

Real Estate Title Insurance & Construction Law

A Standing Dilemma

Is possession of a negotiable note required to foreclose a securitized mortgage?

By Robert E. Nies and Michael R. Caruso

Securitization of commercial and residential mortgages to finance investments unrelated to the underlying mortgaged properties has spawned a number of unintended consequences. The most recent such consequence results in a challenge to the proofs required for standing to foreclose based upon the plaintiff's failure to possess a negotiable note when the foreclosure is commenced.

Indeed, because it is axiomatic that a party seeking to foreclose a mortgage must own or control the underlying debt, and may not sue based on control of the mortgage alone (*Gotlib v. Gotlib*, 399 N.J. Super. 295, 312-13 (App. Div. 2008); see also *Wells Fargo Bank v. Ford*, 418 N.J. Super. 592, 597 (App. Div. 2011)), the mortgage fundamentally follows the debt, not vice versa. See e.g., *Stevenson*

Nies is a partner with Wolff & Samson in West Orange. Caruso is an associate at the firm.

v. Black, 1 N.J.Eq. 338, 343 (Ch. 1831). This logically leads to the conclusion that a lender, or its assignee, cannot establish standing to foreclose if it possesses only the mortgage, and not the underlying debt.

In most foreclosure cases, the underlying debt is evidenced by a note. A note in turn may be negotiable or nonnegotiable. A negotiable promissory note is governed by Article 3 of the Uniform Commercial Code (UCC), codified at N.J.S.A. 12A:3-101 et seq. It is not unusual in a securitized loan transaction, however, and arguably it may be wiser, to forgo the use of a negotiable note to evidence the underlying indebtedness for a very practical reason: evidentiary problems created by multiple assignments of loan documents, coupled with conflicting legal authority, has created uncertainty whether Article 3 of the UCC has been usurped by a much older New Jersey statute, N.J.S.A. 46:9-9, when foreclosing a mortgage that secures a negotiable note. But in many securitized loan transactions there is no choice: the industry still has extant underlying debt evidenced by a negotiable note, and this creates a legal dilemma. While recent New Jersey appellate decisions purport to resolve any concerns and, in turn, streamline and expedite the foreclosure process for negotiable notes, legitimate debate

remains and begs a closer review by the state Supreme Court.

The Securitization of Loans

A mortgage loan is securitized when the note, mortgage and accompanying loan documents are pooled with similar (but unrelated) instruments and sold to individual investors, who share in the funds received as the underlying loans are repaid. Loans in the pool are transferred as a package, often numerous times to various assignees. The assignees retain third parties, called "servicers," to administer the underlying loans and institute foreclosure proceedings for a mortgage in default.

The serial transfers of the loan documents cause the relationship between holder of the debt and the borrower to become more attenuated. *Bank of N.Y. v. Raftogianis*, 418 N.J. Super. 323, 333-34 (Ch. 2010). As a result, an assignee of the lender must determine whether the underlying note was properly negotiated or transferred in accordance with the UCC and, thus, whether the assignee has standing to institute foreclosure.

Standing To Foreclose a Mortgage That Secures a Negotiable Note

Under UCC Article 3, a person must have possession of a negotiable note in order to enforce it, either as a "holder" or as a "nonholder in possession of the

instrument who has the rights of a holder," each as defined in N.J.S.A. 12A:3-301. *Raftogianis*, 418 N.J.Super. at 331-32. Possession is the key element in either case. "The purpose of the possession requirement in Article 3 is to protect the [d]ebtor from multiple enforcement claims to the same note." *In re Kemp*, 440 B.R. 624, 633 (Bankr. D.N.J. 2010) (internal cites omitted). In addition, Article 3 of the UCC governs how possession of the negotiable note is transferred and, historically, a lender or its assignee must have possessed the negotiable note to establish standing. An affirmative defense to a foreclosure is based on the strict requirements of UCC Article 3 regarding the transfer and enforcement of negotiable instruments. This contested "standing" issue often arises in the context of securitized mortgage loans, and may delay the foreclosure process for months.

An Old Statute Applied to a Modern Problem

Recently, New Jersey courts are relying on a century-old statute — N.J.S.A. 46:9-9 — in conjunction with an Appellate Division case from 2011, as an alternative to UCC Article 3's strict requirements for standing to enforce a negotiable instrument and thus to foreclose a mortgage. This approach finds its genesis in *Deutsche Bank Nat'l Trust Co. v. Mitchell*, 422 N.J. Super. 214 (App. Div. 2011). *Mitchell*, and its progeny, ostensibly cite N.J.S.A. 46:9-9 as a basis to establish a mortgagee's standing to foreclose, independent of the well-established legal principle stated above that the mortgage follows the debt.

N.J.S.A. 46:9-9 provides in relevant part:

All mortgages on real estate in this State ... shall be assignable at law by writing, ... and any such assignment shall pass and convey the estate of the assignor in the mortgaged premises, and the assignee may sue thereon in his own name

The statute refers to assignments of mortgages, not enforcement of rights in and to a note, debt or other obligation. Indeed, the words "note," "debt" and "obligation" are absent from the statute's language.

In *Mitchell*, the Appellate Division stated its holding as follows:

We reverse the grant of summary judgment [to the plaintiff Deutsche Bank] and remand for a hearing to determine whether or not, before filing the original complaint, plaintiff was in possession of the note or had another basis to achieve standing to foreclose, pursuant to N.J.S.A. 12A:3-301.

(Emphasis supplied.) Thus, the holding was a remand to consider the "standing" issue that courts historically would analyze under UCC Article 3, i.e., whether plaintiff was in possession of the note with the rights of a holder when the complaint was filed. In two sentences that immediately precede the operative holding, the *Mitchell* court stated:

Deutsche Bank could have established standing as an assignee, N.J.S.A. 46:9-9, if it had presented an authenticated assignment indicating that it was assigned the note before it filed the original complaint. The only evidence presented by Deutsche Bank was to the contrary.

(Emphasis supplied.)

Subsequent cases misconstrue the above dictum for *Mitchell*'s holding. See e.g., *HSBC Bank USA v. Ulversoy*, 2012 N.J. Super. Unpub. 2012 WL 3021460 at *14-15 (App. Div. July 25, 2012) ("An assignee can also establish standing under N.J.S.A. 46:9-9 by presenting a properly 'authenticated assignment indicating that it was assigned the note before it filed the original complaint.'"); *BAC Home Loans Servicing v. Durelli*, 2012 N.J. Super. Unpub. 2012 WL 3638876 at *16 (Ch. Jul 11, 2012) (same).

While other cases have followed *Mitchell* in this regard, neither *Mitchell* nor its progeny examine the history and purpose of N.J.S.A. 46:9-9, a statute that is over a century old and, on its face, appears to be inapposite to negotiable instruments. Indeed, *Mitchell* and its progeny seem to ignore an important Appellate Division case from 1992, *Carnegie Bank v. Shalleck*, 256 N.J. Super. 23, 46 (App. Div. 1992) ("N.J.S.A. 46:9-9 applies only to mortgages given to secure a debt embodied in a non-negotiable instrument such as a bond.").

In *Shalleck*, the Appellate Division examined the history and purpose of N.J.S.A. 46:9-9, explained that mortgage debts in 1863 were not embodied in negotiable instruments to any appreciable degree, and aptly noted that when UCC Article 3 was enacted in New Jersey a full century after N.J.S.A. 46:9-9 had been in effect, the legislature never changed the language of N.J.S.A. 46:9-9 because, by that time, it was well-settled that the purpose of N.J.S.A. 46:9-9 related to assignments of mortgages and their underlying nonnegotiable mortgage bonds, while the purpose of UCC Article 3 related to the enforcement and transfer of negotiable instruments.

N.J. Bankruptcy Case and Commentator Undercut the Mitchell Dictum

In *In re Kemp*, 440 B.R. 624 (Bankr. D.N.J. 2010), the bankruptcy court presciently applied New Jersey law and held that "a recorded assignment of the mortgage does not establish the enforceability of the note [because] the UCC governs the transfer of a promissory note." The bankruptcy court explained that the "attempted assignment of the [negotiable] note in the assignment of mortgage document, together with the terms of the Pooling and Servicing Agreement, created an ownership issue, but did not transfer the right to enforce the note." (Citing N.J.S.A. 12A:3-203 (Comment 2)). Simply put, a recorded assignment of mortgage may include a provision assigning the note, but such provision gives the assignee only a claim of ownership to the note; it does not establish a right to enforce the note under the UCC.

More recently, a leading mortgage commentator has observed that ordinarily there is no separate document in a foreclosure action entitled "assignment of note" and, therefore, *Mitchell*'s dictum in this regard is a curious statement. Even if there were such a separate document, a negotiable note to be enforceable under the UCC must be transferred by delivery of possession, not assignment. See Myron C. Weinstein, 30 N.J. Prac., *Law of Mortgages* §28.9 (2d ed.).

Does Mitchell Survive Simply to Expedite Foreclosures?

While the N.J. Supreme Court has yet to weigh in on this question, consider that *Mitchell* and its progeny came into

existence at the height of the foreclosure malaise in New Jersey and across the country. They allowed foreclosures to proceed more expeditiously, unfettered by evidentiary obstacles imposed upon securitized loan transactions in which the chain of custody for underlying negotiable notes often was neither properly

documented nor readily provable. As the throng of foreclosures hopefully begins to subside, courts and practitioners should be more cautious in broadly reading *Mitchell* and its progeny for the dubious proposition that a properly authenticated assignment of mortgage, which references in its language the underlying

negotiable note, is — by itself — sufficient to establish standing to foreclose a negotiable debt. Unexamined reliance upon dictum in *Mitchell* runs counter to the history and purposes of both N.J.S.A. 46:9-9 and Article 3 of the UCC, and may not survive further judicial scrutiny. ■