

PUBLICATION

Mortgages and the UCC

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Who is entitled to enforce a mortgage note?

How can the owner of a note effectively transfer ownership?

What is the effect of such a transfer?

May an assignee who has not obtained a recordable assignment of a secured interest in the mortgaged property take steps to become the assignee of record?

While you might expect that these questions would have a different answer in each state, the Permanent Editorial Board (PEB) for the Uniform Commercial Code sought to answer these questions for the nation as a whole in a report it issued on November 14, 2011.

While acknowledging that foreclosure law is largely the province of the states, the board declared nevertheless that the UCC is relevant under state law and, further, that "legal determinations made pursuant to the [...] Report will, in many cases, be central to the administration of [state foreclosure] law." Report, pp. 1 & 14. The board therefore issued the report with the stated intent to further a more consistent, nationwide application of the UCC principles to state real property law in an era when "not all courts and attorneys are familiar with them." Report, p. 1.

The UCC is a model code sponsored by the American Law Institute and the Uniform Law Commission that governs commercial transactions and has been enacted, in one form or another, in each of the 50 states. Generally, Articles 3 and 9 of the UCC are relevant to mortgage loans. If the note is considered a negotiable instrument, Article 3 provides rules governing both the obligations of parties to a note as well as enforcement of those obligations. Article 9 governs the transfer of notes, whether the note is a negotiable instrument or not. The UCC constitutes enforceable law in each state only to the extent that it has been adopted by the state legislature.

Who is entitled to enforce a mortgage note?

According to the PEB report, the UCC provides three ways in which a person may qualify as the party entitled to enforce a note. First, a person may be the holder of the note. To be a holder, a person must be in possession of the note and the note must either be payable to that person or to a bearer. Second, a person may be a non-holder in possession of the note who has the rights of a holder, either through operation of state law or by receipt of the note from a holder in circumstances in which the receiver is not a holder (for example, where a holder assigns the note to another, but fails to indorse it). Third, a person may qualify to enforce a note without possession of the note in very limited circumstances where the instrument was destroyed, where its location cannot be determined or where it is in the possession of an unknown person.

Certainly, the first scenario is the most common in the lending industry as when a mortgage loan is assigned the note is typically either indorsed to the assignee lender or is indorsed in blank (i.e. to bearer). It is worth remembering, however, that there may be other options available.

How can the owner of a note effectively transfer ownership?

The board identified three criteria that must be met in order for an owner of a mortgage note to sell the note to a buyer:

1. Value must be given in exchange for the note;
2. The seller must have the authority to transfer rights in the note; and
3. The buyer must take possession of the note pursuant to the security agreement signed by the debtor.

As an aside, these same criteria apply to the creation of a security interest securing an obligation to repay a mortgage note: value must be given, the debtor must have authority to transfer an interest in the property, and the debtor must execute a security agreement.

What is the effect of a transfer of an interest in a mortgage note?

According to the board, the sale of a mortgage note not accompanied by a separate conveyance of the secured interest securing the note does not result in the mortgage being severed from the note. Instead, assignment of the interest in the note by the seller automatically transfers a corresponding interest in the mortgage to the buyer. This conclusion is interesting, as many plaintiff-borrowers contend that the UCC requires the opposite conclusion.

May an assignee, who has not taken a recordable assignment, take steps to become the assignee of record?

Certain states prohibit a note buyer without a recorded interest in the real property from foreclosing. Article 9 of the UCC provides a buyer lacking such an interest a procedure by which the buyer may record its interest in the real estate records in order to foreclose. This is particularly important where the seller is no longer in business and is unable to provide a recordable assignment. Where no assignment is available, the board opined that the buyer may record a copy of the security agreement in the real estate records along with a sworn affidavit stating that default has occurred and that the secured party is entitled to enforce the mortgage non-judicially.

It is not yet clear whether these conclusions will have a real-world effect on the mortgage industry. The development of a consistent, nationwide approach is certainly an admirable goal.