

Understanding Today's Foreclosure Defense

Online Continuing Legal Education

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Online Continuing Legal Education

Understanding Today's Foreclosure Defense

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Part I

Application of the Uniform Commercial Code as it Relates to Mortgage Notes

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Module Objectives

- To provide a guide for analyzing how mortgage loans are conveyed pursuant to the UCC.
- To distinguish specific provisions of UCC Article 3 and Article 9 as they relate to the sale of mortgage loans.

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Module Objectives

Exploring the Key Questions:

- Is there a Security Agreement for each sale of the Note?
- When does the Mortgage actually follow the Note?
- Why is it important for a Mortgage to follow a Note?

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BACKGROUND

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Background of the UCC

The Uniform Commercial Code is a uniform law sponsored by the American Law Institute and the Uniform Law Commission. It has been enacted in every state (as well as the District of Columbia, Puerto Rico, and the United States Virgin Islands) in whole or significant part.

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Background of the UCC

In 1961, the American Law Institute and the Uniform Law Commission, the organizations that jointly sponsor the Uniform Commercial Code, established the Permanent Editorial Board for the Uniform Commercial Code (PEB). One of the charges of the PEB is to issue commentaries “and other articulations as appropriate to reflect the correct interpretation of the [Uniform Commercial] Code and issuing the same in a manner and at times best calculated to advance the uniformity and orderly development of commercial law.”

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Background of the UCC

Such commentaries and other articulations are issued directly by the PEB rather than by action of the American Law Institute and the Uniform Law Commission.

This presentation is based in part upon the November 14, 2011 report of PEB found at:

www.ali.org/00021333/PEB%20Report%20-%20November%202011.pdf

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Background of the UCC

The UCC preempts common law to the extent it is inconsistent with the UCC (§1-103)

- (a) [The Uniform Commercial Code] must be liberally construed and applied to promote its underlying purposes and policies, which are:
- 1) to simplify, clarify, and modernize the law governing commercial transactions;
 - 2) to permit the continued expansion of commercial practices through custom, usage, and agreement of the parties; and
 - 3) to make uniform the law among the various jurisdictions.

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Background of the UCC *Principles and Practices*

The UCC preempts common law to the extent it is inconsistent with the UCC (§1-103)

- (b) Unless displaced by the particular provisions of [the Uniform Commercial Code], **the principles of law and equity**, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, and other validating or invalidating cause **supplement its provisions**.

- *Official Comment 2 to §1-103(b)*

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Background of the UCC *Principles and Practices*

Applicability of supplemental principles of law. §1-103(b)
Official Comment 2 states the basic relationship of the Uniform Commercial Code to supplemental bodies of law.

The Uniform Commercial Code was drafted against the backdrop of existing bodies of law, including the common law and equity, and relies on those bodies of law to supplement its provisions in many important ways.

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Principles and Practices Background of the UCC

At the same time, the Uniform Commercial Code is the primary source of commercial law rules in areas that it governs, and its rules represent choices made by its drafters and the enacting legislatures about the appropriate policies to be furthered in the transactions it covers.

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Principles and Practices Background of the UCC

*Therefore, while principles of common law and equity may supplement provisions of the Uniform Commercial Code, **they may not be used to supplant its provisions**, or the purposes and policies those provisions reflect, unless a specific provision of the Uniform Commercial Code provides otherwise. In the absence of such a provision, **the Uniform Commercial Code preempts principles of common law and equity that are inconsistent with either its provisions or its purposes and policies.***

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Relevant Parts of the Uniform commercial code

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Relevant Articles

Together, the provisions in Articles 3 and 9 of the UCC (along with general principles that appear in Article 1 and that apply to all transactions governed by the UCC) provide legal rules that apply to these questions. Moreover, these rules displace any inconsistent common law rules that might have otherwise previously governed the same questions.

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Familiar Article 3 Terms:

Holder, Person Entitled to Enforce, Non-Holder with Rights of a Holder, Special Indorsement, Indorsement in Blank, Bearer Paper, etc.

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All those terms are the language of Article 3. They apply to notes that are negotiable instruments.

You need to learn the language of Article 9.

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Learning Article 9

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Learning Article 9 *Principles and Practices*

- Article 9 covers both traditional secured transactions and also the sale of most rights to payments.
- Article 9 governs the sale of “promissory notes.” UCC 9-103(a)(3).

The term ‘promissory note’ includes notes that are of a ‘type that in ordinary business is transferred by delivery with any necessary indorsement or assignment regardless of the requirements of negotiable instruments under UCC § 3-104.

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Learning Article 9

Article 9 of the UCC governs the sale of promissory notes regardless of whether such notes are negotiable or non-negotiable.

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Learning Article 9

When there is a conflict between Article 9 and Article 3 of the UCC, Article 9 governs.

“If there is conflict between this Article and Article 4 or 9, Articles 4 and 9 govern.”

- § 3-102(b)

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Learning Article 9

Article 9 uses the same terminology to govern multiple different types of transactions. The term “security interest” includes “not only an interest in a property that secures an obligation but also the right of a buyer of a payment right in a transaction governed by Article 9.”

--PEB Report, p. 8-9

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Learning Article 9

The buyer is called the “secured party.” The seller is called the “debtor.”

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Learning Article 9

When reviewing a section of Article 9, add or substitute “buyer” for “secured party” and “seller” for “debtor.”

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Transferring mortgage loans: requirements

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THREE BASIC REQUIREMENTS

In order to transfer secured loans to another party, three basic requirements must be satisfied:

1. Buyer must give **VALUE**
2. Seller must have the **RIGHTS**
3. There must be a **SECURITY AGREEMENT**

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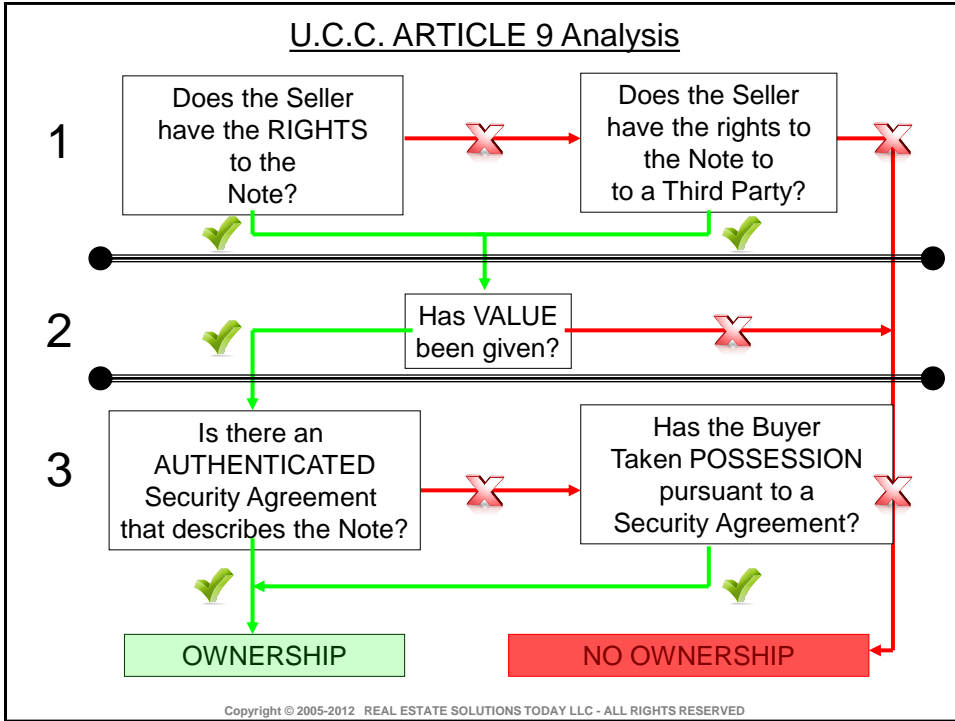
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Analysis

Section 9-203(b) has only three requirements for a lawful sale of a promissory note. First the buyer/secured party must give "value." Second, the debtor/seller must have "rights in the collateral or the power to transfer right in the collateral" to the buyer/secured party. Third, the debtor/seller must authenticate a security agreement that "provides a description" or the promissory note or the secured party/buyer must take possession of the note pursuant to such security agreement.

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Analysis

Section 9-203(g) provides for the collateral security rights of a debtor/seller to pass automatically to the secured party/buyer when the secured party/buyer's right becomes enforceable against the debtor/seller:

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Analysis

“The attachment of a security interest in a right to payment or performance secured by a security interest or other lien on personal or real property is also attachment of a security interest in the security interest, mortgage, or other lien.”

This is the codification of the concept of the “mortgage follows the note.” When a party buys a promissory note pursuant to Article 9 and that note is secured by collateral, the buying party automatically obtains the selling party's rights the collateral.

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Analysis

A party that obtains the rights to enforce a negotiable note through negotiation, does not automatically obtain rights to the collateral. Article 3 contains no corresponding provision to Article 9's section 203(g). Therefore, the negotiation of a promissory note generally gives the party entitled to enforce a negotiable note only the right to collect, but not the right to foreclose on the collateral.

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Analysis

When a party is seeking to foreclose on property, whether the promissory note is negotiable or non-negotiable is largely irrelevant. If any party other than the party originating the loan is seeking to foreclose, such party generally must show that it obtained its rights pursuant to Article 9.

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APPLICATION TO SECURITIZED TRUSTS

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Analysis

Issues relating to the transfer, ownership, and enforcement of mortgage notes are primarily governed by two Articles of the Uniform Commercial Code

In cases in which the mortgage note is a negotiable instrument, Article 3 of the UCC provides rules governing the obligations of parties on the note and the **enforcement** of those obligations.

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Analysis

Securitization of mortgage loans is premised on multiple “true sales” of each mortgage loan to place them in a securitized trust.

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Analysis

There are usually four or five entities that buy and/or sell mortgage loans in a securitization. The “Originator” is the original lender on the note. The “Aggregator” is the entity that funds or purchases mortgage loans from various originators. The “Sponsor/Seller” may or may not be the same entity that will purchase notes from the Aggregator and Sell them to the “Depositor” as well as put the “offering” together for the investors. The “Depositor” is a special purpose entity that has no assets and exists solely to buy mortgage loans from the Sponsor and sell them to the “Trust.”

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Analysis

To satisfy the requirements for the securitization, each loan must be sold lawfully as follows:

1. Originator to Aggregator
2. Aggregator to Sponsor/Seller
3. Sponsor/Seller to Depositor
4. Depositor to the Trust

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Analysis

The last of the sales (i.e., from the Depositor to the Trust) is governed by a long document called a "Pooling and Servicing Agreement." The Pooling and Servicing Agreement **serves as the security agreement for the last sale only.** The Pooling and Servicing Agreement generally is filed with the Securities and Exchange Commission and is available online.

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Analysis

The other security agreements, from the Originator to the Aggregator, from the Aggregator to the Sponsor and from the Sponsor to the Depositor, are often not publically available.

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Analysis

For the Trust to show that it bought the mortgage loan lawfully, there has to be admissible evidence that all sales complied with the requirements of section 9-203(b).

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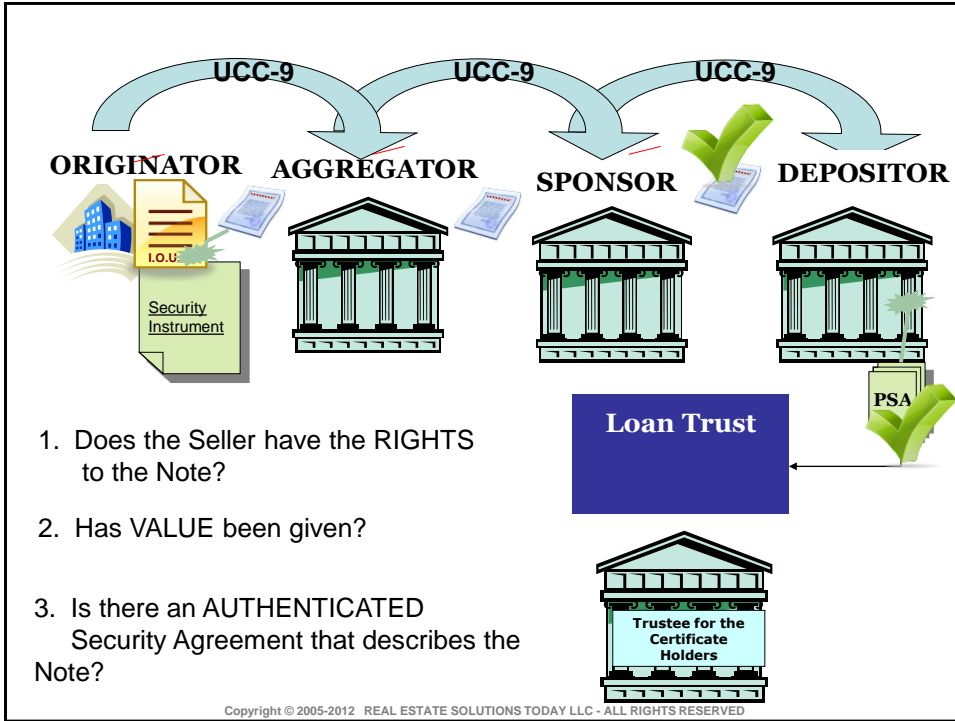
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Analysis

For each sale there are three questions: (a) did the seller have the right to sell the note; (b) did the buyer give value; and (c) is there a security agreement?

For each element, there must be sufficient admissible evidence to support a finding.

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Part II

Application of the Uniform Commercial Code as it Relates to Mortgage Notes

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Module Objectives

- To provide a guide for applying U.C.C. Principles in common factual scenarios

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ILLUSTRATIONS

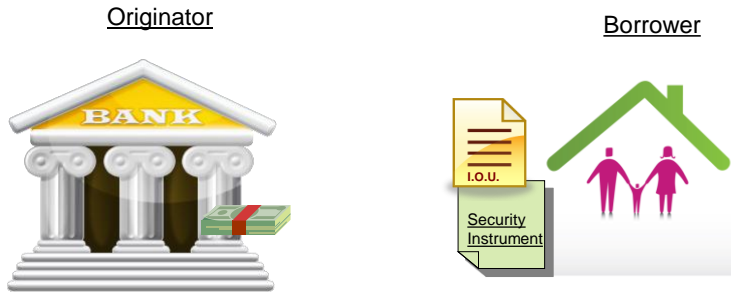
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www.ali.org/00021333/PEB%20Report%20-%20November%202011.pdf

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ILLUSTRATION 1

Borrower issued a negotiable mortgage note payable to the order of Originator. Originator is in possession of the note, which has not been indorsed.

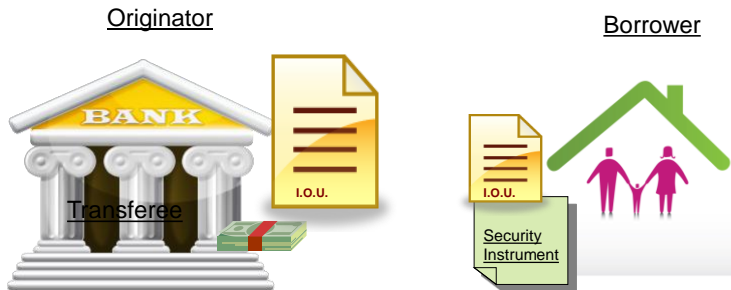


Originator is the holder of the note and, therefore, is the person entitled to enforce it. UCC §§ 1-201(b)(21)(A), 3-301(i).

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ILLUSTRATION 2

Borrower issued a negotiable mortgage note payable to the order of Originator. Originator indorsed the note in blank and gave possession of it to Transferee.

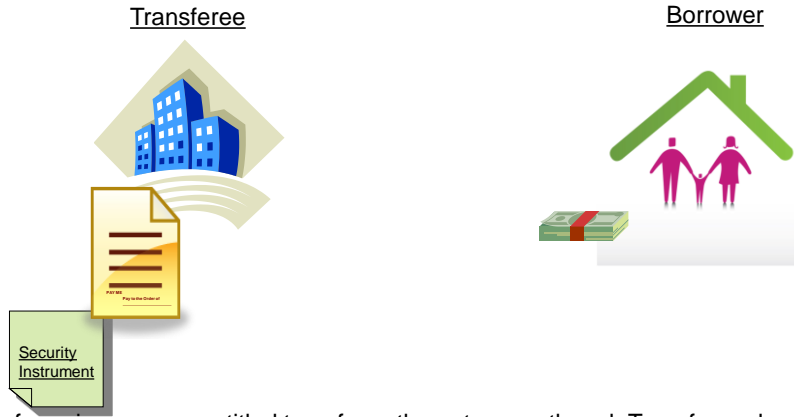


Transferee is the holder of the note and, therefore, is the person entitled to enforce it. UCC §§ 1-201(b)(21)(A), 3-301(i).

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ILLUSTRATION 2a

After obtaining possession of the note, Transferee lost the note and its whereabouts cannot be determined.



Transferee is a person entitled to enforce the note even though Transferee does not have possession of it. UCC § 3-309(a).

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If Transferee brings an action on the note against Borrower, Transferee must establish the terms of the note and the elements of Borrower's obligation on it. The court may not enter judgment in favor of Transferee, however, unless the court finds that Borrower is adequately protected against loss that might occur by reason of a claim of another person (such as the finder of the note) to enforce the note. UCC § 3-309(b).

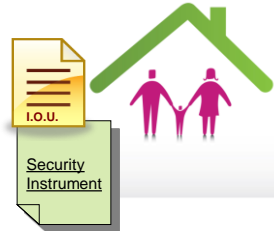
ILLUSTRATION 3

Borrower issued a negotiable mortgage note payable to the order of Originator. Originator sold the note to Transferee and gave possession of it to Transferee for the purpose of giving Transferee the right to enforce the note. Originator did not, however, indorse the note.

Originator



Borrower



Transferee



Transferee is not the holder of the note because, while Transferee is in possession of the note, it is payable neither to bearer nor to Transferee. UCC § 1-201(b)(21)(A). Nonetheless, Transferee is a person entitled to enforce the note.

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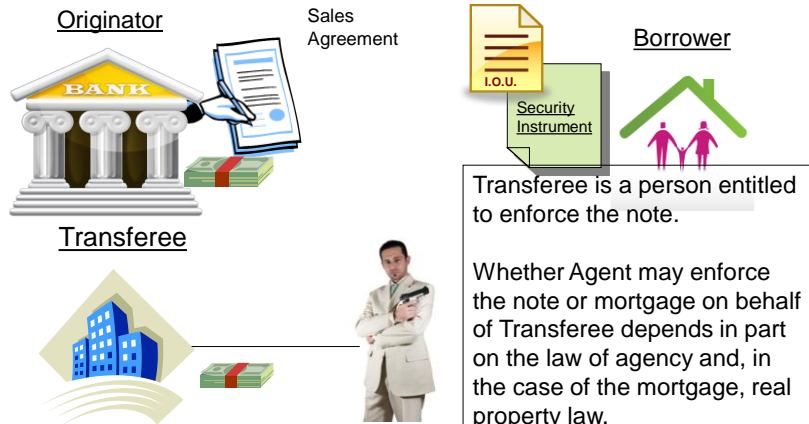
This is because the note was transferred to Transferee and the transfer vested in Transferee Originator's right to enforce the note. UCC § 3-203(a)-(b). As a result, Transferee is a nonholder in possession of the note with the rights of a holder and, accordingly, a person entitled to enforce the note. UCC § 3-301(ii).

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ILLUSTRATION 4

Borrower issued a negotiable mortgage note payable to the order of Originator. Originator sold the note to Transferee and gave possession of it to Transferee for the purpose of giving Transferee the right to enforce the note. Originator did not indorse the note.

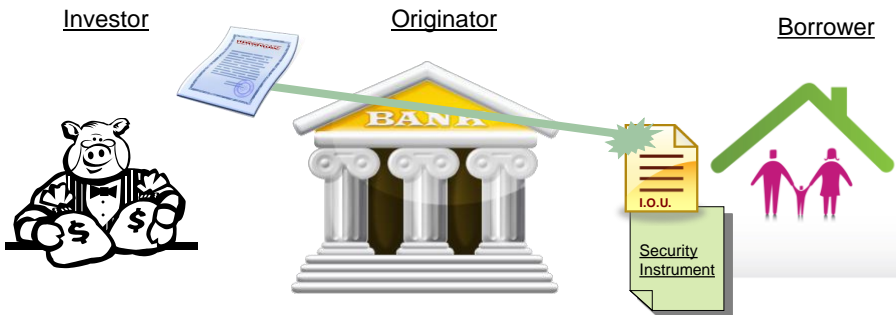
Under the law of agency, Agent is the agent of Transferee for purposes of possessing the note as it is the Agent, rather than the Transferee, to whom actual physical possession of the note is given by Originator.



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ILLUSTRATION 5

Borrower issued a mortgage note payable to the order of Originator. Originator borrowed money from Investor and, to secure Originator's repayment obligation, Originator and Investor agreed that Investor would have a security interest in the note. Simultaneously with the funding of the loan, Originator gave possession of the note to Investor.



Investor has an attached and enforceable security interest in the note.
UCC § 9-203(b).

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This is the case even if Originator's agreement is oral or otherwise not evidenced by an authenticated record.

Originator is no longer a person entitled to enforce the note (because Originator is no longer in possession of it and it has not been lost, stolen, or destroyed). UCC § 3-301.

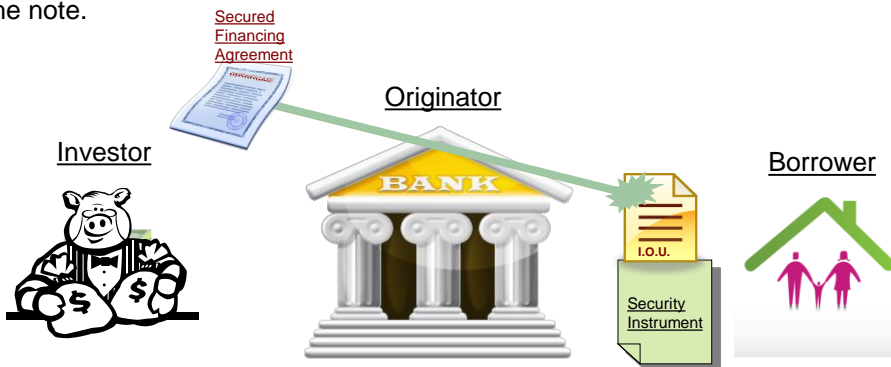
Investor is a person entitled to enforce the note if either

- (i) Originator indorsed the note by blank indorsement or by a special indorsement identifying Investor as the person to whom the indorsement makes the note payable (because, in such cases, Investor would be the holder of the note), or
 - (ii) the delivery of the note from Originator to Investor constitutes a transfer of the note under UCC § 3-203 (because, in such case, Investor would be a non-holder in possession of the note with the rights of a holder).
- See also UCC §§ 1-201(b)(21)(A), 3-205(a)-(b), and 3-301(i)-(ii).

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ILLUSTRATION 6

Borrower issued a mortgage note payable to the order of Originator. Originator borrowed money from Investor and, in a signed writing that reasonably identified the note, granted Investor a security interest in the note to secure Originator's repayment obligation. Originator, however, retained possession of the note.



Investor has an attached and enforceable security interest in the note. UCC § 9-203(b)

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If the note is negotiable, Originator remains the holder and the person entitled to enforce the note because Originator is in possession of it and it is payable to the order of Originator. UCC §§ 1-201(b)(21)(A), 3-301(i).

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ILLUSTRATION 7

Borrower issued a mortgage note payable to the order of Originator. Originator sold the note to Investor, giving possession of the note to Investor in exchange for the purchase price.



The sale of the note is governed by Article 9 and the rights of Investor as buyer constitute a “security interest.” UCC §§ 9-109(a)(3), 1-201(b)(35). The security interest is attached and is enforceable. UCC § 9-203(b).

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Principles and Practices

This is the case even if the sales agreement was oral or otherwise not evidenced by an authenticated record.

If the note is negotiable, Investor is also a person entitled to enforce the note, whether or not Originator indorsed it, because either

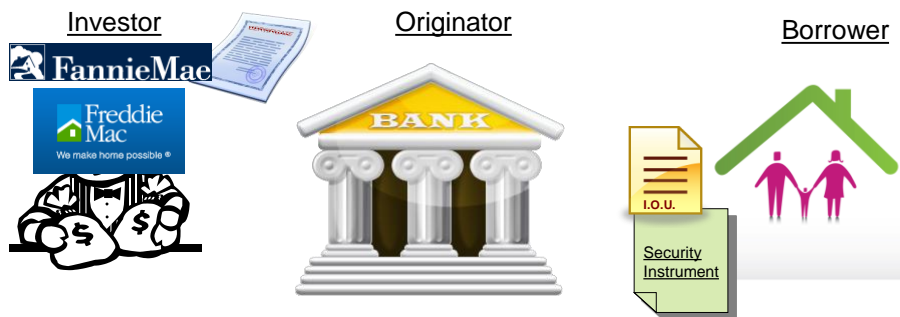
- (i) Investor is a holder of the note (if Originator indorsed it by blank indorsement or by a special indorsement identifying Investor as the person to whom the indorsement makes the note payable) or
- (ii) Investor is a nonholder in possession of the note (if there is no such indorsement) who has obtained the rights of Originator by transfer of the note pursuant to UCC § 3-203.

See also UCC §§ 1-201(b)(21)(A), 3-205(a)-(b), and 3-301(i)-(ii).

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ILLUSTRATION 8a

Borrower issued a mortgage note payable to the order of Originator. Pursuant to a signed writing that reasonably identified the note, Originator sold the note to Investor. Originator, however, retained possession of the note.



The sale of the note is governed by Article 9 and the rights of Investor as buyer constitute a “security interest.” UCC § 1-201(b)(35). The security interest is attached and is enforceable. UCC § 9-203(b).

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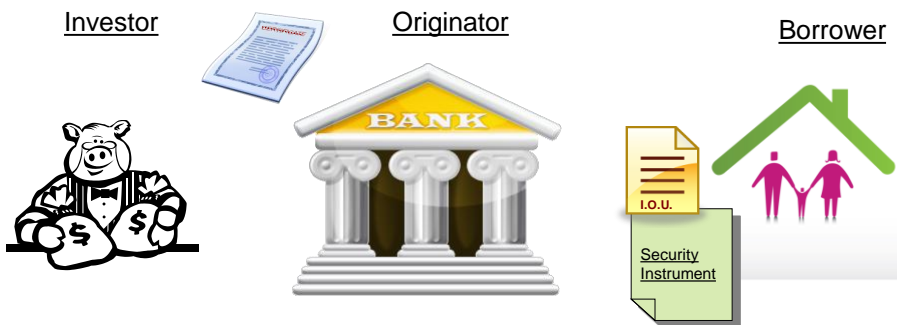
Principles and Practices

If the note is negotiable, Originator remains the holder and the person entitled to enforce the note (even though, as between Originator and Investor, Investor owns the note) because Originator is in possession of it and it is payable to the order of Originator. UCC §§ 1-201(b)(21)(A), 3-301(i).

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ILLUSTRATION 8b

The signed writing was silent with respect to the mortgage securing the note and the parties made no other agreement with respect to the mortgage.



The attachment of Investor's interest in the rights of Originator in the note also constitutes attachment of an interest in the rights of Originator in the mortgage. UCC § 9-203(g).

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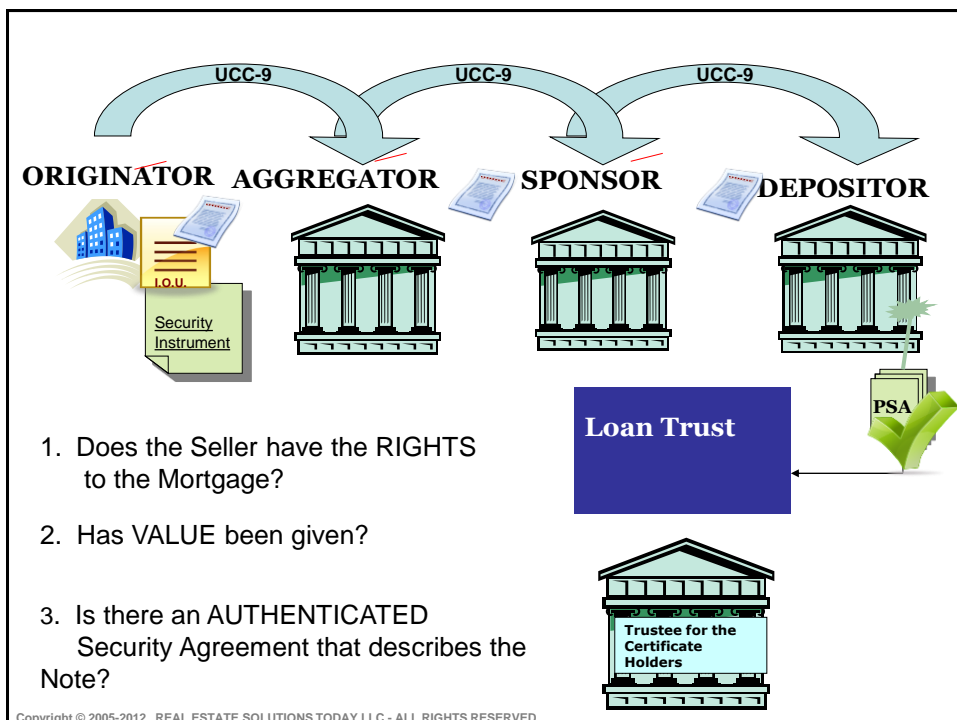
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Principles and Practices

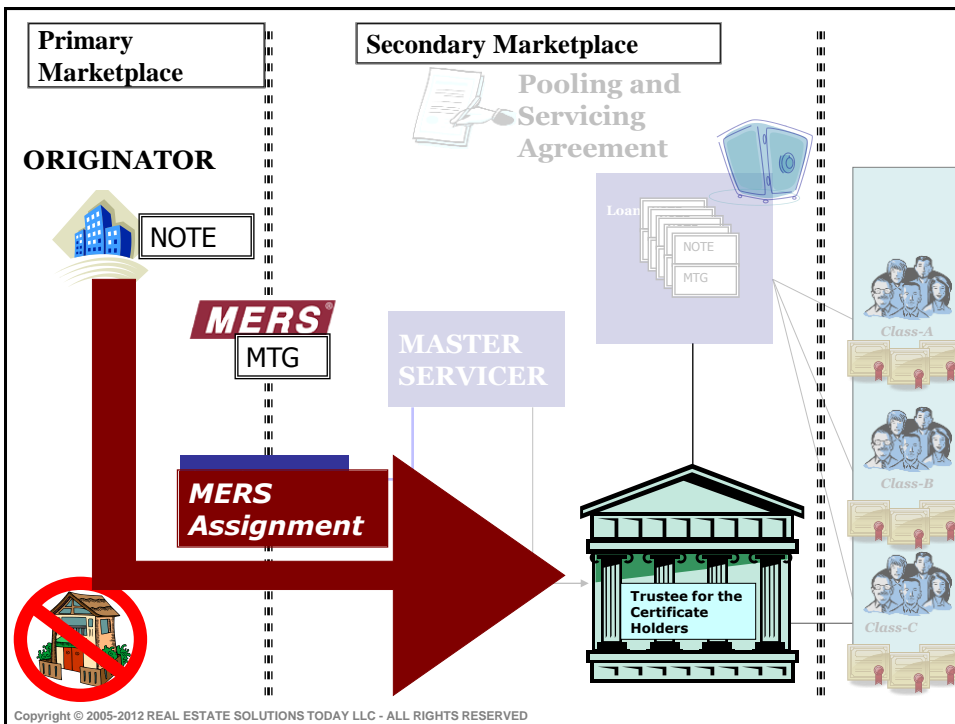
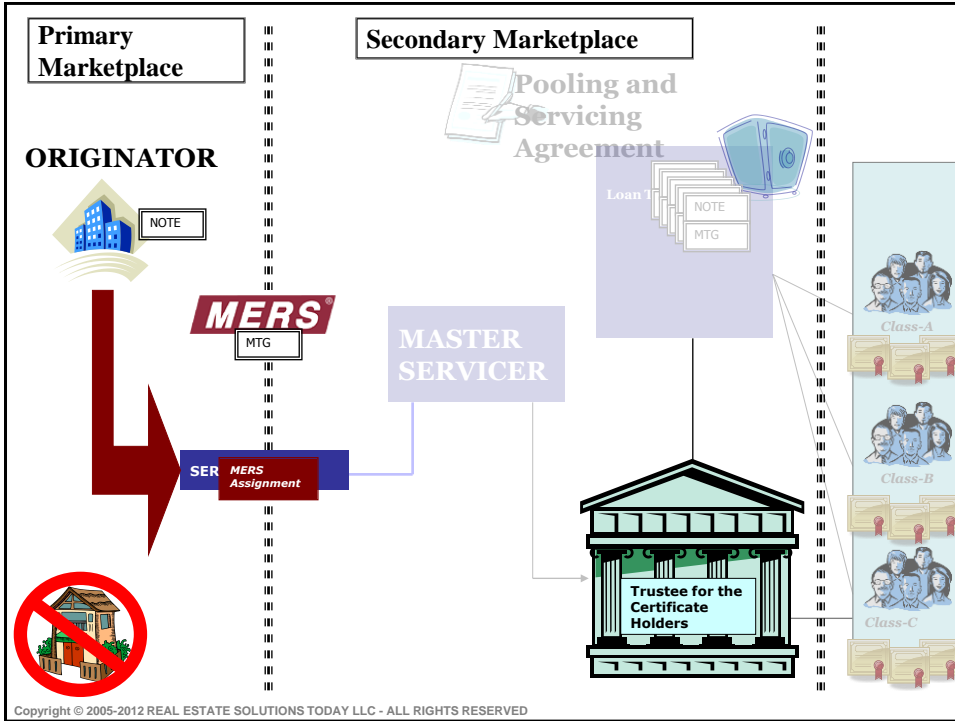
If Borrower has defaulted on the note and mortgage and Investor would like to enforce the mortgage non-judicially then, in the relevant state, only a party with a recorded interest in a mortgage may enforce it non-judicially.

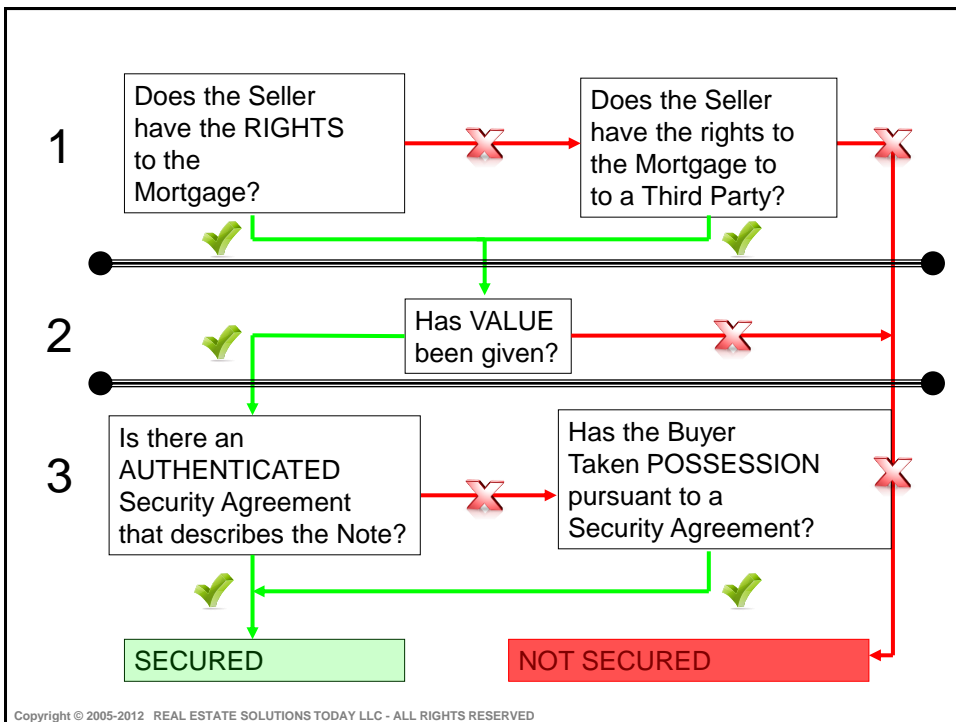
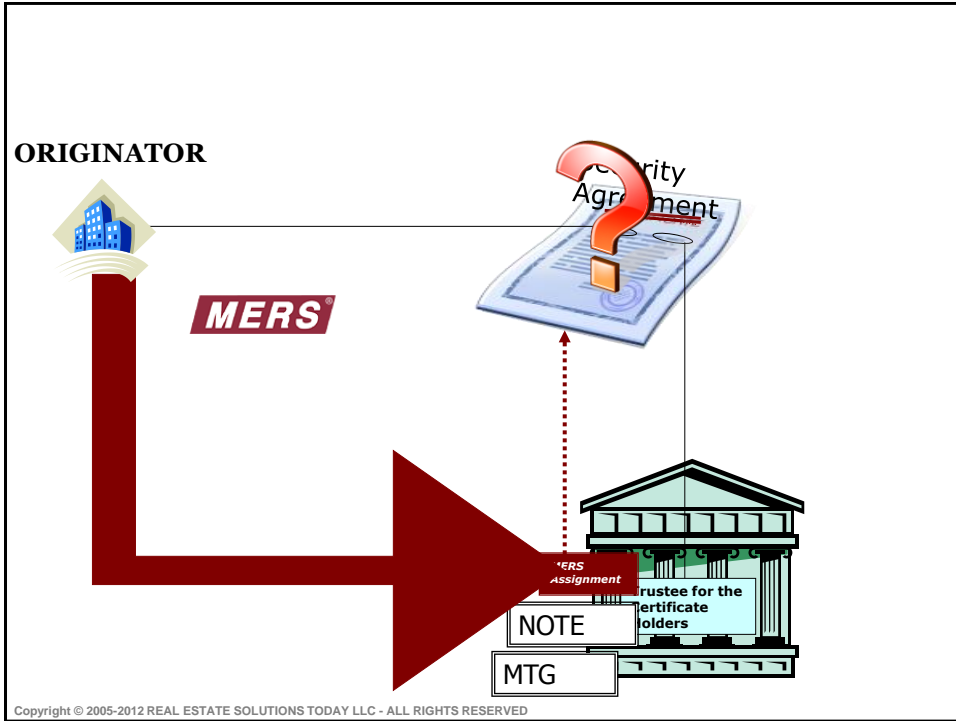
Investor may record in the relevant mortgage recording office a copy of the signed writing pursuant to which the note was sold to Investor and a sworn affidavit stating that Borrower has defaulted and that Investor is entitled to enforce the mortgage non-judicially. UCC § 9-607(b).

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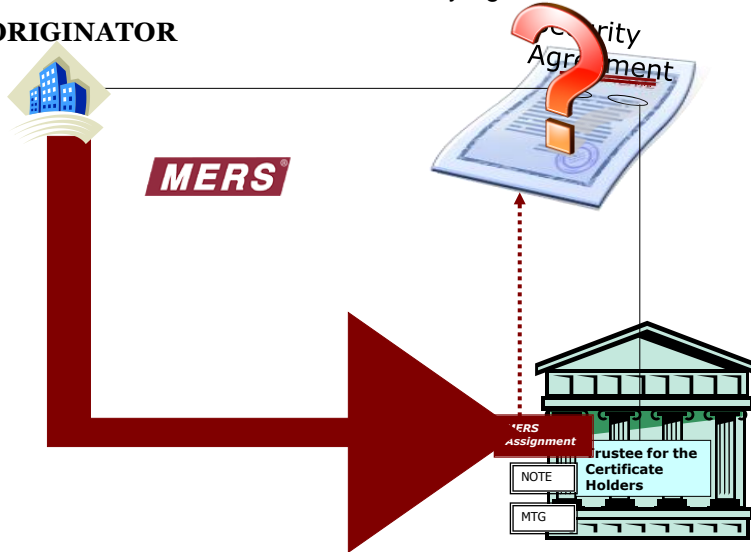
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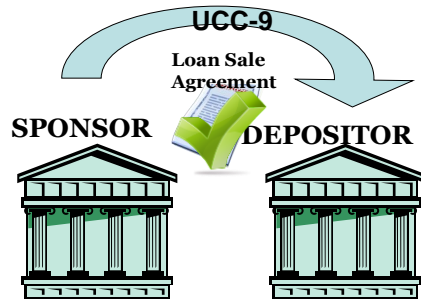
1. Does the Seller have the RIGHTS to the Mortgage?
2. Has VALUE been given?
3. Is there an AUTHENTICATED Security Agreement that describes the Note?

ORIGINATOR

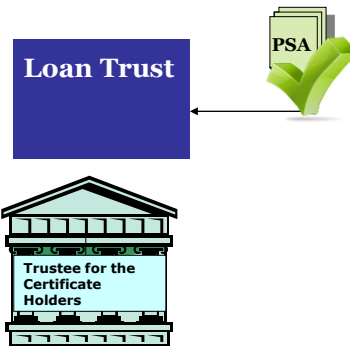


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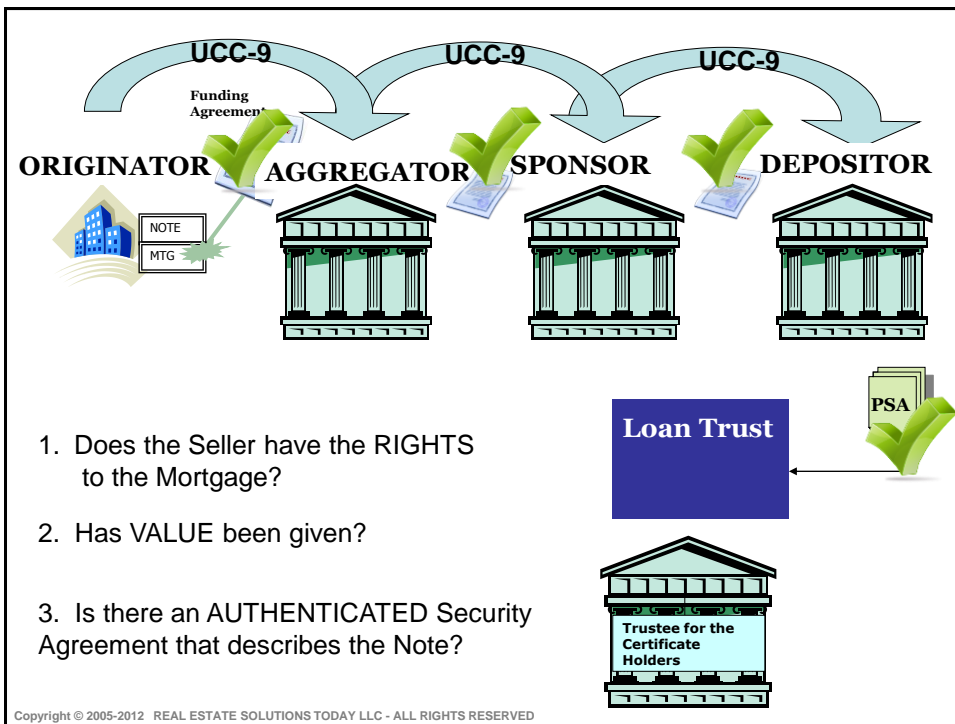
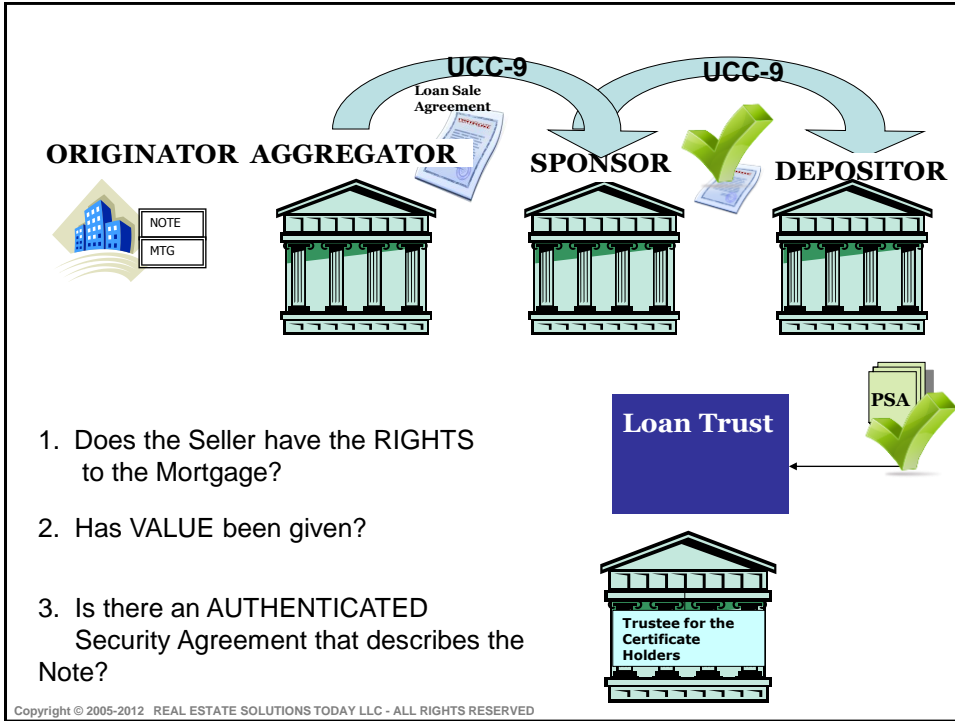
ORIGINATOR



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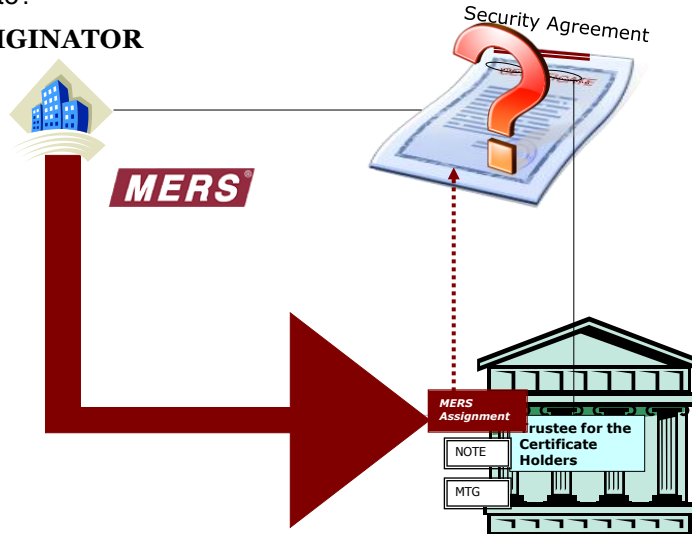


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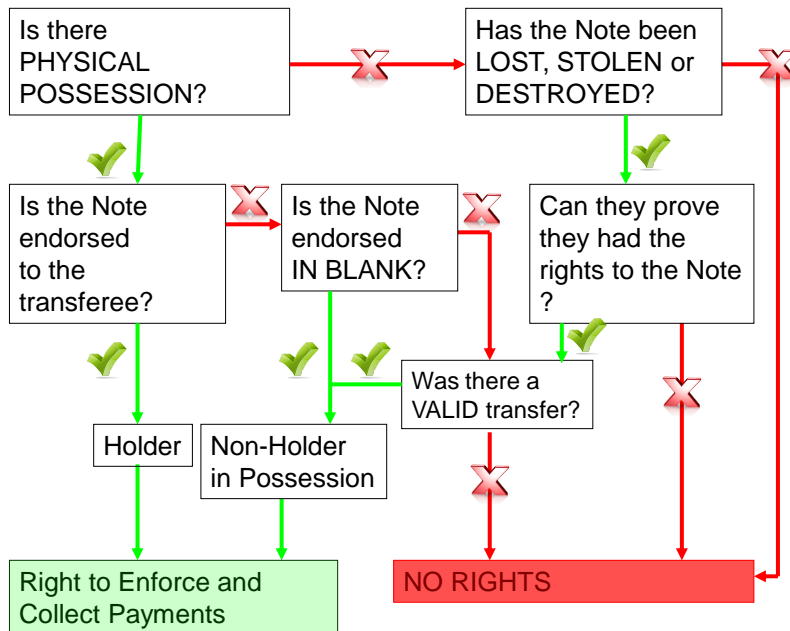


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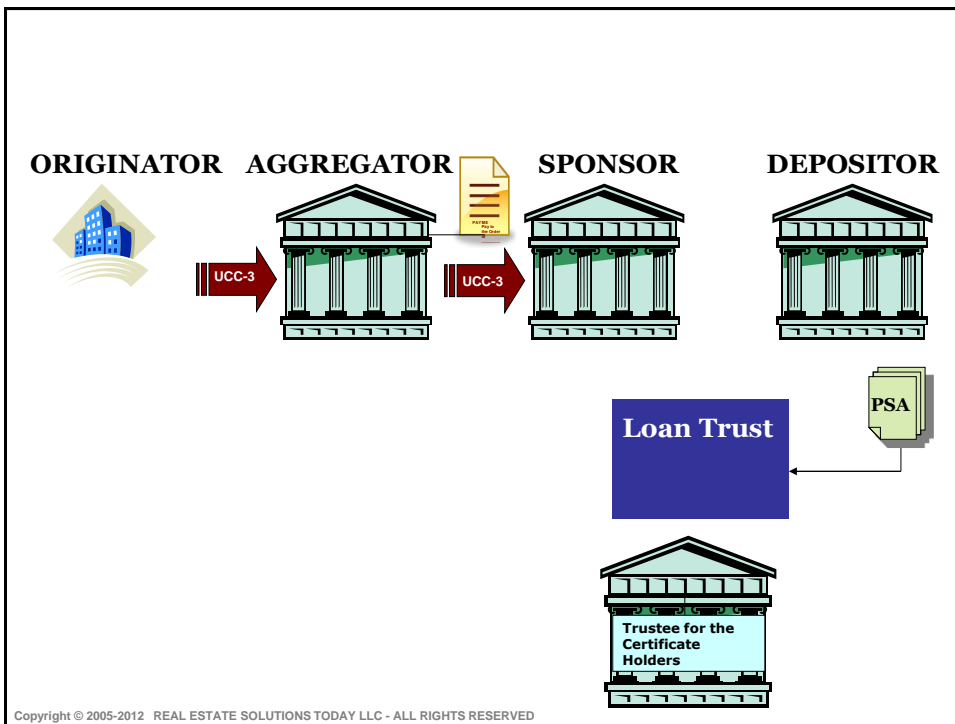
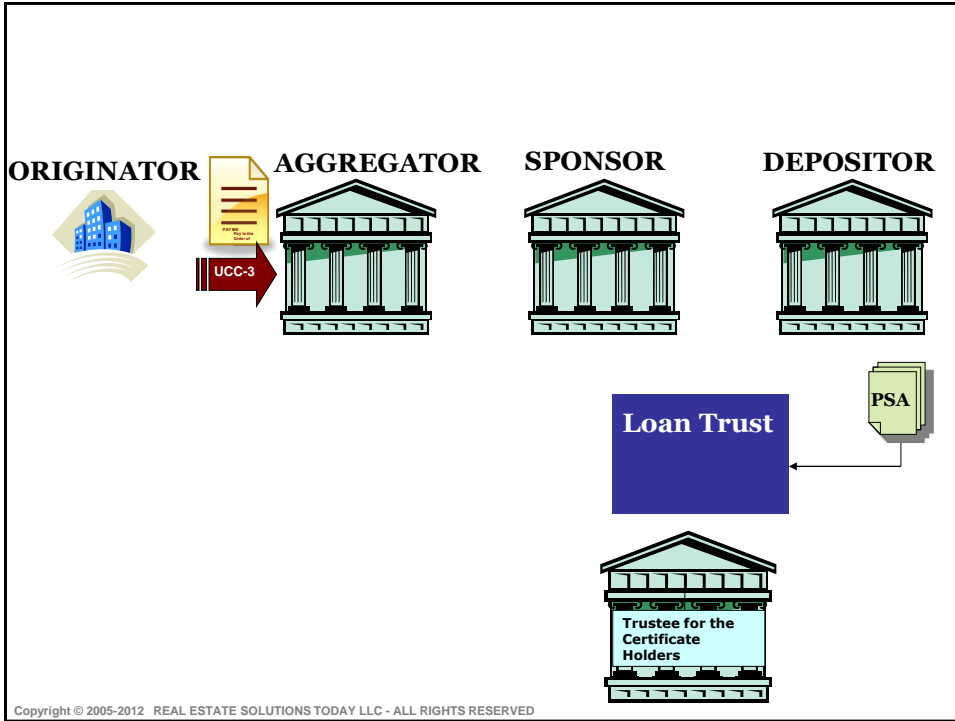
ORIGINATOR

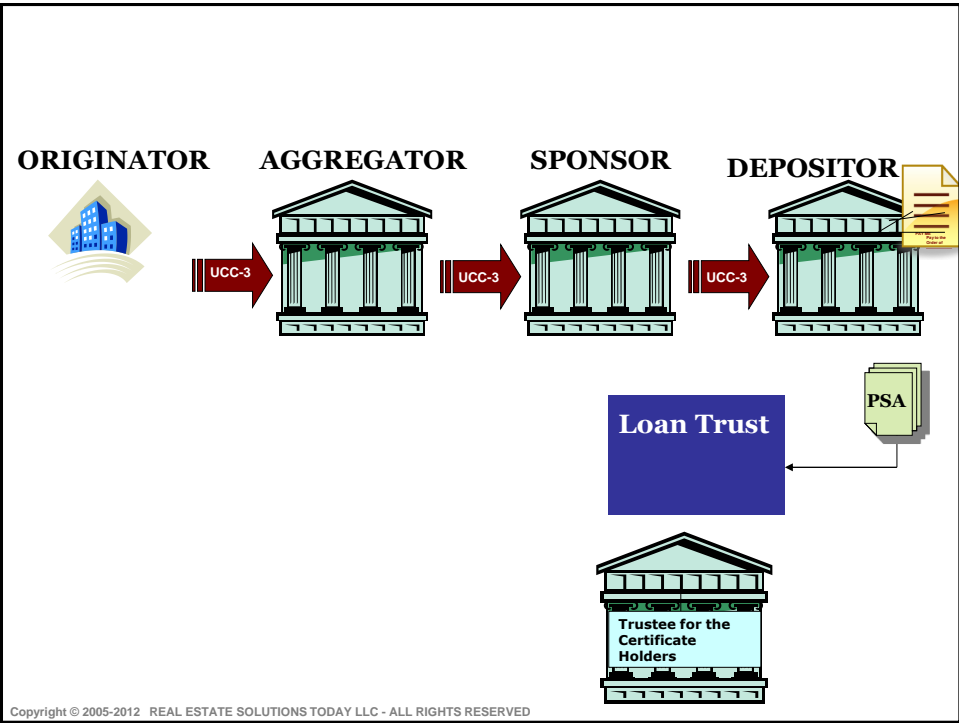
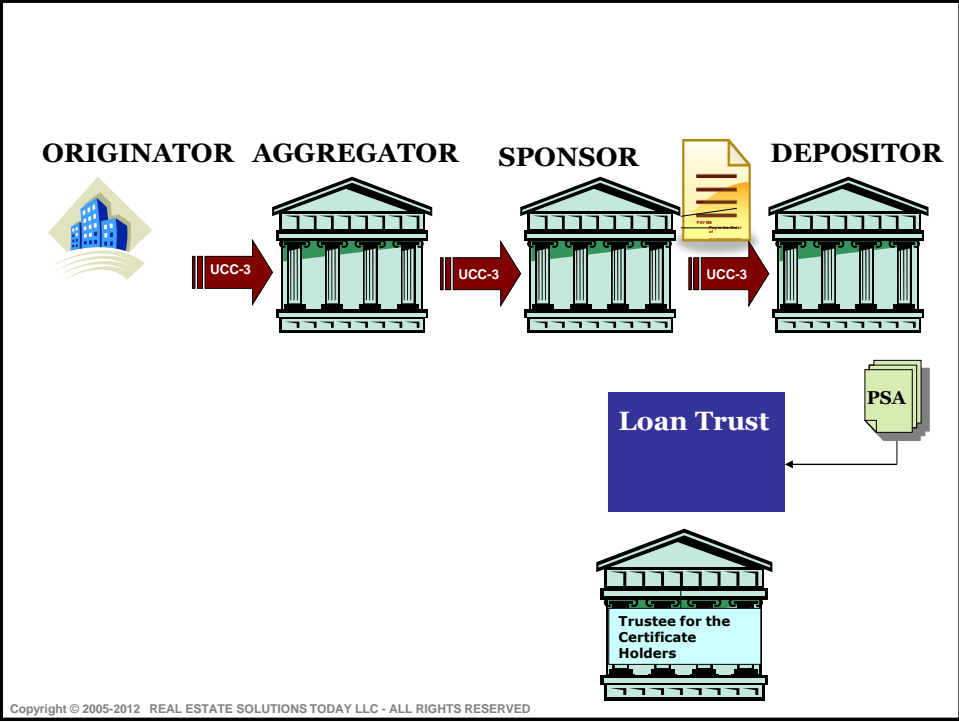


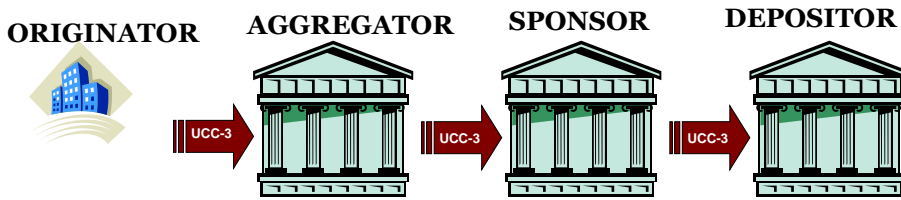
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