an installment contract for the sale of real property is an account, now.[269] Article 9 applies to the sale of accounts.[270]

Initially, enforcement under Article 9 is vague and uncertain because Article 9 relies on a theory of "commercial reasonableness," which is flexible in ways much like the "reasonable period" afforded under the equity of redemption.[271] Commercial reasonableness stands for the proposition that parties are to act in good faith and conduct themselves with fair dealing in coming to a determination as to reasonable value.[272] There is no bright-line test to determine whether a particular result is commercially reasonable, and nor is there an articulated method for specifying the parameters of

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[259] U.C.C. §§ 9-109(a)(5), (6).
[260] U.C.C. § 9-109(a)(3).
[261] *See* U.C.C. § 9-109(a).
[262] Meyer, *supra* note 257, at 326.
[263] *Id.*; *see also* U.C.C. §§ 9-102(a)(44)(iv); 9-302, 9-308, 9-310, 9-317, 9-322, 9-338, 9-606.
[264] *See* U.C.C. § 9-302, providing specifically for the jurisdictional parameters of perfection and priority of agricultural liens; *see also* Moritz Implement Co. v. Matthews, 959 P.2d 886 (Kan. 1998), discussed by Meyer as holding "that Article 9 is the exclusive statutory scheme governing security interests in growing crops" and that attachment of such liens is independent of the occurrence of a foreclosure sale of the property. Meyer, *supra* note 257, at 326 n.14.
[265] U.C.C. § 9-109(d)(5).
[266] U.C.C. § 9-109(d)(11).
[267] Meyer, *supra* note 257, at 327.
[268] *Id.* (alteration in original) (internal quotations omitted) (citing U.C.C. § 9-102(a)(2)(i)).
[269] Meyer, *supra* note 257, at 328.
[270] U.C.C. § 9-109(a)(3).
[271] *See* Donald J. Rapson, *Default and Enforcement of Security Interests under Revised Article 9*, 74 CHI. KENT L. REV. 893, 893, 907 (1999).
[272] *See* U.C.C. § 1-201(b)(20).

commercial reasonableness.[273] Moreover, commercial reasonability may differ from jurisdiction to jurisdiction, furthering confusion as to what is or may be commercially reasonable in a particular set of circumstances.[274] Contributing to the unpredictable air surrounding commercial reasonableness under Article 9 is the fact that, while Article 9 provides the right to foreclose, it never defines the word "foreclose."[275]

Furthermore, Article 9 fails to promote sufficient uniformity in real estate law.[276] A secured party who exercises rights under Article 9, with respect to personal property, is not prejudiced as to any rights under real estate law.[277] However, revised Article 9, as applied in a one-form-of-action pleading state, may cause the secured party to lose the right to proceed against personalty where such a secured party first engages in an action to judicially enforce a mortgage.[278]

Perhaps most importantly, Article 9 provides for the harsh remedy of strict foreclosure. Revised Article 9 encourages strict foreclosure in at least five separate ways: (1) the secured party may elect to accept collateral in satisfaction of a debt if the secured party does not receive an objection within 20 days; (2) in certain circumstances, the secured party may accept collateral in partial satisfaction of a debt; (3) the secured party may strictly foreclose intangible collateral; (4) the secured party may accept collateral and use such acceptance as a discharge of junior claimants, without the junior claimants having the equitable due process rights to seek surplus proceeds; and (5) the secured party may hold collateral for an undefined, indefinite, uncertain period of time and still seek a deficiency.[279] The acerbity of Article 9 is only furthered by the fact that, in conjunction with allowing a party to proceed by

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[273] John P. McCahey, *Commercial Reasonableness in the Disposition of Collateral: Proceed with Care*, COMMITTEE ON COMMERCIAL & BUSINESS LITIGATION, AMERICAN BAR ASSOCIATION (Summer 2002) (providing that "the particular facts and circumstances of each disposition will determine whether or not it was commercially reasonable").

[274] *Id.* Compare the inscrutable, unwieldy process in Article 9 with revised Article 8. Article 8 was revised in a manner that represents "a bold and long overdue advance that facilitates the day-to-day transfer and registration of securities in the country's active securities markets." Richard A. Hakes, *UCC Article 8: Will the Indirect Holding of Securities Survive the Light of Day?*, 35 LOY. L.A. L. REV. 661, 664 (2002). The revisions to Article 8 had an intended goal of simplifying, rather than complicating the rules concerning the purview of Article 8. *See id.* at 671.

[275] Rapson, *supra* note 271 at 907 (calling Article 9's treatment of foreclosure "loose and informal"); *see also* U.C.C. § 9-601(a)(1).

[276] U.C.C. § 9-604(a).

[277] Barkley Clark, *Revised Article 9 of the UCC: Scope, Perfection, Priorities, and Default*, 4 N.C. BANKING INST. 129, 171–72 (2000). A state with one form of action is a state that utilizes a single procedural vehicle for attempting to enforce or protect private rights.

[278] *Id.*

[279] *Id.* at 178–80; *see also* U.C.C. §§ 9-620, 9-621, 9-622.

judicial process, it also permits a secured party to take possession of collateral without judicial process.[280]

B. The Benefits of Enforcement under Article 3

In contrast to the problematic scheme contemplated in Article 9,[281] Article 3, revised in 2002 and adopted by a number of states,[282] avoids the problems of the past. Negotiability under Article 3, as the traditional enforcement mechanism for mortgage promissory notes, fosters predictability and uniformity amongst jurisdictions.[283] Article 3 requires physical possession of the note, unless the note has been lost or destroyed.[284] The physical possession requirement protects borrowers in the face of potentially dishonest lenders.[285] The protection provided by Article 3 is balanced by the ability, under Section 3-309 of the Uniform Commercial Code, to enforce an instrument not in possession of the lender where ownership can be proven, even if the purchaser and the seller were never in possession of the note.[286]

Under Article 3, proof of the ability to enforce an instrument is a mandatory element that addresses concerns that borrowers would otherwise be vulnerable to having to satisfy obligations more than once, because a holder in due course could acquire possession of the note after a person not in possession had already sought to enforce the note.[287] Due to the fact that most other states had already adopted the 2002 revisions to Article 3 by 2004, nationwide adoption and use of Revised Article 3 promotes further

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[280] U.C.C. §§ 9-609(b)(1), (2). Presumably, the only limitation on the ability of a secured party to take possession of collateral or remove, render useless, or dispose of collateral on a debtor's premises is that the secured party is required to do so "without breach of the peace." U.C.C. § 9-609(b)(2).

[281] In addition to the problems discussed, *supra*, resort to enforcement by way of Article 9 restricts the free flow of negotiable paper, notwithstanding the fact that the mortgage servicing industry has normalized negotiation as a means to transfer mortgage promissory notes. Such a move should be rejected in favor of the free circulation of promissory notes. *See* Jack J. Fisher, *The Effect of Fluctuating Rates of Interest on the Negotiability of an Instrument*, 23 WASH. U.L.Q. 385, 391–92, 398 (1938).

[282] Natalya Ter-Grigoryan, *Improving the Law of Negotiable Instruments: Support for Arizona's Adoption of the 2002 Proposed Revisions to Uniform Commercial Code Section 3-309*, 42 ARIZ. ST. L.J. 1331, *passim* (Winter 2010/2011).

[283] White, *supra* note 3, at 472–73 (stating that Article 3 is utilized as the traditional, assumed approach for enforcement, while parties and courts are presently simultaneously opposing the injection of Article 9 enforcement)*; see also* Nyquist, *supra* note 57, at 898–99.

[284] U.C.C. §§ 3-201, 3-309.

[285] Ter-Grigoryan, *supra* note 282, at 1334–35.

[286] U.C.C. § 3-309; *see also* Ter-Grigoryan, *supra* note 282, at 1345 (discussing Florida's adoption of the 2002 revisions to Section 3-309).

[287] SENATE STAFF ANALYSIS AND ECON. IMPACT STATEMENT, S.B. 282 (Fla. 2004), http://archive.flsenate.gov/data/session/2004/Senate/bills/analysis/pdf/2004s0282.cm.pdf

uniformity.[288] Likewise, Revised Article 3 allows for electronic maintenance of real estate finance documents, making it easier for parties to trace the chain of a promissory note.[289] Enforcement under Article 3 therefore protects consumers, guards against secret liens, and encourages transactions to function through an open, increasingly transparent, and ordinary course.[290] The question, then, is whether mortgage notes are negotiable, and thus entitled to Article 3 enforcement.

Resorting to enforcement by way of Article 9 restricts the free flow of negotiable paper, notwithstanding the fact that the mortgage servicing industry has normalized negotiation as a means to transfer mortgage promissory notes. Such a move should be rejected in favor of the free circulation of promissory notes.

VI. CONCLUSION

The historical developments of negotiability and foreclosure law, along with the present foreclosure backlog, point toward the fact that negotiability provides a predictable framework in an otherwise chaotic mess. A mortgage promissory note is a negotiable instrument, which entitles a plaintiff lender to claim status as the holder of the negotiable instrument. As the holder of the negotiable instrument, the plaintiff lender gains the incidental right to enforce any mortgage related to the note. This formula is nearly universal and has existed since before the Great Depression ushered forth the last foreclosure backlog. Recent attempts to privilege Article 9 over Article 3 will not result in better outcomes in foreclosure cases, but will instead replicate the errors seen throughout the history of the law relating to foreclosure.

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[288] *See id.*; Ter-Grigoryan, *supra* note 282, at 1346.
[289] Ter-Grigoryan, *supra* note 282, at 1348.
[290] Nyquist, *supra* note 57, at 902.