Does "the Mortgage Follow the Note"?

Lessons Learned, Best Practices for Assignment of a Note and Mortgage

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Ask any first-year law student who has completed a property course and he or she will tell you that good title to real property requires a recording of the deed in the local county records. Have a lien on real property? Record it with the local county. An easement? Record. In law school, if it is not recorded, it might as well not exist. Ask any law student who has taken secured transactions or a commercial paper course, and he or she will also tell you that in order to enforce and collect a note, one must be holder. The requirements seem so simple, so black and white. So then why are courts rejecting foreclosure actions for chain-of-title issues and improper note transfers, and what can lenders or servicers do to avoid these issues?

Deborah L. Thorne

With the increase in foreclosures and single-asset real estate cases, courts have increased scrutiny of note transfers, mortgage assignments and the transfer of collateral documents. Further complicating this problem are the varying standards and practices for assignment of interests from lender to lender and the customs and practices of securitization. Unfortunately, the customs and practices for the assignment or transfer of a note and the accompanying collateral documents may not hold up in an enforcement action before a court. The recent criticism of the Mortgage Electronic Registration Systems (MERS) and securitization practices highlight the problem.

Back to the Basics: UCC Article 3 Primer

Forgetting for the moment the realities or practicalities of note assignments, what would constitute the proper method for the assignment of a mortgage note? First, mortgage notes are negotiable instruments pursuant to § 3-104(a) of the Uniform Commercial Code (UCC). Also, under § 3-301 of the UCC, the right to enforcement of a note lies with the holder of a note and nonholders in possession of a note. "Nonholders in possession" must demonstrate possession of the note and that the transferor was the holder at the time of the transfer to the transferee in order to enforce the note.[1]

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Lien on Me

Transfer of the note by a holder is usually accomplished by negotiation, which requires the transfer of possession and endorsement of the note.[2] Endorsement may be made to a specific person to whom the instrument is made payable or "in blank," in which case the endorsement does not identify the person to whom the note is payable.[3] In the case of blank endorsements, the note may be negotiated by possession alone.[4] In either case, possession of the note entitles the holder to collect and enforce the note.

Section 3-301 also permits a party to enforce a mortgage note if the note has been lost, stolen or destroyed. However, in these instances, the party that seeks to enforce the note must prove that it has the right to enforce the note, commonly established by a lost document affidavit.

"Mortgage Follows the Note"

The common-law rule is that the transfer of the note carries with it the security.[5] Section 9-203(g) of the UCC provides that "[t]he 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." In some states, absent an express transfer of the mortgage or security interest, the noteholder is vested with only an equitable interest in the mortgage, while legal title to the mortgage remains with the mortgage-holder that holds the mortgage in constructive trust for the noteholder.[6] Even so, as a matter of state-specific real estate law, without a recorded mortgage assignment, a party may not be able to enforce the mortgage. Section 9-607(b) of the UCC provides that a secured party may record a copy of the security agreement transferring an interest in the note to the secured party and the secured party's sworn affidavit in recordable form stating that the default has occurred in the office in which the mortgage is recorded, in order for the secured party to exercise the right to enforce the mortgage nonjudicially. Further, because the assignment of a note is not made publicly and a borrower may not have any notice of the assignment, for practical purposes, even if the note was transferred, an unrecorded assignment of the mortgage may weigh heavily in a court's determination of the proper party and standing to foreclosure the mortgage. Finally, as

1 U.C.C. §§ 3-301 and 3-203 (2002), cmt. 2.
2 U.C.C. § 3-203 (2002).
3 U.C.C. § 3-205 (2002).
4 U.C.C. § 3-201(b) (2002) ("[N]egotiation requires transfer of possession of the instrument and its [e]ndorsement by the holder. If an instrument is payable to bearer, it may be negotiated by transfer of possession alone.").
5 *See* Draft Report of the Permanent Editorial Board on the UCC Rules Applicable to the Assignment of Mortgages Notes and to the Ownership and Enforcement of Those Notes and the Mortgages Securing Them, Permanent Editorial Board for the Uniform Commercial Code, http://extranet.ali.org/directory/files/PEB_Report_on_Mortgage_Notes-Circulation_Draft.pdf; *Carpenter v. Longan*, 83 U.S. 271, 274 (1872) ("The note and mortgage are inseparable...the assignment of the note carries the mortgage with it, while an assignment of the latter alone is a nullity.").
6 In a few states, such as Massachusetts, state courts have held that legal title to the mortgage is held by another party in trust for the noteholder, and the mortgage-holder must be named in any foreclosure proceeding. *See First Nat'l Bank of Cape Cod v. North Adams Hoosac Savs. Bank*, 7 Mass. App. Ct. 790, 796 (1979).

the following cases demonstrate, reliance on the common law principles of note assignment alone may lead to unpredictable results.

U.S. Bank v. Ibanez

The recent Massachusetts Supreme Court decision in *U.S. Bank National Association v. Ibanez*[7] highlights the issues raised by inaccurate recording of mortgage assignments. U.S. Bank National Association and Wells Fargo Bank NA each filed separate actions in the Massachusetts Land Court for a declaration of clear title after each foreclosed on residential mortgages and purchased the property at the foreclosure sale. In both instances, the trial court ruled that the foreclosure sales were invalid because the foreclosure sales named U.S. Bank and Wells Fargo as the mortgage-holders, but neither had yet been assigned the mortgages at the time of the respective foreclosure sales, therefore, at the time of the publication of notice and foreclosure sale, neither had an interest in the mortgages. Both moved to vacate the judgment on the grounds that they could demonstrate that they were the holders of the note and mortgage at foreclosure. Because the two actions addressed the same issues, the cases were heard together on appeal.

In 2005, Antonio Ibanez took out a loan for $103,500, which was secured by a mortgage to the original lender, Rose Mortgage Inc. The original mortgage was properly recorded, and several days later, Rose Mortgage executed an assignment of the Ibanez mortgage in blank. The assignment was eventually stamped with the name of Option One Mortgage Corp. as assignee, which was recorded on June 7, 2006. Prior to the recording of the Option One mortgage assignment, Option One executed a subsequent assignment in blank. U.S. Bank asserted that Option One assigned the Ibanez mortgage to Lehman Brothers Bank FSB, which was assigned to Lehman Brothers Holdings Inc., which then assigned it to the Structured Asset Securities Corp., as part of a securitization, and then assigned it to U.S. Bank, as trustee, for the Structured Asset Securities Corp. Mortgage Pass-Through Certificates, Series 2006-Z.

On July 5, 2007, U.S. Bank, as trustee, purchased the Ibanez property at the nonjudicial foreclosure sale. The foreclosure deed and the statutory foreclosure affidavit from U.S. Bank, as trustee, were recorded on May 23, 2008. On Sept. 2, 2008, American Home Mortgage Servicing Inc., "as successor-in-interest" to Option One, executed an assignment of mortgage to U.S. Bank, which was recorded nine days later. It is unclear from the facts described in the case whether this was a new assignment or if the prior blank assignment by Option One was stamped with U.S. Bank as assignee.

Similarly, in *Wells Fargo v. LaRace*, Mark and Tammy LaRace gave a mortgage to Option One as security for a $103,200 loan, and the mortgage was recorded on the same day, on May 19, 2005. On May 26, 2005, Option One executed an assignment in blank. Well Fargo asserted that Option One assigned the mortgage to Bank of America on a July 28, 2005, and pursuant to a sale and serving agreement, Bank of America assigned the mortgage to Asset Backed Funding Corporation (ABFC) in an Oct. 1, 2005, mortgage loan-purchase agreement. AFBC then assigned the LaRace mortgage to Wells Fargo, as trustee for a pool of securitized mortgages. However, Option One remained the record-holder of the mortgage. The foreclosure sale occurred on July 5, 2007, and the statutory foreclosure affidavit and foreclosure deed were executed on May 7, 2008, by Wells Fargo.

In both *Ibanez* and *LaRace*, the alleged assignments to both mortgages were not recorded at the time of the foreclosure sale, and neither U.S. Bank nor Wells Fargo produced executed documentation of the alleged assignments. Because Massachusetts permits nonjudicial foreclosure, strict compliance with the statutory requirements is imposed on mortgage-holders. One of these requirements is that the power of sale can only be exercised by the mortgagee. The Massachusetts Supreme Court held that U.S. Bank and Wells Fargo lacked the authority to exercise the power of sale because they were not the assignees of the mortgages at the time of the notice of sale and subsequent foreclosure sale.

Bayview v. Nelson

In *Bayview Loan Servicing LLC v. Nelson*,[8] the Illinois appellate court held that a loan-servicing company was not the proper party to bring a foreclosure action because the assignment of the note and the mortgage were made to a separate partnership and the loan-servicing company did not obtain any legal interest in the subject mortgage other than merely servicing the mortgage payments. In *Bayview*, the assignment of the mortgage was dated June 22, 2004, and assigned the interest of Old National Bank's (the original lender) interest in the mortgage to Bayview Financial Trading Group LP (the "partnership"). However, the partnership's servicer, Bayview Loan Servicing LLC, brought the foreclosure action and asserted that it was the owner of the mortgage and note at issue, and therefore was entitled to foreclose.

At a hearing on Bayview's motion for summary judgment, Bayview's counsel acknowledged that Bayview was a legal entity separate and distinct from the partnership, that the partnership is the correct legal entity to which Old National Bank assigned the mortgage and note, and that Bayview is not the correct plaintiff.[9] Based on this acknowledgment and coupled with the fact that no evidence was presented that Bayview obtained legal interest in the subject property, the court concluded that "there was no basis for entry of a summary judgment in favor of Bayview, a stranger to the mortgage."[10]

Bank of America v. Alvarado

In *Bank of America NA v. Alvarado*,[11] the defendant did not dispute that she executed a note and mortgage to Washington Mutual Bank and that she was in default of the loan; instead, she contested the chain of ownership of the note. The defendant further contended that because the plaintiff was not in possession of the note, it could not enforce the note. The plaintiff, Bank of America, conceded that it was not in possession of the note because the note was lost by Washington Mutual before the loan was securitized and transferred.[12] Bank of America presented an affidavit of lost note as evidence that the original note was certified as lost by Washington Mutual, as original lender, and that the obligation represented in the affidavit was intended to be included in the pooled loans that were transferred.

The Superior Court of New Jersey Chancery relied on equity and unjust enrichment to conclude that to preclude Bank of America's right to enforce the note would unjustly enrich the defendant. The court held that New Jersey recog-

7 941 N.E.2d 40 (Mass. 2011).

8 890 N.E.2d 940, 944 (Ill. App. Ct. 2008).

9 *Id.* at 943.

10 *Id.* at 944.

11 Superior Court of New Jersey, Chancery, Bergen County, Docket No. BER-F-47941-08 (Jan. 7, 2011).

12 *Bank of America NA v. Alvarado*, Case No. BER-F-47941-08, (N.J. Super. Ct. Ch. Div. Jan. 7, 2011).

continued on page 84

from page 55

nizes "an equitable assignment when the equities of a circumstance so compel."[13]

Interestingly, the court also addressed the possibility that another person may seek to enforce the note in the future. Accordingly, the court also ordered that Bank of America be required to intervene and participate in the defendant's defense in the event another party sought to enforce the note against the defendant such that the defendant would not be liable twice on the same note.

Lessons Learned, Best Practices to Ensure Proper Chain of Title

These cases highlight the scrutiny courts give to the chain of title and loan documentation in support of foreclosure actions nationwide. Each case underscores the importance of ensuring proper documentation prior to initiating any foreclosure action.

First, in addition to proper negotiation of the note, there is no substitute for a formal assignment of the mortgage. All assignments should be dated, identify the assignor and assignee, and be recorded. Blank assignments may not be sufficient and may be void.[14] Even a statement of a future intent to sell or transfer a note or mortgage may not be sufficient evidence of an actual assignment. Documents (*e.g.*, purchase agreements, pooling and servicing agreements, etc.) evidencing an intent to assign the mortgage are not sufficient proof of actual assignment.[15]

Second, the chain of title should correspond and make chronological sense. Altering the "effective date" to a date prior to the foreclosure sale if the execution of the assignment is after the sale is not sufficient to establish the mortgageholder's right to foreclose at the time of the foreclosure sale.[16]

Lastly, in many states, the traditional rule is that an assignment of the mortgage without the corresponding note is ineffective (*i.e.*, the note does not follow the mortgage).[17] Prior to initiating any foreclosure proceeding, lenders and their counsel should, at minimum, ensure the following:

> Being mindful of the basic principles of property law, secured transactions and commercial paper will prevent the inconsistencies experienced by many plaintiff lenders and servicers who were not.

1. *Any purchase agreement for the note and mortgage at issue should include a specific intent to sell and granting language for the mortgage loan with a specific identification of the loan at issue.* This should include language that establishes an intent to sell the mortgage loan(s) to the purchaser, including a specific listing of each mortgage loan being sold, granting language specifically conveying the mortgage loans and language identifying the effective date of the sale transaction.

2. *Confirm proper transfer and endorsement of the note.* The endorsement should be made on the instrument itself or on separate paper firmly affixed to the instrument.[18] While the practice of blank endorsements has been widely used in securitization, the practice has recently been called into question by state attorneys general and the Senate Banking Committee, so the better practice is to use a specific endorsemsent.

3. *Confirm possession of the note.* If the note has been lost, an affidavit of lost note by the assignor of the note may suffice.

4. *Confirm that all required assignments of the mortgage, and assignment of rents and leases, if applicable, have been properly recorded in the local land records.* There should be a corresponding assignment of the mortgage with each transfer. The date of execution for each assignment should ideally correspond to the date of the transfer. If the assignment is executed after the foreclosure proceeding is commenced but the effective date relates back to a date prior to the commencement of foreclosure proceedings, this may still create potential chain-of-title issue.

Conclusion

Being mindful of the basic principles of property law, secured transactions and commercial paper will prevent the inconsistencies experienced by many plaintiff lenders and servicers who were not. Although ensuring the proper transfer documents and recording the documents may create a delay in initiating a foreclosure proceeding, resolving any issues prior to litigation will almost certainly alleviate lenders and their counsel of the headaches of heightened scrutiny and additional costs in foreclosure actions by courts. ■

13 *Id.*
14 *See U.S. Bank Nat'l Ass'n v. Ibanez*, 941 N.E.2d 40 (Mass. 2011).
15 *Id.*
16 *Id. See also Davenport v. HSBC Bank USA*, 739 N.W. 2d 383 (Mich. Ct. App. 2007) (interest in mortgage and note must be acquired prior to first notice of publication for foreclosure).
17 *Vega v. CTX Mortg. Co. LLC*, ----F.Supp.2d----, 2011 WL 192514 (D. Nev. 2011).
18 U.C.C. § 3-204(a) (2002).